Report on Litigation

Summarized below are recent significant Wisconsin Tax Appeals Commission (WTAC) and Wisconsin Court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher Court.

The following decisions are included:

INDIVIDUAL INCOME TAXES

Estoppel; Interest — erroneous written advice; Private letter ruling. *Steven J. and Mary Ann Hogan vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, March 29, 1995). The issues in this case are:

A. Whether a letter to the taxpayers, signed by the Secretary of the Wisconsin Department of Revenue, constituted a private letter ruling issued under the authority of sec. 73.035, Wis. Stats., in a form prescribed by the department.

B. Whether the department may be equitably estopped from assessing additional taxes and interest because of the taxpayers' reliance upon written representations made in a letter from the department, where the department issued refund checks for three of the years under review as a result of that letter and then audited the returns subsequent to the issuance of those refunds.

C. Whether the department should have absolved the taxpayers of liability for interest due under sec. 73.03(47), Wis. Stats., because the underlying taxliabilities owing may have resulted from their reliance on an erroneous, written statement made by an employe of the department acting in an official capacity in response to adequate and accurate information provided by the taxpayers.

Taxpayer Steven J. Hogan served in the United States Navy from February 1969 until his retirement in March 1989. On account of that service, pension payments were issued to him from the U.S. military retirement system during each year at issue, 1989, 1990, 1991, and 1992. Mr. Hogan claimed the pension payments he received during each of those years as taxable income on his income tax returns.

During early 1992, the taxpayers read or heard various media accounts of a United States Supreme Court decision (*Barker v. Kansas*), which dealt generally with state income taxation of federal military retiree pension payments. In an effort to obtain more information concerning its relevance to his personal circumstances, Mr. Hogan wrote a letter to Mr. Mark

Bugher, Secretary of the Wisconsin Department of Revenue, on April 22, 1992. The letter did not contain all the facts pertinent to the legal conclusion sought by him. Material information omitted included the beginning date of Mr. Hogan's military service. The letter also did not contain a declaration that the facts which were disclosed were presented by the requestor under penalty of perjury.

On April 30, 1992, Secretary Bugher responded by letter to Mr. Hogan's inquiry. The text of one paragraph of Mr. Bugher's letter read as follows:

"You first ask how the *Barker* decision affects the taxability of your 1992 military pension payments. Our response is that this decision has no affect on your 1992 military pension payments. We now exempt from state income tax, as we have since 1989 when our legislature created this exemption in § 71.05(1)(a), Wis. Stats. (1989-90), all payments received from the U.S. military employe retirement system."

Shortly after receiving Secretary Bugher's letter, Mr. Hogan filed amended 1989 and 1990 Wisconsin income tax returns, and the taxpayers jointly filed an amended 1991 return, eliminating Mr. Hogan's military pension payments from each year's income. They attached a copy of Secretary Bugher's April 30, 1992 letter to each amended return and incorporated it in their explanation of changes in income on each return. The taxpayers received refund checks from the department as a result of the amended returns as filed.

The taxpayers filed a 1992 joint income tax return, in which they excluded the federal retirement benefits. A copy of the april 30, 1992 letter from Secretary Bugher was attached.

The taxpayers wrote a letter to the department on February 22, 1993, which included statements to the effect that they regarded Secretary Bugher's April 30, 1992 letter as a private letter ruling, and that they had at some point requested from the department a retraction of the letter, according to the procedures set forth in Department of Revenue Publication 111 "How To Get a Private Letter Ruling from the Wisconsin Department of Revenue."

In April and May, 1993, the department issued notices of amount due to Mr. Hogan for additional 1989 and 1990 taxes and interest due, and to both taxpayers for additional 1991 taxes and interest due, as a result of an audit of the amended 1989 to 1991 returns, and to both taxpayers for additional 1992 taxes and interest due (effectively denying the refund claimed on their 1992 return).

Mr. Hogan filed a letter which the department deemed to be a petition for redetermination of the assessment for 1989 and 1990, contending that the April 30, 1992 letter from Secretary Bugher was a private letter ruling. Mr. Hogan also noted that he considered the assessment for 1989 and 1990 to be an effective withdrawal of the purported private letter ruling and asked that the additional tax and interest be forgiven, because of his contention that these amounts would otherwise constitute a retroactive revocation of the department's supposed position in Secretary Bugher's letter.

The taxpayers jointly filed a letter, which was deemed to be a petition for redetermination of the assessment for 1991. This letter reiterated many of the arguments raised in the petition for 1989 and 1990 and added a request that an interest abatement be granted them under sec. 73.01(47), Wis. Stats., based upon what they considered to be erroneous written advice given to them by the department.

The taxpayers also petitioned the department for a redetermination of its assessment and refund denial for 1992. The letter renewed their interest abatement claim and raised a claim that the department should be equitably estopped from its assessment actions for each of the tax years 1989 to 1992, in accordance with the taxpayers' interpretation of Secretary Bugher's April 30, 1992 letter.

The Commission concluded as follows:

A. The April 30, 1992 letter written to the taxpayers and signed by Mr. Mark D. Bugher in his capacity as Secretary of the Wisconsin Department of Revenue did not constitute a private letter ruling issued under the authority of sec. 73.035, Wis. Stats. The taxpayers did not comply with the requirements of form prescribed in the department's Publication 111. They failed to provide material facts which were pertinent to the issue of inquiry, particularly, the date of Mr. Hogan's entry into military service, and they failed to include in their original request letter a declaration under penalty of perjury that the facts presented were true, correct, and complete.

B. The department may not be equitably estopped from assessing additional taxes and interest due because of the taxpayers' reliance upon written representations made by the Secretary of the department in a letter dated April 30, 1992. The letter specifically cites the section of the statutes which limits the exemption to participants or retirees as of December 31, 1963, whereas Mr. Hogan did not join the military service until 1969. Furthermore, the issuance of

refunds after initial processing of amended returns, and before audit, is not a binding determination on which a taxpayer may rely as final. The taxpayers' reliance on the department's representations or actions was not reasonable under the facts and circumstances presented.

C. The department had no duty to absolve the taxpayers of liability for interest due under sec. 73.03(47), Wis. Stats. The underlying tax liabilities owing did not result form the taxpayers' reliance on an erroneous, written statement made by an employe of the department, and the department's April 30, 1992 letter did not constitute a response to adequate and accurate information provided by the taxpayers. The omission of information regarding the military service starting date constitutes a failure to provide adequate information.

The taxpayers have not appealed this decision. □

Tax home; Travel expenses — substantiation. *Richard and Karen Cody vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 2, 1995). The issues in this case are whether the Department of Revenue ("the department") properly determined:

A. The taxpayer's tax home during the years at issue.

B. The amount of additional taxable income for the year 1984.

C. That unsubstantiated travel expenses should be disallowed.

During the years 1981 through 1985 ("the years at issue"), taxpayer Richard Cody ("the taxpayer") resided in Lake Mills, Wisconsin. During 1981 through 1984, he worked as an outside salesman for corporations which operated cemeteries in Madison, Beaver Dam, Ixonia, and Milwaukee. He was not an employe but received commissions on the sale of cemetery lots. From time to time, he also helped prospect for new cemeteries to purchase and helped recruit and train new salespeople.

The taxpayer worked in Madison during the period January through August 1981, in Milwaukee during the period September 1981 through September 1982, and in Beaver Dam during the period October through December 1982. During the period 1983 and 1984, the taxpayer worked primarily in Milwaukee but made several trips to southern Wisconsin, Illinois, and Minnesota, prospecting for cemeteries to purchase. During 1985 he worked for himself in Sheboygan, where he acquired a cemetery.

On audit, the department determined the taxpayer's tax home to be Madison for the period January through August, 1981, Milwaukee for the period September 1981 through 1984, and Sheboygan for 1985. The taxpayer disputes the determination that Milwaukee was his tax home for any of the years at issue. Although he claims that his work in Milwaukee from 1981 through 1984 was "temporary," the evidence did not substantiate this claim and in fact showed his work assignment in Milwaukee during those years was of indefinite duration.

During the years at issue, the taxpayer claimed but did not substantiate travel expenses. He was not reimbursed for this travel expenses, except that in 1984 he received $750 per week as a "draw" against travel expenses for his trips away from Milwaukee. He did not report this draw on his 1984 income tax return. The department disallowed the taxpayer's unsubstantiated travel expenses and added to 1984 income the difference between the taxpayers' bank deposits and the amount of income actually reported on their return.

The Commission concluded as follows:

A. The department properly determined the taxpayer's tax home for 1981 though 1985.

B. The department properly determined that the taxpayer's unsubstantiated travel expenses should be disallowed.

C. The department properly determined the taxpayers' additional taxable income for 1984.

The taxpayers have not appealed this decision. □

Writ of mandamus; Assessments — due process of law; Retirement pay. *William E. Currier vs. Wisconsin Department of Revenue* (Circuit Court for Milwaukee County, April 6, 1995). The issues in this case are:

A. Whether the department's failure to pursue its petition for a writ of mandamus, after a remand to Clark County Circuit Court, bars assessment for taxable years 1982 and 1983.

B. Whether the department failed to provide administrative due process of law when it denied the taxpayer's request for a conference relating to an assessment it made for failure to file income tax returns for 1982 to 1990.

C. Whether retirement pay the taxpayer received in 1984 to 1990 is taxable income, and whether taxing that income violates the

Equal Protection clause of the Fourteenth Amendment to the United States Constitution.

The taxpayer seeks review of a ruling and order of the Wisconsin Tax Appeals Commission (Commission), which granted the department's motion for summary judgment and affirmed the assessment for 1982 to 1990.

The taxpayer contends that the department is barred from issuing an assessment for 1982 and 1983, because the department failed to pursue a lawsuit in Clark County Circuit Court, in which it sought a writ of mandamus compelling the taxpayer to file 1982 and 1983 tax returns. That Court entered a default judgment against the taxpayer, which the Court of Appeals reversed and remanded for further proceedings. Neither the Circuit Court nor the department pursued the mandamus action.

The taxpayer also contends that the department failed to provide administrative due process of law when it denied his request for a conference in response to the assessment for 1982 to 1990. He had requested the informal conference in his petition for redetermination of the assessment, which was issued for failure to file income tax returns for those years. The department instead further explained its basis for the assessment, denied the conference request, and denied the petition for redetermination.

As an alternative argument, it is the taxpayer's position that his retirement benefits earned as a result of his service as a police officer for the City of West Allis are not taxable income.

The Circuit Court concluded as follows:

A. The mandamus action and the department's failure to further litigate the action do not bar the assessment for 1982 and 1983. There is no requirement for the department to pursue the action, and there is no bar to relitigation for 1982 and 1983 because no issues were decided in a court of law.

B. The department's denial of the taxpayer's request for a conference does not constitute a failure to provide administrative due process of law. Due process was adequately afforded him through the appeal process to the Commission and to this Court.

C. The taxpayer's retirement benefits are taxable because they are not included in the statutory list of specifically exempt retirement benefits. Furthermore, the law does not support his position that he is denied equal protection.

The taxpayer has appealed this decision to the Court of Appeals. □

HOMESTEAD CREDIT

Homestead credit — property taxes accrued — joint ownership. *Edna Leitgeb vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 23, 1995). The issue in this case is whether the department appropriately adjusted the claimant's allowable homestead credit by recharacterizing the portion of property taxes accrued corresponding to the ownership percentages of the joint owners (who did not reside in the homestead) as rent constituting property taxes.

During the year at issue, 1992, the claimant lived in one unit of a two-family dwelling. Her daughter, Mrs. Judith Petroff, lived in the rental unit.

On May 6, 1992, the claimant conveyed her ownership in the property to herself and five of her children (including Judith Petroff) as joint tenants. The claimant paid the entire 1992 property tax bill, in the amount of $3,408.05. One-half of the total property taxes, or $1,704.00, was deemed by the claimant to be applicable to the portion of the property in which she lived during 1992.

The department adjusted the claimant's 1992 homestead credit claim, allowing her a pro rata portion of taxes corresponding to the days she was sole owner of the property, as well as her 1/6 fractional share for the days the property was held in joint tenancy. The department also allowed 25% of the fractional portion (4/6) of property taxes attributable to nonresident owners (i.e., all children other than Judith Petroff) during the days after joint tenancy, treated as "rent paid — heat not included." After the hearing was held in this case, the department recalculated the homestead credit, allowing an additional 1/6 share of the property taxes as rent constituting property taxes, since Judith Petroff resided in the rental portion rather than the claimant's homestead.

The Commission concluded that as modified, the department acted appropriately in adjusting the claimant's allowable homestead credit by recharacterizing the portion of property taxes accrued corresponding to the ownership percentages of joint owners, who did not reside in the claimant's homestead, as rent constituting property taxes.

The claimant has not appealed this decision.

CAUTION: This is a small claims decision of the Wisconsin Tax Appeals Commission and may not be used as a precedent. The decision may be used for informational purposes only. □

CORPORATION FRANCHISE AND INCOME TAXES

Allocation of income — business income. *Port Affiliates, Inc., vs. Wisconsin Department of Revenue* (Court of Appeals, District I, December 20, 1994). The taxpayer appeals from the Circuit Court judgment affirming a decision of the Wisconsin Tax Appeals Commission. The Commission affirmed a franchise tax assessment made by the department with respect to the taxpayer's taxable years 1984 through 1987. For summaries of the Circuit Court's and Commission's decisions, see *Wisconsin Tax Bulletins* 84 (October 1993), page 13, and 78 (July 1992), page 6.

At issue in this appeal is the department's determination that the computation of the taxpayer's apportionable income should include: (1) certain interest, dividends, and gains derived by the taxpayer from its investment portfolio of marketable securities, and (2) only a certain portion of rental losses incurred by the taxpayer in connection with an office building it owned.

The taxpayer originally was organized and incorporated in Wisconsin in 1918 as The Milwaukee Gear Company (MGC). Through approximately 1980, MGC's sole business activity was manufacturing and selling gears and gear drives. From about 1950 until the events involved in this case, MGC's activities were carried out at its manufacturing facility in Glendale, Wisconsin, where it also had its principal offices. In 1980, MGC developed an investment portfolio and, in 1983, MGC constructed an office building called the MG Atrium Building (Atrium) immediately in front of its Wisconsin facility. In 1984, MGC acquired a boat house and marina business in Florida. Later in 1984, MGC changed its name to Port Affiliates, Inc. (Port), and moved its principal offices to Florida.

In 1986, Port spun off the Milwaukee gear division of its operation into a wholly-owned subsidiary, incorporated in Wisconsin, called Milwaukee Gear Company, Inc. (MGC Inc.). The MGC Inc. subsidiary included not only the gear manufacturing business, but also the boat house and marina business. Port retained ownership of the gear manufacturing plant but rented it to the subsidiary. Port also transferred six executives — five located in Wisconsin, and one in Florida — to the subsidiary.

The Commission determined that Port's investment activities were integrated with the rest of its activities. Therefore, the Commission concluded that the investment income was derived from an activity constituting "an integral part of a unitary business" and, thus, that the income was apportionable. The Court of Appeals held that the Commission correctly concluded that the investment activity was an integral part of Port's unitary business.

Port's own summary of the circumstances leading to the establishment of the investment portfolio demonstrates the integral relationship, from the very beginning, between the investments and Port's overall operations. To maintain its economic strength, Port sought to diversify and created the portfolio for that purpose. Further, throughout the time period considered in this case, the chief executive officer made the major decisions for Port and its MGC Inc. subsidiary, including those decisions relating to the investment portfolio. The computer system located in the Wisconsin office processed the data for both Port's investment activities and its other operations. Port's casualty and property insurance policies covered all the activities related to Port, the MGC Inc. subsidiary, and the investment activities. Port's retirement plan and health insurance policy covered all employes, including those connected to the investment activities. Finally, the investment income came primarily from short-term investments that remained within Port's control and that were always available as working capital.

The facts of this case demonstrate far more than "the mere flow of funds arising out of a passive investment." As stated in the January 1, 1986, "Management Agreement" between Port and MGC Inc., "Port shall, from time to time, advance to Gear sums of money necessary to finance capital equipment purchases and its working capital requirements." In 1987, the investment portfolio loaned MGC Inc. $500,000 in March and another $483,000 in April, at least in part for capital acquisitions.

The Commission held that the Atrium was used in Port's business. The rental loss was apportionable because of Port's ownership of and close financial connection to the Atrium, and because of Port's active participation in the management of the Atrium.

The Court of Appeals concluded that the Commission reasonably held that the Atrium did constitute real property used in Port's business.

Port's own brief to the Court explains that the Atrium was "another step in its diversification efforts." The purpose, according to Port, was "to take advantage of a large unused parcel of land" adjacent to its manufacturing facility. The Atrium was physically connected to that facility with a "bridge" or "passageway" and Port's chief executive officer maintained an office there and its staff participated in the ongoing operations of the Atrium. Port does not dispute that the