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:

CORPORATION FRANCHISE AND INCOME TAXES

Insurance companies – interest from United States government obligations. *American Family Mutual Insurance Company and American Standard Insurance Company vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, October 30, 1997). The taxpayers appeal from an order affirming decisions of the Tax Appeals Commission assessing taxes on income generated from U.S. government obligations for the period 1984-1991. The sole issue on appeal is whether the statute imposing the tax, sec. 71.43(2), Wis. Stats., is a nondiscriminatory franchise tax within the meaning of 31 U.S.C. sec. 3124(a)(1), which exempts U.S. government obligations from all state and local taxation *except* such as may be imposed by "a nondiscriminatory franchise tax."

See *Wisconsin Tax Bulletins* 98 (July 1996), pages 21 and 23, and 102 (July 1997), page 14, for summaries of the previous decisions.

The facts are not in dispute. The taxpayers are subject to sec. 71.43(2), Wis. Stats., which imposes a franchise tax on the net income of Wisconsin-based insurance companies. The term "net income" is defined as "federal taxable income as determined in accordance with the provisions of the internal revenue code." Section 71.45(2)(a), Wis. Stats. The effect of incorporating the federal statutes is to bring income from federal obligations within net income and make it taxable.

The taxpayers did not report income derived from federal obligations on their returns for the years in question. After conducting a field audit, the department assessed additional taxes on the companies based, in part, on their income from federal government obligations. After the department denied their requests for redeterminations, the taxpayers appealed to the Tax Appeals Commission, arguing, among other things, that because Wisconsin law does not tax income on state and municipal obligations, its taxation of income from federal obligations renders the tax discriminatory and thus impermissible under 31 U.S.C. sec. 3124(a)(1). In support of

their argument, the taxpayers referred the Commission to several statutes expressly exempting various state and municipal obligations from "all taxation."

The Commission upheld the assessments. The Commission ruled that the existence of the other exemption statutes was not enough to render the tax discriminatory. According to the Commission, the taxpayers must show not only that sec. 71.43(2), Wis. Stats., when considered in light of related exemptions from the tax, is discriminatory on its face but also that the department actually applied it in a discriminatory manner to defeat the tax. On the department's assertions that it does not, in practice, exempt state and local obligations from the tax, the Commission concluded that, as applied, the tax was not discriminatory and dismissed the taxpayers' appeals. The taxpayers sought judicial review of the Commission's decisions, and the Circuit Court affirmed.

The Court of Appeals concluded that because its terms plainly direct the taxation of federal obligations in the face of statutes which, equally plainly, exempt various state and municipal obligations from the tax, sec. 71.43(2), Wis. Stats., is discriminatory within the meaning of 31 U.S.C. sec. 3124(1)(a) and thus violates the ban of the federal statute.

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

Loss deductions (prior law); Interest on assessments and refunds. *Madison Gas and Electric Company vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 15, 1997). This matter is before the Commission on the taxpayer's motion for summary judgment. The first issue is whether the department properly disallowed the taxpayer's deductions claimed in 1975, 1976, and 1977 concerning the line collapse in 1975. The second issue is whether the department erred when it failed to credit or offset the taxpayer's overpayment of 1978 taxes against amounts owed to the department as of the date of the overpayment.

At all times relevant to this matter, the taxpayer was a Wisconsin corporation doing business in Wisconsin as an electric and gas utility.

On January 11, 1975, the 63-mile transmission line between the taxpayer's North Madison substation and the South Fond du Lac substation collapsed and was totally destroyed. As a result of the collapse, the taxpayer's use of the line was totally extinguished.

In February 1975, the taxpayer filed suit against 4 defendants seeking compensation for damages caused by the collapse. The 4 defendants were (1) a consulting engineering firm, (2) the manufacturer of the line's tower structures, (3) the builder of the tower structures and the transmission line, and (4) a railroad that allegedly cut a conductor causing the remainder of the line to collapse after the initial, partial collapse.

The taxpayer had no insurance that covered the loss related to the line collapse and did not receive any compensation from any of its insurers. The taxpayer claimed losses related to the line collapse on its 1975 through 1977 Wisconsin franchise tax returns.

In June 1978, the taxpayer reached a settlement with the defendants, the terms of which paid the taxpayer $3.5 million. This was the only compensation the taxpayer received with regard to the line collapse. The taxpayer reported the amount from the June 1978 settlement as income on its 1978 Wisconsin franchise tax return.

In January 1983, the department assessed the taxpayer additional franchise taxes and interest for the years 1972 through 1979. The assessment dealt with a plethora of issues, one of which was the treatment of losses related to the line collapse. In March 1983, the taxpayer filed a petition for redetermination objecting to the assessment. In December 1996, the department issued a notice of action granting in part and denying in part the petition for redetermination.

The delay in issuing the notice of action was primarily caused by an agreement between the department and the taxpayer to wait until the completion of a federal audit of the taxpayer covering the same years at issue in the department's audit. Although the

federal audit was apparently completed in June 1989, the taxpayer did not forward the federal audit workpapers to the department until May 1995.

In the notice of action, the department denied 85% of the losses related to the line collapse claimed by the taxpayer for 1975, 1976, and 1977. The remaining 15% was allowed for each year as a then-current deduction for cost to remove the line, consistent with the results of the federal audit.

In the notice of action, the department allowed the taxpayer to deduct $2,537,648 for losses related to the line collapse in 1978, the year the taxpayer had reported the $3.5 million settlement as income.

As a result of the department's notice of action, the taxpayer was determined to have underpaid its franchise tax liability for 1976, 1977, and 1979 and overpaid its franchise tax liability for 1978. The department charged interest at the rate of 12% on amounts underpaid and credited the taxpayer with interest at the rate of 9% on amounts overpaid. The department did not credit or offset any portion of the taxpayer's overpayment of tax for 1978 against the principal amounts owing to the department for the other years covered by the audit.

The Commission concluded:

1. There is no genuine issue of material fact, and this matter is appropriate for summary judgment as a matter of law.

2. The department properly disallowed the deductions relative to the line collapse claimed by the taxpayer for 1975, 1976, and 1977 because these losses were later compensated.

3. The department properly calculated interest on the amounts owing to the department and amounts overpaid by the taxpayer because the department has the discretion whether to issue a refund or credit amounts overpaid by the taxpayer against amounts owed by the taxpayer.

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

HOMESTEAD CREDIT

Household income - social security benefits; Computation of credit. *John and Kathy Lizan vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 30, 1997). The issues in this case are:

A. Whether the department properly adjusted the claimants' 1992 through 1994 homestead credit claims to include social security benefits each year and aid to families with dependent children (AFDC) in 1994.

B. Whether the adjusted amount of homestead credit each year was properly calculated.

During the period under review, calendar years 1992 through 1994, the claimants were married and had a minor child.

John Lizan has been diagnosed with a medical condition which has prevented him from maintaining employment. As a result of his condition, Mr. Lizan received social security benefits of $8,196 in 1992, $8,436 in 1993, and $8,562 in 1994. During 1994 only, Mrs. Lizan received $2,160 of social security benefits and $208 of AFDC. Their son also received social security benefits during those years as a result of Mr. Lizan's condition, but they are not involved in this proceeding.

The claimants filed homestead credit claims for 1992, 1993, and 1994 but failed to include the social security benefits received in these years, or the AFDC benefits received in 1994. In each year under review, the instruction booklet issued by the department stated that claimants were required to include in household income payments received in the form of social security benefits.

In September 1996, the department issued an assessment against the claimants, denying all of the homestead credit allowed for 1992 and 1994, and $144 of the $196 homestead credit allowed for 1993. The assessment was for the purpose of including in household income the social security and AFDC benefits received during the years at issue.

The claimants argued on appeal that the social security benefits they received during 1992 through 1994 should not be included in household income for purposes of the homestead credit, and that even if the law requires this, the homestead credit instructions did not state this, and thus they should be able to keep all of the homestead credit claimed. They further argued that because their income, even with the social security benefits added, is well below the maximum allowable, they should be entitled to some credit for 1992 and 1994. The claimants also argued without any relevant rationale, that the department should not have considered AFDC benefits Mrs. Lizan received in 1994.

The Commission concluded as follows:

A. The department's adjustments to the claimants' homestead credit claims are correct because the department properly included in household income the amounts received in social security benefits.

B. The department properly calculated the adjustment to the claimants' homestead credit as a result of the inclusion of social security benefits in household income.

Income, as defined by sec. 71.52(6), Wis. Stats., clearly includes the social security benefits paid to the claimants. Furthermore, the instructions for each year made it clear the social security benefits had to be included in income for purposes of the homestead credit calculation.

Under sec. 71.54(1)(d)2, Wis. Stats., in order to receive any credit the real estate taxes claimed must be greater than 13% of household income above $8,000. In 1992 and 1994, the claimants' property taxes did not exceed 13% of their household income in excess of $8,000; thus, the department properly reduced their homestead credit to zero for 1992 and 1994.

AFDC benefits are clearly cash public assistance and properly considered by the department. However, there is no need to consider this issue since it would not have affected the claimants' entitlement to a credit for 1994.

The claimants have 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. This decision is provided for informational purposes only. □

SALES AND USE TAXES

Containers, packaging and shipping materials - delivery of newspapers. *Madison Newspapers, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 28, 1998). The issue is whether the taxpayer's carriers or its subscribers are its "customers" for purposes of the exemption from sales tax for packaging materials in sec. 77.54(6)(b), Wis. Stats.

Section 77.54(6)(b), Wis. Stats., provides an exemption for the gross receipts from the sale of and the storage, use or consumption of "Containers, labels, sacks, cans, boxes, drums, bags or other packaging and shipping materials for use in packing, packaging or shipping tangible personal property, *if such items are used by the purchaser to transfer merchandise to customers...*" (Emphasis added.) Section 77.54(6r), Wis. Stats., states that "The exemption under sub. (6) shall be strictly construed."

The primary business of the taxpayer is the production and distribution of newspapers. When the taxpayer distributed its newspapers to carriers, it bundled them with packaging materials. After the carriers took possession of the newspaper bundles, the carriers removed the packaging materials and discarded them. The packaging materials were not on the newspapers when they were delivered to subscribers.

The taxpayer contends that its customers were the carriers, rather than the subscribers. It asserts the following testimony (list not all-inclusive):

1. The taxpayer entered into an agreement with the carriers which provided that the carriers sell and distribute the newspapers as independent contractors;

2. Within certain limits, carriers were free to deliver newspapers to subscribers on their route in any manner that they chose;

3. Each carrier could arrange to have other persons assist on the route and was expected to find a substitute when the carrier was unable to complete the route; and
4. The billing statement that the taxpayer gave the carriers had language such as "Total Charges For Papers You Bought" and "Money Received From Your Customers Who Paid At The Office."

The department argues that the taxpayer's customers were the subscribers. The department presents the following evidence (list not all-inclusive):

1. Between 92 and 93 percent of the taxpayer's subscribers remitted their subscription payments directly to the taxpayer. The taxpayer maintained a central billing system to bill subscribers, collect subscription payments, and credit each carrier for amounts received from subscribers on that carrier's route;
2. Money paid in advance to the taxpayer for subscriptions was invested in interest-bearing investments, and this interest was retained by the taxpayer. These funds were treated as the taxpayer's funds and not funds held in trust for carriers;
3. The taxpayer paid an additional subsidy to all carriers on routes requiring a motor vehicle;
4. The taxpayer also subsidized certain low-profit routes;
5. When office pay subscribers failed to renew their subscriptions on time, the taxpayer would continue to pay carriers the retail rate for 10 days;
6. When a carrier commenced a carrier collect subscription, the taxpayer would demand the name of the subscriber;
7. When carriers solicited new subscriptions, they were instructed by the taxpayer to have new subscribers make their checks payable to the taxpayer;
8. The taxpayer paid for worker's compensation insurance for its carriers and obtained a street trades permit for every carrier under the age of 18 as required by state law; and
9. In general, a carrier received credit for each newspaper delivered by a missed delivery system as if the carrier had delivered the newspaper.

The Commission concluded that the taxpayer's purchase of packaging materials was not exempt from the use tax because the bundles of newspapers on which the packaging material was used were transferred to carriers who were not the taxpayer's "customers" within the meaning of sec. 77.54(6)(b), Wis. Stats.

The taxpayer's contracts and documents show a general, but inconsistent, intent to treat carriers as its customers and subscribers as the customers of the carriers. Although the taxpayer argued that the carriers were independent contractors, the taxpayer's policies insulated the carriers form most risks of loss and absorbed the majority of the carrier's expenses. The taxpayer exercised much more control over carriers than would be expected if the carriers were the taxpayer's customers.

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

Estoppel. *Spickler Enterprises, Ltd. vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, November 20, 1997). This is an appeal from the Circuit Court's January 22, 1997, decision. See *Wisconsin Tax Bulletin* 102 (July 1997), page 16, for a summary of the January 22, 1997 decision. *Wisconsin Tax Bulletin* 99 (October 1996), page 21, provides a summary of the December 21, 1995, decision of the Wisconsin Tax Appeals Commission that the taxpayer appealed to the Circuit Court.

The issue in this case is whether the Circuit Court was correct in upholding the Commission's decision that the taxpayer was not entitled to estoppel against the department to defeat the department's sales tax assessment. The Commission determined that the elements of estoppel were not clearly present in this case.

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, and 4) which is to his detriment. The party asserting

estoppel must prove all four elements by clear and convincing evidence.

The taxpayer is a registered motor vehicle dealer which sells motorized recreational vehicles, non-motorized trailers and campers, pickup truck toppers, and associated accessories. It has held a state sales tax permit since 1976. The department assessed sales tax on the taxpayer's sales in Wisconsin of motor vehicles and non-motorized trailers and pickup toppers to out-of-state residents. The taxpayer did not dispute the amount of tax; however, it claimed the department should be estopped from assessing a tax on the sales of non-motorized trailers and related items of tangible personal property and services. The taxpayer claimed that it relied on oral statements by clerical employes of the Department of Transportation (DOT) that sales tax on the items in question should be paid to the purchaser's state of residence.

The Circuit Court held that the Commission had properly denied the imposition of estoppel. The Commission found that the taxpayer failed to provide clear and convincing evidence that the elements of estoppel were met.

The Court of Appeals affirmed the Commission, deciding that it was not reasonable for the taxpayer to rely upon oral statements of DOT clerical employes in failing to pay sales tax on its sales of motorized trailers to out-of-state residents. The Court of Appeals concluded that the taxpayer has not met its burden to establish the elements of estoppel against the department.

The taxpayer appealed the decision to the Wisconsin Supreme Court, which denied the petition for review. The decision is final. □

Motor vehicles and trailers - sold to nonresidents. *Mrotek, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, September 9, 1997). The issues in this case are:

A. Whether the taxpayer's sales of snowmobiles and ancillary items are exempt under sec. 77.54(5)(a), Wis. Stats., because they were sold to Minnesota residents.

B. Whether the effect of the department's assessment will lead to unconstitutional double taxation.

The taxpayer is a retailer located in Hayward, Wisconsin, and is engaged in the sale of snowmobiles, all-terrain vehicles, trailers, and accessories. The department issued a sales tax assessment for the period January 1, 1990, through December 31, 1993, for additional sales tax and interest. The department's assessment was for uncollected sales tax on certain sales of snowmobiles, all-terrain vehicles, trailers, and accessories, as well as unpaid sales tax on certain manufacturer's rebates, customer down payments, and allegedly exempt sales for which there was no valid exemption certificate.

The Commission concluded as follows:

A. Snowmobiles, all-terrain vehicles, trailers, and accessories do not qualify for the exemption from sales tax in sec. 77.54(5)(a), Wis. Stats., which provides that sales of motor vehicles to nonresidents who will not use the motor vehicles in Wisconsin are exempt from the sales tax. Section 340.01(35), Wis. Stats., defines the term "motor vehicle." Two of the aspects of this definition are: 1) that the vehicle must be "self-propelled"; and 2) that snowmobiles and all-terrain vehicles are not motor vehicles.

B. The taxpayer provided no evidentiary facts to show that any of the items purchased by Minnesota residents will be subject to any Minnesota tax.

The taxpayer has not appealed this decision. □

Transportation charges. *Rhinelander Paper Co., Inc. vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, December 18, 1997). This is an appeal from the December 19, 1996 decision of the Wisconsin Tax Appeals Commission. For a summary of that decision, see *Wisconsin Tax Bulletin* 102 (July 1997), page 17.

The issue in this case is whether the Commission properly reversed the department's use tax assessment of amounts paid by the taxpayer to transport coal to its facility by rail after it was loaded onto rail cars. The Commission held that "sales price" as defined in sec. 77.51(15)(a)3, Wis. Stats. (1995-96), does not include transportation charges paid to persons other than the coal vendors.

The taxpayer is a Wisconsin corporation primarily engaged in the business of manufacturing paper. During the period under review, the taxpayer bought coal from three coal vendors for use in its facility in Rhinelander, Wisconsin. Except for a portion of the coal not at issue, the purchase price paid by the taxpayer to the coal vendors included shipment of the coal F.O.B. the vendor's dock. The coal was loaded onto railroad cars and was shipped by various railroad companies to the taxpayer's facility. The amount that the taxpayer paid for the coal did not include the cost of transporting the coal to its facility once it had been loaded onto the railroad cars.

All coal was transported by rail under separate arrangements between the taxpayer and the respective railroad companies. The taxpayer paid all of the cost of transporting the coal after it was loaded onto the rail cars. The railroad companies billed the taxpayer directly for the rail freight charges, and the taxpayer paid the railroads directly for the delivery. The taxpayer paid Wisconsin sales and/or use tax on the coal but did not pay any sales or use tax on the freight charges for shipping the coal by rail to its facility.

The measure of the "use tax" is defined to be the "sales price" of the coal or the tangible personal property. Section 77.51(15)(a)3, Wis. Stats., provides that "'Sales price' means the total amount for which tangible personal property is sold, leased or rented, valued in money, whether paid in money or otherwise, without any deduction on account of any of the following: . . . 3. The cost of transportation of the property prior to its purchase."

Section 77.51(15)(b)3, Wis. Stats., further states that "'Sales price' shall not include any of the following: . . . 3. Transportation charges separately stated, if the transportation occurs after the purchase of the property is made."

The Circuit Court concluded that the Commission was correct that, as a matter of law, transportation costs, when separately paid by the purchaser of tangible personal property to a third party (other than the vendor of said personal property), and which are not reflected in the actual price paid to the vendor of said personal property, are not included in the statutory definition of "sales price" permitting the imposition of use tax. The Court also noted that if the statutes regarding this issue are ambiguous, they are construed in favor of the taxpayer.

The department has not appealed this decision. □

Transportation charges. *Trierweiler Construction and Supply Co., Inc. vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, December 12, 1997). This is an appeal from the April 30, 1997, decision of the Wisconsin Tax Appeals Commission. For a summary of that decision, see *Wisconsin Tax Bulletin* 102 (July 1997), page 18.

The issue is whether transportation charges that the taxpayer paid to its carriers are included in the "sales price" of the property purchased and subject to use tax. Section 77.51(15)(a)3, Wis. Stats., provides that "'Sales price' means the total amount for which tangible personal property is sold, leased or rented, valued in money, whether paid in money or otherwise, without any deduction on account of any of the following: . . . 3. The cost of transportation of the property prior to its purchase."

The taxpayer is a Wisconsin corporation engaged in the business of highway construction. The taxpayer manufactured ready-mix concrete, some of which it used for its own projects, most of which was sold to other parties. During the period under review, the taxpayer purchased cement from various suppliers in Wisconsin for use at either its road construction sites or its concrete manufacturing plant. These suppliers were retailers of the cement. The suppliers added sales tax to the amount they charged for the cement. The

supplier's charge for the cement to the taxpayer did not include transportation costs for shipment from the supplier to the taxpayer.

The carriers were hired by the taxpayer and were completely independent of the suppliers. These carriers were not engaged in the sale of the cement but merely in the business of hauling it for others. The taxpayer was billed directly by the carriers for their transportation services, and the taxpayer paid the carriers directly. The carriers did not charge sales tax for the transportation.

The taxpayer did not pay sales tax on the transportation charges. The taxpayer stored, used, or consumed the cement in Wisconsin and did not pay use tax on the transportation charges incurred in the shipping of the cement.

The Circuit Court concluded that transportation charges paid separately to common carriers by the taxpayer for hauling cement purchased by the taxpayer from the taxpayer's suppliers are not included in or added to the cement's "sales price," as that term is defined in sec. 77.51(15)(a), Wis. Stats, and, therefore, not subject to the use tax under sec. 77.53(1), Wis. Stats.

The department has not appealed this decision. □

SALES TAXES AND WITHHOLDING TAXES

Officer liability. *Michael A. Pharo vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 11, 1997). The issue in this case is whether the taxpayer is a responsible person under secs. 71.83(1)(b)2 and 77.60(9), Wis. Stats.

The taxpayer converted his sole proprietorship into a corporation, Town & Country Communications ("the corporation"). The taxpayer assumed the title of General Manager and effectively controlled the corporation. He hired and assigned duties to all employes and determined their compensation. The taxpayer opened all mail, controlled the corporate checkbooks, made bank deposits, and had signature authority on the corporation's checking accounts, including the payroll account. He also did the corporation's bookkeeping, sometimes with the help of others.

The taxpayer signed and filed most of the corporation's sales tax returns with the department during the period under review, without remitting the taxes due thereon. He signed and filed the corporation's withholding tax deposit report with the department for the first quarter of 1991, without remitting the taxes due. The taxpayer also signed checks to the department for payroll taxes at various times during the period under review, as well as a payroll check to an employe in January 1991.

The Commission concluded that the taxpayer was a responsible person under sec. 71.83(1)(b)2, Wis. Stats. and sec. 77.60(9), Wis. Stats., and was personally liable for the unpaid withholding and sales and use taxes. The taxpayer had the **authority** and the **duty** to pay the corporation's withholding and sales and use taxes, and the taxpayer **intentionally breached that duty**.

The taxpayer had virtually total control over the financial affairs of the corporation. With the exception of his own testimony, the taxpayer presented no evidence showing that anyone else had *authority* over the corporation's financial decision-making, including which creditors were paid and when, at any time during the periods under review.

With no one else controlling the corporation's checkbook or opening the mail, the Commission concluded that the taxpayer had constructive knowledge and most likely actual knowledge that both sales and withholding taxes were unpaid and subsequently delinquent. The taxpayer was shown to be the corporation's primary - if not its only - owner, its only manager, and the only one who exercised financial and management control during the periods under review. His knowledge of and control over the corporation and its employes throughout the periods was such that he was *duty-bound* to see to it that the sales and withholding taxes were paid as they became due.

Intentional breach of duty is established by the taxpayer's failure to direct payment of taxes while allowing other creditors to be paid. The evidence shows that the corporation continued to do business and meet its payroll during the periods under review (and beyond) while taxes went unpaid. This *breach of duty* is attributable to the taxpayer because he controlled and directed corporate finances as owner and general manager.

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

WITHHOLDING TAXES

Employers required to withhold. *Robar International, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 30, 1997). The issues in this case are:

A. Whether the payments made by the taxpayer to its president and sole shareholder are wages subject to withholding under sec. 71.64, Wis. Stats.

B. Whether the department properly imposed the negligence penalty provided in sec. 71.83(1)(a)3, Wis. Stats., for the taxpayer's failure to withhold.

The taxpayer is a corporation which manufactures trash compactors. Robert J. Hoelzl began the business in 1973 as a sole proprietor, and converted it to a corporation in 1989. Hoelzl owned all of the taxpayer's stock and was employed as its president and chief operating officer, devoting 100% of his time to these duties. Hoelzl did not offer his management services to any other company.

Hoelzl signed the taxpayer's corporate franchise or income tax returns for the fiscal years 1989 through 1992, which is the period under review. The returns were prepared by an accountant and showed deductions for "management fees" which were paid to Hoelzl. The taxpayer withheld no taxes on these management fees, although it did withhold taxes on wages paid to its other employes.

Hoelzl paid himself "draws" from the taxpayer monthly, or more frequently, during the period under review. The draws were recorded on the taxpayer's books as "notes receivable - officers," although there were no signs of actual signed notes. No interest was charged by the taxpayer nor did the notes have any due date. At the end of each fiscal year, Hoelzl reclassified the notes receivable as "management fees."

The Commission concluded that:

A. The payments made by the taxpayer to Hoelzl are wages subject to withholding. Hoelzl was an employe of the taxpayer.

B. The department properly imposed the negligence penalty. Hoelzl clearly was not an independent contractor, and it was neglect for the taxpayer to treat him as such.

The taxpayer has not appealed this decision. □