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

Basis of assets — gifts — basis for gain or loss. *Patrick J. and Jo Ann Murphy, Jr., and Patrick and Carrie Murphy, III vs. Wisconsin Department of Revenue* (Circuit Court for Waukesha County, March 7, 1996).

The taxpayers appealed the September 14, 1995, Wisconsin Tax Appeals Commission decision to the Circuit Court. The Commission had upheld the department's assessment of taxes and interest on the gain from the sale of real property. See *Wisconsin Tax Bulletin* 95 (January 1996), page 22, for a summary of the Commission decision.

The taxpayers withdrew their petition for review, and the Circuit Court dismissed the case. The case is final. □

Marital property. *Werner Brandt, and Werner and Elizabeth Brandt vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 23, 1996). The issue in this case is whether shares of Continental Gummiwerke ("Continental") stock sold during the years 1969 through 1974 were property held for the joint benefit of Werner and Melitta Brandt, thereby entitling taxpayers Werner and Elizabeth Brandt to a capital loss carryforward during the years 1979 through 1987, or whether the shares were the individual property of Melitta Brandt.

Melitta and Werner Brandt were married in West Germany, in 1952.

They entered into a post-nuptial agreement whereby they agreed to maintain their separate estates, declaring that their particular individual interests in property would remain individual in character.

In 1963, Melitta's mother died, leaving a will which provided that her bequests should forever remain the separate property of the beneficiaries, and that the inheritances were never to become marital property. Melitta inherited a large estate. Melitta's inheritance remained in Germany for a period of time following her mother's death. In 1966, Melitta and Werner moved to Wisconsin.

Nearly all of Melitta's assets from her inheritance were invested in Continental stock in Germany. In 1969, Melitta and Werner decided to transfer the bulk of Melitta's inheritance to the United States. When the Continental stock arrived from Germany, an investment account for Melitta was created. The account was initially established in both spouses' names. When this error was discovered by Melitta, the account was changed to Melitta's name at her and Werner's direction.

Eventually, the Continental stock was sold during various periods from 1969 through 1975. The vast majority of the sales of the Continental stock were made from the account in the individual name of Melitta Brandt.

Melitta filed for divorce in 1980, and in 1982 the trial court granted the divorce. Property division issues were taken under advisement. Ultimately, the proceeds of the Continental stock, among other assets, were deemed to be unidentifiably commingled at the time of the filing of the divorce petition, and were accordingly included in the marital estate subject to division upon dissolution of the marriage.

Werner Brandt filed income tax returns during the years 1979 and afterward in which, for some years, he claimed capital losses associated with the earlier sales of Continental stock. The department assessed the taxpayers for additional income taxes and interest for the years 1979 through 1987, on the basis that they were not entitled to capital losses associated with sales of the Continental stock during 1969 through 1974. The department deemed the Continental stock to be the individual property of Melitta Brandt at the time of the sales and therefore not subject to capital loss carryforwards claimed on the taxpayers' income tax returns.

The Commission concluded that the taxpayers were not entitled to capital loss carryforwards during the years 1979 through 1987 for losses associated with the sales of Continental stock during the years 1969 through 1974, because the shares sold at a loss were the individual property of Melitta Brandt, precluding the subsequent utilization of capital loss carryforwards on the part of the taxpayers.

The taxpayers have appealed this decision to the Circuit Court. □

CORPORATION FRANCHISE AND INCOME TAXES

Apportionment – factors; Dividends – deductible dividends; Foreign source income. *Wisconsin Department of Revenue vs. NCR Corporation* (Court of Appeals, District IV, July 31, 1996). Both NCR Corporation and the department appealed an April 30, 1993, decision of the Circuit Court for Dane County. See *Wisconsin Tax Bulletin* 82 (July 1993), page 21, for a summary of the Circuit Court's decision. The issues in this case are as follows:

A. Do the Foreign Commerce and Due Process Clauses of the United States Constitution force Wisconsin to exclude from a corporate taxpayer's Wisconsin apportionable income under the state corporate franchise and income tax all interest, royalties, and dividends paid the corporate taxpayer by its overseas unitary subsidiaries?

B. In the alternative, do the Foreign Commerce and Due Process Clauses force Wisconsin to adjust the corporate taxpayer's three-factor apportionment formula in order to provide the corporate taxpayer relief against allegedly impermissible multiple taxation of interest, royalties, and dividends paid the corporate taxpayer by its unitary subsidiaries?

C. Do the Interstate Commerce and Equal Protection Clauses bar Wisconsin from granting corporate taxpayers a dividend-received deduction for dividends paid the corporate taxpayer by qualifying Wisconsin-based payor corporations, without also granting a dividend-received deduction for dividends paid the corporate taxpayer by out-of-state payor corporations?

The Court of Appeals stated that since the questions raised have both constitutional and international taxation implications, they deserve definitive resolution by the Wisconsin Supreme Court. Therefore, the Court of Appeals certified the case to the Wisconsin Supreme Court.

The taxpayer and the State agreed to a resolution of the case, and on September 24, 1996, the Wisconsin Supreme Court dismissed the case. □

SALES AND USE TAXES

Claims for refund – time limitation for filing. *D & S Dental Laboratory, Inc. vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, May 13, 1996). This is a review of the June 14, 1995 decision of the Wisconsin Tax Appeals Commission (Commission). For a summary of that decision, see *Wisconsin Tax Bulletin* 94 (October 1995), page 17. The issue in this case is whether the department's interpretation of the starting date for the two year time period to file a refund claim under sec. 77.59(4)(a), Wis. Stats., is correct.

The department issued a field audit assessment of sales tax to the taxpayer on August 1, 1991. The taxpayer paid the assessment on August 6, 1991. On August 6, 1993, the taxpayer filed a refund claim with the department for the amount paid pursuant to the assessment. The taxpayer received a letter from the department dated September 13, 1993, stating that the refund claim had not been timely filed under sec. 77.59(4)(a), Wis. Stats.

The taxpayer filed a petition for review with the Commission and the department filed a motion to dismiss. On June 14, 1995, the Commission ruled that the two year period to file a claim for refund under sec. 77.59(4)(a), Wis. Stats., began on August 1, 1991, and ended on August 1, 1993, thereby causing the Commission to lack jurisdiction to hear the taxpayer's petition for review.

The Circuit Court concluded that the refund claim was not timely filed and the Commission properly granted the department's motion to dismiss for lack of jurisdiction.

Once a determination of tax liability is made by the department in a field audit, and the appeal period expires, that determination is final unless one of three exceptions applies. One of the three exceptions is sec. 77.59(4)(a), Wis. Stats., which states: "A claim for refund ... may be made within 2 years of the determination of a tax assessed by ... field audit and paid if the tax was not protested by the filing of a petition for redetermination."

The "and paid" language in sec. 77.59(4)(a), Wis. Stats., indicates to the Circuit Court that what is being discussed is how a tax liability will be allowed to be adjusted. The Circuit Court therefore found that the "and paid" language does not relate to the original payment of an assessment.

The taxpayer has not appealed this decision. □

Computer software – tangible vs. intangible. *Wisconsin Department of Revenue vs. Manpower International, Inc.* (Court of Appeals, District IV, August 22, 1996). This is a review of the June 15, 1995 decision of the Circuit Court for Dane County. For a summary of that decision, see *Wisconsin Tax Bulletin* 94 (October 1995), page 17. The issue in this case is whether the Wisconsin Tax Appeals Commission properly determined that the taxpayer did not owe sales tax on its sale of pre-written computer software from 1987 through 1990.

Section 77.52(1), Wis. Stats., imposes a sales tax on the sale or lease of tangible personal property, "including accessories, components, attachments, parts, supplies and materials."

Section 77.52(2)(a)10, Wis. Stats., imposes a sales tax on the "repair, service, alteration ..., inspection and maintenance of all items of tangible personal property ..."

Section 77.52(2)(a)11, Wis. Stats., imposes the tax on "the producing, fabricating, processing, printing or imprinting of tangible personal property" for consumers who furnish the materials used in the process.

For the period 1987 through 1990, sec. 77.51(20), Wis. Stats. (1989-90), defined tangible personal property as "all tangible personal property of every kind and description ..." Section 77.51(20), Wis. Stats., has since been amended to expressly define computer programs, except custom computer programs, as tangible personal property.

Pre-written or "canned" software is defined as that which "is produced in quantity, available for sale to the public, selected by the customer to meet the customer's hardware requirements, is generally usable by the customer as written, and is 'loaded' into the computer memory by the customer." The taxpayer usually delivered the canned software on magnetic tapes or diskettes that the taxpayer placed into a computer's magnetic tape or disc drive for copying into the computer's memory unit. The memory units are physically altered and rearranged at the molecular level when new programs are copied into it. The cost of the magnetic tapes or diskettes was a minimal part of the taxpayer's charge for the software. In some cases, the taxpayer delivered the software by telephone.

The Court of Appeals affirmed the Circuit Court's decision, concluding that the taxpayer did not owe sales

tax on its sale of pre-written computer software from 1987 through 1990.

Before the legislature amended sec. 77.51(20), Wis. Stats., canned computer software was not "tangible personal property." In *Janesville Data Center, Inc. vs. Wisconsin Department of Revenue* (June 30, 1978), the Wisconsin Supreme Court held that the sale of keypunch cards, magnetic tapes and computer printouts was not taxable because the essence of the transaction was the intangible data embodied in these products. Here, the technology may have advanced, but the principle remained the same; the essence of the transaction was the sale of information offered by the taxpayer. Under *Janesville Data Center*, information is intangible property not subject to a sales tax.

The department argues, alternatively, that the transactions were taxable because canned software is an accessory, component, attachment or part for the computer because the computer is useless without software. However, sec. 77.52, Wis. Stats., imposes a sales tax only upon the retail sales of tangible goods, not the sales of intangibles. Under *Janesville Data Center*, software is an intangible and is not taxable as such, even if computers are useless without it.

The department also argues in the alternative that the lease of canned software is taxable as a service under sec. 77.52(2)(a)10 and 11, Wis. Stats., because loading it into the computer physically alters the computer's memory core. While that may be true, it is not the essence of the transaction, which remains the transfer of intangible data. Such transactions therefore remained nontaxable events until the legislature amended sec. 77.51(20), Wis. Stats.

The department has appealed this decision to the Wisconsin Supreme Court. □

Construction contractors – highway construction. *Hanz Contractors, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 30, 1996). The issue in this case is whether the taxpayer's transfers of sand and aggregate to Vinton Construction (Vinton) and Trierweiler Construction (Trierweiler) are subject to Wisconsin sales and use tax and penalty.

The taxpayer is a Wisconsin corporation, with its principal place of business located in Wausau, Wisconsin. The taxpayer is a manufacturer and retailer of construction materials, as well as a contractor engaged in various road construction activities. The taxpayer is involved in gravel crushing and base aggregate preparation for roadbed construction as well as the actual road construction itself. The taxpayer has held a Wisconsin seller's permit since 1977, and filed regular sales tax returns since that time.

Vinton is a Wisconsin corporation, with its principal place of business located in Manitowoc, Wisconsin. Vinton is also a contractor that is engaged in the road construction business. Vinton and the taxpayer have worked on the same highway construction projects many times over the years.

The taxpayer was the prime contractor in two highway construction projects. The taxpayer hired Vinton to batch and lay concrete for both projects.

The taxpayer provided sand and aggregate to Vinton to make the concrete. The taxpayer obtained the sand and aggregate from its own gravel pit without the payment of any sales or use tax. Vinton manufactured the concrete at its batch plant by adding water and cement mix to the sand and aggregate in proper proportions and mixing it all together. Vinton then transported the concrete in its cement mixing trucks to the highway construction site, where Vinton then used its slip-form paver to pour, form, puddle, float, and trowel the concrete into the roadbed of the highway construction project.

The taxpayer "back charged" the dollar amount of sand and aggregate it supplied to Vinton, deducting this amount from the amount the taxpayer owed Vinton under the subcontract agreement. No sales or use tax was collected or paid to the State of Wisconsin on this sand and aggregate provided to Vinton.

Trierweiler is a Wisconsin corporation, with its principal place of business located in Marshfield, Wisconsin. Trierweiler is also a contractor engaged in the road construction business. Trierweiler and the taxpayer have worked on the same highway projects many times over the years.

The taxpayer was a subcontractor and Trierweiler was the prime contractor on two highway construction projects. Both of these highway construction projects involved the laying of base course upon which to pour the concrete highway as part of the road construction process. The taxpayer delivered base course to the job sites pursuant to its subcontract agreements. The taxpayer obtained the aggregate from its own gravel pit without the payment of any sales or use tax. The taxpayer did not, however, "place" this base course onto or into the roadbed itself. The actual spreading, packing, and forming into

place was provided by Trierweiler. No sales or use tax was paid to the State of Wisconsin on these items.

Trierweiler transported part of the base course material from its place of business to the road construction site and provided for the placement of the base course by spreading, grading, packing, and forming it into the proper place to support the pouring of the concrete roadbed.

The taxpayer provided other base course that it did not deliver to the construction site. Trierweiler picked up this base course at the taxpayer's place of business and hauled it directly to the construction site itself. Trierweiler did not provide the taxpayer with an exemption certificate for these transactions. No sales or use tax was paid on these items.

The Commission concluded that the department properly determined that the transfers of sand and aggregate to Vinton and the transfers of aggregate to Trierweiler were "sales" within the meaning of sec. 77.51(14), Wis. Stats., and therefore subject to the imposition of sales tax. The department properly imposed the penalty provided in sec. 77.60(3), Wis. Stats., because the taxpayer did not show that its incorrect return was not due to neglect.

The taxpayer has not appealed this decision. □

Estoppel. *Spickler Enterprises, Ltd. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 21, 1995). The issue in this case is whether the Department of Revenue should be estopped from collecting sales tax from the taxpayer on its sales of nonmotorized trailers to non-Wisconsin residents and on its sales of related items of tangible personal property and services performed at the same time and in conjunction with the sales of the trailers.

The taxpayer was organized under the laws of Wisconsin in 1972 and has done business in Wisconsin as a registered motor vehicle dealer since that date. During the period under review, the taxpayer had its principal place of business in Chippewa Falls, Wisconsin, and was primarily engaged in the business of selling both motorized recreational vehicles as well as nonmotorized trailers, such as recreational vehicles, 5th wheel trailers, tent campers, and pickup truck toppers.

The taxpayer has held a Wisconsin seller's permit since July 1976, except for a short period in 1982 when the permit had been inactivated.

In July 1992, the Department of Revenue issued a sales tax assessment against the taxpayer. The only sales at issue from the assessment are those involving nonmotorized trailers and related items of tangible personal property and services for which the taxpayer did not charge or pay over any Wisconsin sales tax.

In deciding not to collect Wisconsin sales tax on its sales of nonmotorized recreational campers, trailers and /or toppers to out-of-state residents, the taxpayer relied on an oral statement or statements from the Wisconsin Department of Transportation.

During the period under review, the taxpayer never contacted the Department of Revenue or any of its employes to inquire whether its various sales at issue herein were subject to Wisconsin sales tax. The taxpayer did not pay any sales tax to any states other than Wisconsin and Minnesota during the audit period.

The Department of Revenue's *Sales and Use Tax Report* dated June 1977 was mailed to all those who held Wisconsin seller's permits and who were sent a return for the month or quarter of June 1977, which included the taxpayer. *Sale and Use Tax Information: Motor Vehicle Sales, Leases and Repairs*, Publication 202 (12/87), was also sent to the taxpayer.

The Department of Revenue has consistently taken the position that sales of nonmotorized trailers and pickup toppers, such as those in question in this case, are taxable.

Two employes of the taxpayer testified they relied on oral statements of clerical employes of the Department of Transportation. Both performed clerical functions for the taxpayer in connection with vehicle registrations. Neither had tax return preparation or filing responsibilities, and neither read the tax publications sent to the taxpayer by the Department of Revenue which contained the proper tax payment information pertaining to the transactions under review.

The Department of Transportation and the Department of Revenue are separate state agencies, and there was no agency-principal relationship between them, either express or implied, with respect to determining sales tax liability or providing specific tax information to the public, including vehicle dealers such as the taxpayer.

The Commission concluded that the taxpayer is not entitled to estoppel against the Department of Revenue to defeat the Department of Revenue's assessment. The taxpayer has not clearly shown that it reasonably relied on an action by the Department of Revenue in failing to pay the taxes assessed.

The elements of estoppel are (1) action or non-action, (2) on the part of one against whom estoppel is asserted, (3) which induces reasonable reliance thereon by the other, either in action or non-action, and (4) which is to his detriment.

There was no convincing proof of the date or dates of oral statements from the Wisconsin Department of Transportation or of the contents of the statements. The record contains only uncorroborated testimony which lacked specifics.

In order to succeed in its estoppel claim, the taxpayer must also show that the statement relied on was made by the one against whom estoppel is sought. But the statement or statements here were made by an employe or employes of the Department of Transportation, not the Department of Revenue whom the taxpayer seeks to estop. Under these circumstances, there can be no estoppel.

The Commission also rejected the taxpayer's assertion that the Department of Transportation was acting as an agent of the Department of Revenue in disseminating tax advice during the period under review. If the alleged tax advice was in fact provided by Department of Transportation clerical employes, they were acting outside the scope of their authority.

The Commission found it is not reasonable for the taxpayer, an experienced and sizeable business which has an established tax filing relationship with the Department of Revenue, to rely for its tax advice on oral statements to its clerical employes by clerical employes of the Department of Transportation, where thousands of dollars in potential sales tax liability are implicated. The evidence is not clear as to detriment to the taxpayer resulting from its reliance on statements of Department of Transportation employes.

The taxpayer has appealed this decision to the Circuit Court. □

Exemptions – commercial vessels and barges. *La Crosse Queen, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, April 4, 1996). This is an appeal from the August 10, 1995 decision of the Circuit Court for Dane County. The Circuit Court affirmed the decision of the Wisconsin Tax Appeals Commission, that the gross receipts of the taxpayer are subject to sales tax. For a summary of the Circuit Court decision, see *Wisconsin Tax Bulletin* 95 (January 1996), page 28.

The issue is whether the taxpayer's receipts from the lease of an excursion vessel are exempt from sales tax as a commercial vessel of fifty-ton burden or over primarily engaged in interstate commerce.

During the years 1989 through 1991 the taxpayer was the owner of an excursion vessel named the La Crosse Queen IV and leased it to Riverboats America, Inc. The vessel carries passengers on sightseeing and dinner cruises and operates exclusively on the Mississippi River. The western boundary of the State of Wisconsin is the center of the main channel of the Mississippi River. All passengers embark and disembark at La Crosse, Wisconsin. Approximately seventy-five percent of the passengers carried by the vessel are from states other than Wisconsin.

On the one and one-half hour cruise, the vessel goes upstream, crosses over the Wisconsin boundary into Minnesota territorial waters, travels to the lock and dam at Dresbach, Minnesota, then turns around and returns to La Crosse. There is a longer four-hour cruise that serves a meal and includes this same route. On this cruise and on charter cruises, the vessel typically "locks through" the lock at Dresbach before it turns around. There is also a two-hour dinner cruise that goes south on the river and then turns around to return to La Crosse. A guide provides information about the river and its history during the cruises. No passengers disembark at any point during the cruises.

The vessel operates under Interstate Commerce Commission (ICC) authority. Until the time of deregulation, the vessel was required to file tariff reports with the ICC. Because the Mississippi River is considered an interstate waterway, the vessel must be, and is, certified by the United States Coast Guard, and must report annually to the Army Corps of Engineers. The vessel exceeds a fifty-ton burden.

The Court of Appeals concluded that the vessel was engaged in interstate commerce during the years in question, but was unable to decide, based on the record, whether it was "primarily" engaged in interstate commerce. The vessel is engaged in interstate commerce when it crosses into Minnesota territorial waters on its excursion routes.

The Court of Appeals reversed the judgement of the Circuit Court and directed the Circuit Court to remand to the Wisconsin Tax Appeals Commission for a determination of whether the vessel was "primarily" engaged in interstate commerce.

The department has appealed this decision to the Wisconsin Supreme Court. □