through December 31, 1996, $99 for the period January 1, 1997 through December 31, 1997, and $102 for the period January 1, 1998 through December 31, 1998.

(8)(b)3.(intro.) Motor vehicles held for sale and not assigned to and used by a specific dealer employe subject to federal withholding on wages are subject to Wisconsin use tax on the lease value of the motor vehicle computed on a calendar month basis. If a motor vehicle is used by the dealer for a period of less than one calendar month, the amount subject to use tax is the daily lease value calculated by multiplying the applicable monthly lease value by a fraction, the numerator of which is the number of days used by the dealer for a purpose in addition to retention, demonstration or display and the denominator of which is the number of days in the calendar month. Lease value is computed using the internal revenue service lease value table contained in ~~internal revenue service regulation s.~~ 26 CFR 1.61-21(d)(2). In the lease value table, the "automobile fair market value" is one of the following:

(8)(c)(intro.) It is presumed that all dealer plates issued by the department of transportation to a licensed motor vehicle dealer are used each month on motor vehicles assigned to employes subject to withholding for federal income tax purposes or owners who actively participate in the day-to-day operations of the dealership for a purpose in addition to retention, demonstration or display and are subject to use tax as provided in par. (b)1. and 2., unless one of the following applies:

(8)(d) Transitional provision. For motor vehicles, not assigned to employes or salespersons subject to federal withholding on wages or owners who actively participate in the day-to-day operations of the dealership, that are used by the dealer for a purpose in addition to retention, demonstration and display both prior to September 1, 1995, and on and after September 1, 1995, upon which a sales or use tax was paid on the purchase price of the motor vehicle by the dealer, the imposition of use tax as described in par.(b)~~2.~~3. does not apply. □

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

Allocation of income – compensation for services. *Kenneth H. Paker and Marianne Flood Paker vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 23, 1999). The issue in this case is whether income to which the taxpayer acquired rights in Illinois in 1995 and received from his former employers in 1996 after becoming a Wisconsin resident is taxable under Wisconsin income tax law.

The taxpayers filed a joint 1996 Wisconsin income tax return as part-year residents from January 20, 1996 to December 31, 1996. Two wage statements for Kenneth H. Paker ("the taxpayer"), both showing Wisconsin income tax withheld, were attached to the return.

The taxpayers did not report all of the income shown on the wage statements because they felt the unreported income is not subject to Wisconsin income tax. The department adjusted the tax return to include all of the wage income shown on the wage statements, stating that the income was taxable to Wisconsin because it was received while the taxpayers were Wisconsin residents.

The Commission concluded that the income which the taxpayer received from his former employer, to which he acquired rights in 1995 while an Illinois resident, and which he received in 1996 after he established residence in Wisconsin, is taxable as Wisconsin income pursuant to secs. 71.02 and 71.04, Wis. Stats. Income received while a Wisconsin resident is subject to Wisconsin income tax no matter where it was earned.

The taxpayers have not appealed this decision. □

Appeals – frivolous. *Timothy Van Groll vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 16, 1999). The issue in this case is whether the department properly denied the taxpayer's claim for refund of income taxes paid.

In April 1998 the taxpayer filed amended Wisconsin income tax returns for 1994, 1995, and 1996. On each amended return he indicated that he was "unvolunteering in the income tax system," and that Wisconsin has no jurisdiction over him to impose or collect income tax.

The department denied the taxpayer's claims for refund, and he filed a petition for redetermination. The department denied that petition, and the taxpayer filed a timely petition for review with the Commission. In the petition for review he stated that "I've decided not to volunteer to pay Income tax. Income tax is voluntary…"

The Commission concluded that the taxpayer failed to allege or demonstrate any justiciable error of law by the department in its denial of the claims for refund, and it dismissed the petition for review. The Commission also concluded that the taxpayer's position is frivolous and groundless, thereby subjecting him to an additional assessment under sec. 73.01(4)(am), Wis. Stats., and assessed him an additional $500.

In its ruling the Commission held that the taxpayer's "gobbledygook and the additional worthless ramblings in his communications and 'brief' have no merit in the real world…. It is unfortunate that his (and everyone's) tax dollars must be wasted in dealing with them."

The taxpayer has not appealed this decision. □

Assessments – correctness; Appeal procedure – disclosure under oath; Appeals – frivolous. *Derick J. Norskog vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 17, 1999). The issues in this case are:

A. Whether the assessment against the taxpayer was incorrect because he was not a Wisconsin resident.

B. Whether the taxpayer should be sanctioned for failing to answer questions under oath at trial as required by sec. 71.89(2), Wis. Stats.

C. Whether the taxpayer should be sanctioned because his position is frivolous and groundless.

The taxpayer did not file a proper Wisconsin income tax return for any of the years 1993 through 1996. The department estimated the taxpayer's income for those years and in December 1997 assessed him additional taxes for those years, as well as interest and a 25% negligence penalty. The taxpayer filed a petition for redetermination, arguing that he was not a Wisconsin resident during that period, except for the last four months of 1996. The department denied the petition, and the taxpayer appealed to the Commission.

At trial the taxpayer failed to answer questions asked of him by the department and by the Commission. He presented absolutely no evidence to support his position and refused to reveal the state to which he allegedly changed his residency.

The Commission concluded as follows:

A. The taxpayer failed to establish that the assessment was incor-

rect or that he abandoned his Wisconsin residency and established a domicile in another state.

B. The taxpayer is subject to sanction because he failed to make a full disclosure under oath before the Commission as required by sec. 71.89(2), Wis. Stats.

C. The taxpayer is subject to sanction because his position in the proceeding is frivolous and groundless.

The Commission further concluded that the appropriate sanction under sec. 73.01(4)(am), Wis. Stats., is $750 and assessed the taxpayer that amount.

The taxpayer has not appealed this decision. ☐

Claim for refund – statute of limitations. *Keith and Ellen Bower vs. Wisconsin Department of Revenue (*Wisconsin Tax Appeals Commission, May 11, 1999). The issue in this case is whether the taxpayers' claim for refund should be allowed, even though it was filed after the statutory deadline for filing, because of "mitigating" circumstances.

The taxpayers filed amended 1990, 1991, and 1992 Wisconsin income tax returns, each claiming a refund, more than four years after the unextended due dates of the returns, the statutory time for filing provided in sec. 71.75(2), Wis. Stats. They argued that the statute should not be applied in this situation, because the four-year period is "arbitrary" and "could be interpreted as a guideline where there are mitigating circumstances." Keith Bower also argued that the statute should not be applied because no governmental agency ever informed him that his teacher pension income was not taxable, that physical and mental impairment contributed to his filing incorrect returns, and that there is no public or societal interest served in the application of that statute in these circumstances.

The Commission concluded that the taxpayers' claim for refund should not be allowed. Section 71.75(1), Wis. Stats., states that the refund provisions in sec. 71.75, Wis. Stats., "shall be the only method" for filing claims for refund. The language is clear and unambiguous, and the taxpayers do not meet any of the statutory exceptions to the four-year claim for refund provision.

The taxpayers have not appealed this decision. ☐

Claim for refund – timely filed; Claim for refund – proper filing. *Ronald H. and Mary Ann Hummitzsch vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 26, 1999). The issues in this case are:

A. Whether the taxpayers properly filed a timely claim for refund with respect to their 1984 income taxes.

B. What is the status of the taxpayers' claim for refund regarding their 1982 and 1983 taxes?

Ronald Hummitzsch ("the taxpayer") served in the United States armed forces and during the years at issue collected a military pension. On or about March 19, 1990, the taxpayers filed what purported to be amended tax returns for 1982 to 1984. The basis of the refund claim was apparently that since the taxpayer was a member of the military retirement system as of December 31, 1963, they are entitled to a refund on taxes they paid, based on the holding in the U.S. Supreme Court decision in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), on March 28, 1989. The taxpayers failed to sign each of the purported amended returns for 1982 to 1984.

In October 1990, the department denied the claim for refund for 1982 to 1984, based on its position that the *Davis* decision did not apply to years prior to 1989. The taxpayers filed a petition for redetermination, and the time to act on it was extended per a written agreement on January 25, 1991.

The taxpayers subsequently became members of a class-action suit against the department. In late 1993 or early 1994, the department and the class members' representative entered into a stipulation under which members could receive installment payments on their "timely individual refund claims." The stipulation apparently dealt with claims for refund for 1984 to 1988 (the taxpayers had earlier filed a claim for refund for 1985 to 1988, and the time to act on that claim had also been extended). The taxpayers agreed to the stipulation in February 1994 and returned a release to the department, indicating their consent.

On May 15, 1994, the department issued a letter to the taxpayers setting forth the terms of the refund and indicating that the department considered their 1984 claim for refund not timely. The letter made no reference to the claims for 1982 and 1983.

The Commission concluded as follows:

A. The department properly denied the claim for refund for 1984 because the claim was not filed in a timely manner as required by sec. 71.75(2), Wis. Stats. In addition, the claim was not signed by the taxpayers as re-

quired by sec. 71.75(6), Wis. Stats.

B. The Commission lacks the subject matter authority to consider the claims for refund for 1982 and 1983. It does not appear that the department acted on the taxpayers' petition for redetermination with respect to these claims, and the taxpayers never appealed the denial of these claims to the Commission.

The taxpayers 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. □

Dependent credit. *Cynthia M. de Werff vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 2, 1999). The issue in this case is whether the taxpayer is entitled to claim the dependent credit for her children Christina and Sean for 1992 to 1995.

Cynthia M. de Werff ("the taxpayer") and her former husband, Timothy C. de Werff, were divorced by order of the Waukesha County Circuit Court (the "Court") as of April 7, 1989. However, the judgment of divorce was not entered until January 31, 1992. At the time of the judgment, there were four minor children of the marriage: Christina, Sean, Michele, and Cassandra.

In an order dated September 4, 1991, the Court found that Mr. de Werff was current on his child support obligation and awarded him dependent credits associated with Christina and Sean. In the judgment of divorce, the Court determined that as of November 16, 1989, there was no child support arrearage and that it was fair to split the tax exemptions between the parties. The Court awarded Mr. de Werff dependent credits associated with Christina and Sean, and the taxpayer was awarded sole custody and primary physical placement of the four minor children of the marriage.

On June 23, 1992, the Court entered an amended judgment of divorce which added the proviso that Mr. de Werff could claim the dependent credits only if all child support payments were paid on time in that year. Following a hearing on July 28, 1992, however, the Court held that he was entitled to the dependent credits even if he was not current on his child support obligations.

Mr. de Werff may have been delinquent on his child support obligations during 1992 to 1995. During each of those years he never provided less than $600 of support for each of the four children of the marriage. He claimed dependent credits associated with Christina and Sean for 1993, and he and his current wife ("Mr. and Mrs. de Werff") claimed the credits for 1992, 1994, and 1995.

The taxpayer claimed dependent credits for all four children for each of the years 1992 to 1995. She apparently refused each year to execute an IRS Form 8332 releasing the dependent exemptions for Christina and Sean to Mr. de Werff.

The department issued assessments in the alternative against the taxpayer and against Mr. and Mrs. de Werff with respect to the dependent credits associated with Christina and Sean. The taxpayer failed to appeal the assessment, and it went delinquent. She filed a timely claim for refund that was denied, and her petition for redetermination was also denied by the department.

Mr. and Mrs. de Werff filed a petition for redetermination with respect to their assessment, which was denied by the department. The Commission reversed the department's assessment on May 20, 1998, before the taxpayer filed her claim for refund.

The Commission concluded that the taxpayer is entitled to claim the dependent credit for 1992 to 1995 for Christina and Sean, because the record fails to show that she ever executed a Form 8332 releasing the dependency exemption with respect to these children to Mr. de Werff. For divorces after December 31, 1984, sec 152(e) of the Internal Revenue Code provides that a noncustodial parent may not claim a dependent exemption unless the custodial parent releases the dependent exemption to the noncustodial parent, the terms of the divorce judgment notwithstanding. In the prior matter involving Mr. and Mrs. de Werff, both parties argued the law that was in effect prior to that, when the release by the custodial parent was not required. The Commission is not compelled in a small claims case such as this, to correct the department's misunderstanding of the law.

The department 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. This decision is provided for informational purposes only. □

Earned income credit. *Deana M. Siemik, n/k/a Deana Casarez vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 1, 1999).

The issue in this case is whether the taxpayer is entitled to claim earned income credits for 1994 and 1995 for a qualifying child of both herself and another individual.

During 1994 and 1995 the taxpayer and Rodney Casarez ("Casarez") resided in the same household with the taxpayer's three children. Two of the children were "qualifying children" (with respect to the earned income credit) of the taxpayer, and a third child, Austin, was the qualifying child of both the taxpayer and Casarez. In 1994 and 1995 respectively, Casarez's Wisconsin income was $28,011 and $33,997 and the taxpayer's Wisconsin income was $6,183 and $6,161.

The department issued an income tax assessment against the taxpayer, in which it disallowed the earned income credits with respect to Austin for 1994 and 1995. The basis of the assessment was that she was not entitled to those credits because Casarez was eligible to claim the credit for Austin, and he had a higher modified adjusted gross income than the taxpayer.

The Commission concluded that the taxpayer is not entitled to claim the earned income credit for Austin for 1995, because Casarez had a higher modified adjusted gross income. Internal Revenue Code (IRC) sec. 32(c)1(C). She is entitled to the earned income credit for Austin for 1994, however, because in that year the earned income credit was a function of state law, which contained no provision similar to IRC sec. 32(c)1(C). Section 71.07(9e)(ap)-(at), Wis. Stats. (1995-96).

Neither the department nor the taxpayer has 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 is provided for informational purposes only. □

Earned income credit; Head of household; Personal exemptions; School property tax credit – renters. *Sheila Edwards vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 1, 1999). The issues in this case are:

A. Whether Sheila Edwards ("the taxpayer") is entitled to claim earned income credits for 1992 to 1995.

B. Whether the taxpayer is entitled to claim the "head of household" filing status for 1994 and 1995.

C. Whether the taxpayer is entitled to claim personal exemption credits for her three children for 1992 to 1995.

D. Whether the taxpayer is entitled to claim the renter's school property tax credit for 1993 to 1995.

In September 1996 the department issued assessments in the alternative to the taxpayer and to Leroy Bentley, Jr. ("Bentley") for 1992 to 1995. During the years at issue the taxpayer and Bentley lived together in a home owned by him.

The assessment against Bentley largely mirrored the assessment against the taxpayer. Bentley filed a petition for redetermination, which the department denied, and he then filed a petition for review with the Commission. The Commission dismissed the petition on May 18, 1999, on the grounds that Bentley failed to prosecute his appeal. He did not file an appeal of the Ruling and Order, and thus the assessment is now final and conclusive.

With respect to the assessment against the taxpayer, the department's denial of her earned income credits was based on the fact that Bentley had a higher modified adjusted gross income than her. The disallowance of the head of household filing status was based on the department's belief that Bentley provided more than one-half of the cost of maintaining the household in 1994 and 1995. The denial of the personal exemption credits was based on the department's assertion that Bentley provided most of the support for the three children. The denial of the renter's school property tax credit was based on the department's assertion that the taxpayer did not pay rent to Bentley for the years at issue.

The taxpayer's Wisconsin income was $1,133 in 1992, $2,764 in 1993, $6,495 in 1994, and $7,393 in 1995. She also received Aid to Families with Dependent Children of between $200 and $300 per month during 1992, 1993, 1994, and the first several months of 1995. In 1994 and 1995 she provided more than one-half of the support for each of her three children out of her earned income.

The taxpayer paid rent to Bentley in the amounts of $4,500 in 1993, $5,100 in 1994, and $5,088 in 1995. These amounts were equal to one-half of the mortgage payments paid by Bentley. In addition, the taxpayer paid for the bulk of her children's food and clothing during each of the years at issue, as well as most of the utility bills for the household.

The Commission concluded as follows:

A. The taxpayer is not entitled to claim the earned income credit for 1992, 1993, or 1995, because Bentley had a higher modified adjusted gross income in each of

those years. Internal Revenue Code ("IRC") sec. 32(c)(1)(C). She is entitled to the earned income credit for 1994, however, because in that year the earned income credit was a function of state law, which contained no provision similar to IRC sec. 32(c)(1)(C). Section 71.07(9e)(ap)-(at), Wis. Stats. (1995-96).

B. The taxpayer is not entitled to head of household filing status for 1994 or 1995, because she did not show that she paid for more than one-half of the cost of maintaining the household.

C. The taxpayer is not entitled to claim personal exemption credits for 1992 or 1993 but is entitled to the credits for 1994 and 1995. She failed to prove that she provided more than one-half of the support for her children in 1992 or 1993, since her AFDC benefits for those years exceeded her earned income, and she had the benefit of medical assistance and food stamps. However, since her income was higher in 1994 and 1995, it is likely she provided more than one-half of the support for those years.

D. The taxpayer is entitled to claim the renter's school property tax credits for 1993 to 1995 because she paid rent to Bentley during those years.

Neither the department nor the taxpayer has 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 is provided for informational purposes only. ☐

Farm loss – limitation. *Thomas W. and Marilynne A. Maciejczak vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 19,1999). The issue in this case is whether the department properly limited the taxpayers' farm losses for 1991, 1993, and 1994.

During the years at issue, the taxpayers operated a farm. Mrs. Maciejczak was employed full-time off the farm during this period. Mr. Maciejczak was employed full-time off the farm in 1991 and 1993 and part-time off the farm in 1994.

In 1993, a barn on the taxpayers' farm was destroyed by fire. Due to financial hardship caused in part by the loss of the barn, Mr. Maciejczak withdrew $40,000 from a 401(k) plan that he was in the process of converting to an IRA. The 401(k) account was from his previous nonfarm employment. Later in 1994 he withdrew an additional $5,000 from his IRA. Had it not been for the withdrawal of the $45,000, the taxpayers would not have faced a farm loss limitation in 1994.

The taxpayers make the following arguments:

- The $45,000 withdrawn in 1994 should not be considered "nonfarm Wisconsin adjusted gross income" in determining the farm loss limitation that year.

- The Commission should consider the Legislature's intent of the law, which the taxpayers assert was to limit investors and other high-income people from using farms as tax shelters.

- The department did not audit the taxpayers' returns and inform them in a timely manner so as to minimize the amount of interest.

- The farm loss limitation is unconstitutional because it discriminates against against farmers who have nonfarm income.

- The farm loss limitation violates the uniformity clause of the Wisconsin Constitution, Article VIII, section 1.

The Commission concluded that the department properly limited the taxpayers' farm losses for 1991, 1993, and 1994. The withdrawal from retirement savings constitutes "nonfarm Wisconsin adjusted gross income" in sec. 71.05(6)(a)10, Wis. Stats., and the Commission may not modify the assessment based on legislative intent, because the term's meaning as used here is clear and unambiguous. The assessment was properly issued within the time periods specified in sec. 71.77(2) and (4), Wis. Stats. Finally, the farm loss limitation does not unconstitutionally discriminate against farmers with nonfarm income in excess of $55,000 or violate the uniformity clause of the Wisconsin Constitution.

The taxpayers have not appealed this decision. ☐

Issue preclusion. *Arthur A. and Betty L. Van Aman vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 5, 1999). The issue in this case is whether the taxpayers are prevented, under the doctrine of issue preclusion, from relitigating issues that had been decided in an earlier Commission decision involving them. See *Wisconsin Tax Bulletin* 98 (July 1996), page 18, for a summary of the earlier Commission decision, which involved the years 1990 through 1993.

The taxpayers have been Wisconsin residents since February 1990. Prior

to their retirement and their move to Wisconsin, both taxpayers were school teachers in Illinois, and both were members of the Illinois Teachers Retirement System ("ITRS") on December 31, 1963.

The taxpayers received annuity payments from ITRS during 1990 through 1993 and included the income on their Wisconsin tax returns for those years. In November 1994 they filed a claim for refund for those years, asserting that the annuity payments were exempt under sec. 71.05(1)(a), Wis. Stats. The department denied their claim for refund as well as their petition for redetermination, and the taxpayers appealed to the Commission. In a March 13, 1996, decision, the Commission affirmed the department's action, and the taxpayers did not appeal that decision.

The taxpayers continued to receive annuity payments from ITRS during 1994 through 1996, the years at issue in this case. They reported the income on their tax returns, but in December 1997 they filed a claim for refund. The department denied their claim for refund as well as their petition for redetermination, and the taxpayers appealed to the Commission.

The department filed with the Commission a motion for summary judgment, on the basis that the petition for review must be dismissed under the doctrine of issue preclusion. The department argued that the holdings in the March 13, 1996, decision precludes relitigating the same issues.

The Commission concluded that the doctrine of issue preclusion does prevent the taxpayers from relitigating the validity of sec. 71.05(1)(a), Wis. Stats. The taxpayers could have appealed the earlier decision but did not. The issues are identical in both cases, and there has been no law change that would dictate a change in the earlier decision. The Commission granted the motion for summary judgment and dismissed the petition for review.

The taxpayers have not appealed this decision. □

Trade or business – engaged in for profit. *Ivan Kevo vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 10, 1999). The issue in this case is whether, during 1995 and 1996 (the years at issue), the taxpayer operated his machine shop as a trade or business under sec. 162, Internal Revenue Code ("IRC").

The taxpayer began operating a machine shop in Chicago, Illinois in 1980. He had a business partner until 1986, when he bought out his partner, and he then began operating the shop as a sole proprietor.

In October 1994 the taxpayer moved to Wisconsin and began working full time as an employe in Wisconsin. He also continued operating his machine shop in Chicago, travelling there on weekends and days off. His work in the machine shop included industrial and equipment repairs, welding, and light construction.

The taxpayer reported net losses from his machine shop on his federal tax return each year from 1990 to 1996. The losses ranged from about $12,000 to about $25,600 during 1990 to 1994, $13,763 in 1995, and $8,447 in 1996. The taxpayer contended that prior to moving to Wisconsin in October 1994 he "made a living" from the machine shop. His full-time job in Wisconsin did not allow him to spend much time at the machine shop, but he stated he retained the machine shop to make a profit, not merely to retain his investment in the property. However, he did terminate the business in either 1998 or 1999 because he believed he would not make a profit.

In December 1997,the department issued an assessment to the taxpayer for tax years 1995 and 1996. The taxpayer filed a petition for redetermination with the department, which it denied.

The Commission concluded that the department properly determined that the taxpayer did not operate his machine shop as a trade or business in 1995 and 1996 within the meaning of sec. 162, IRC. Section 162, IRC, allows deductions for ordinary and necessary expenses paid or incurred in carrying on a trade or business. Section 183, IRC, provides that deductions are not allowable if an activity is not engaged in for profit. Treasury Regulation sec. 1.183 describes several factors relevant to this determination, including:

- Time and effort expended by the taxpayer in carrying on an activity;
- Taxpayer's history of income or losses with respect to the activity;
- Amount of occasional profits, if any; and
- Financial status of the taxpayer.

Each of the relevant factors tends to show that the machine shop was not operated for a profit and, therefore, was not a trade or business within the meaning of sec. 162, IRC. The machine shop does not qualify for the "engaged in for profit" presumption in sec. 183, IRC, because it experienced losses in all five of the years 1992 to 1996.

The taxpayer has not appealed this decision. □

CORPORATION FRANCHISE AND INCOME TAXES

Accounting – change in method. *Babcock and Wilcox Company (The) vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 6, 1999 and June 16, 1999). The issue in this case is whether $600 million in deferred income should have been realized by the predecessor corporation at the time of a merger in 1978 and not by the taxpayer.

The taxpayer is a Delaware corporation and a subsidiary of McDermott Incorporated ("McDermott"). In 1977 McDermott began to acquire the stock of The Babcock & Wilcox Company ("Old B&W"), a New Jersey corporation.

Subsequently, McDermott created a wholly owned subsidiary, McDermott Energy, Inc., organized as a Delaware corporation. Effective March 31, 1978, Old B&W was merged into McDermott Energy, Inc., and the name was changed to "The Babcock and Wilcox Company," which is the taxpayer. Effective the same date, the taxpayer acquired all of the assets and liabilities of Old B&W and carried on the same business, with the same management.

During the years at issue (April 1, 1978 to March 31, 1984), in nearly every instance the taxpayer's products were constructed in specific and unique customer specifications, under competitively bid contracts. The duration of these contracts typically covered several years.

The taxpayer and Old B&W used two different methods of accounting with respect to these long-term contracts. They used the completed contract method for state and federal tax reporting purposes and the percentage of completion method for financial reporting purposes.

Under the completed contract method, income and expenses associated with a particular contract are not reported until the year the contract is completed, and thus tax liabilities are not incurred until then. Under the percentage of completion method, income and costs are reported in each year of the contract. In each year, costs actually incurred in that year are reported, and the income to be reported is a portion of the total income expected under the contract.

At the time of the 1978 merger, Old B&W had deferred approximately $600 million of income by use of the completed contract method of accounting. This income had been earned by Old B&W through the performance of its long-term contracts but was not reported on its final return for the year ending March 31,1978. The $600 million was gradually reported by the taxpayer as these contracts were completed.

At the time of the merger, Old B&W had unused manufacturers sales tax credits, as well as an available business loss carryover. The credit and loss carryovers were claimed by the taxpayer on its returns in the years following the merger.

In February 1986 the department disallowed the taxpayer's unused sales tax credits and the net business loss carried forward from Old B&W. The taxpayer filed a petition for redetermination in April 1986, arguing that it was entitled to deduct the credits and the loss carryover. As an alternative, the taxpayer argued that effective with the merger the $600 million in deferred income was properly taxable to Old B&W and should not have been reported by the taxpayer. Under this theory, the taxpayer claimed it would have no taxable income for tax years ending March 31, 1979 to 1981, and it was entitled to refunds for tax years ending March 31, 1982 and 1983.

In June 1986 the taxpayer filed amended 1982 and 1983 tax returns, claiming the refunds that it argued it was entitled to in its April 1986 petition for redetermination. The department denied the claims for refund, and in July 1986 the taxpayers filed a petition for redetermination with respect to this denial. In July 1997 the department denied both the April 1986 and the July 1986 petitions for redetermination.

On appeal, the department argues that in order to obtain the relief it is seeking, the taxpayer would need to change its method of accounting. During the period covered by the amended returns, administrative rules required the department's permission to change the method of accounting, and neither the taxpayer nor Old B&W obtained this permission. The taxpayer is thus not entitled to the refund or offset it seeks.

The Commission concluded that the taxpayer is not entitled to a refund or offset concerning the taxpayer's proposed treatment of the $600 million of income deferred from Old B&W because (1) Wisconsin law does not mandate this treatment, (2) neither the taxpayer nor Old B&W obtained permission to change its method of accounting, and (3) the taxpayer is not entitled to cast its treatment of long-term contracts in a manner different from the manner it and Old B&W reported to the department.

The Commission awarded summary judgment to the department with respect to the treatment of the $600 million of deferred income but noted in its April 6, 1999 ruling and order

that an issue still to be resolved relates to certain depreciation expenses for property located outside Wisconsin. However, that issue was previously resolved by the department's allowance of the disputed depreciation. The taxpayer withdrew that portion of its petition for review, and in its order of June 16, 1999, the Commission concluded that the only issues to be decided were those addressed in the April 6, 1999 ruling and order.

The taxpayer has appealed the decision of April 6, 1999, to the Circuit Court. ☐

Deductions – taxes – single business taxes. *Delco Electronics Corporation vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, May 13, 1999). This is an appeal of a decision of the Circuit Court for Dane County dated March 20, 1998. See *Wisconsin Tax Bulletin* 110 (July 1998), page 18, for a summary of the Circuit Court decision. The issue is whether the taxpayer may deduct the Michigan Single Business Tax (MSBT) from the calculation of its Wisconsin franchise taxes.

The taxpayer ("Delco"), a subsidiary of General Motors, is an automotive electronics manufacturer that has plants in Wisconsin, Michigan, and Indiana and engages in business in those and other states. During the years under review, 1986 through 1989, Delco incurred liability for the MSBT, due to its business activities conducted in Michigan. For the period under review, Delco deducted the MSBT on its federal corporate income tax returns.

Delco filed Wisconsin franchise tax returns, claiming in them a deduction for the MSBT equal to the amounts claimed on its federal returns. The department disallowed the deduction for the MSBT. Upon appeal, the Tax Appeals Commission ("Commission") upheld the department's disallowance of the deduction, on the grounds that the MSBT is a tax "on or measured by all or a portion of" either Delco's net income or its gross receipts. The Circuit Court reversed the Commission decision.

The Court of Appeals concluded that Delco may not deduct the MSBT in calculating it Wisconsin franchise tax liability. It reversed the decision of the Circuit Court and affirmed the Commission's determination that the MSBT is a tax "on or measured by all or a portion of" gross receipts, thus precluding the deduction under sec. 71.04(3), Wis. Stats. (1985-86) and 71.26(3)(g), Wis. Stats. (1987-88).

The taxpayer has appealed this decision to the Wisconsin Supreme Court. ☐

Dividends received deduction. *Firstar Bank Wausau, N.A. vs. Wisconsin Department of Revenue (*Wisconsin Tax Appeals Commission, August 18, 1999). The issue in this case is whether the department properly disallowed, pursuant to sec. 71.26(3)(j), Wis. Stats., the taxpayer's deduction of dividends it received from the Federal Reserve Bank.

The taxpayer is a national bank. On its 1991 Wisconsin franchise tax return it claimed a deduction for dividends received on Federal Reserve Bank ("FRB") stock it owned. The distributions it received from the FRB constitute dividends under federal and state law.

The taxpayer maintains that sec. 71.04(4), Wis. Stats. (1983-86), the dividend deduction statute which was substantially succeeded by sec. 71.26(3)(j), Wis. Stats. (1987-92), was invalidated in its entirety by the decision in *NCR Corp. v. Dep't. of Revenue* (Dane County Circuit Court, April 30, 1993) (the "NCR decision"). The department maintains that some of the dividend deduction statute is severable from the language held unconstitutional in the NCR decision, and the dividends at issue are not deductible because the FRB does not meet the surviving requirements for deductibility.

The taxpayer also maintains that the department's disallowance of the dividends received deduction is barred by the constitutional doctrine of intergovernmental tax immunity. It further contends that the denial of the dividends received deduction amounts to state taxation of a federal obligation, which is prohibited under 31 U.S.C. sec. 3124(a).

The Commission concluded that the department properly denied the taxpayer's deduction for FRB dividends received, because the FRB does not meet all of the valid requirements of sec. 71.26(3)(j), Wis. Stats. (1991-92). The FRB was not subject to tax under ch. 71, Wis. Stats., and did not file a return or deduct dividends under ch. 71.

Sections 71.04(4), Wis Stats. (1983-86) and 71.26(3)(j), Wis. Stats. (1987-92) were not entirely invalidated by the NCR decision. Those statutes are severable pursuant to sec. 990.001(11), Wis. Stats.

The department's action under sec. 71.26(3)(j), Wis. Stats. (1991-92) is not barred by the doctrine of intergovernmental tax immunity or by 31 U.S.C. sec. 3124(a). The statute's effect is to uniformly alleviate what would otherwise be double taxation, at both the corporate level and at the corporate shareholder level. The deduction is not available to the taxpayer as a FRB shareholder because the FRB is not taxed at the state level and therefore there is no

double taxation to alleviate. The statute does not place a burden on the taxpayer greater than on other corporations that receive dividends from corporations that are not taxed by the state. For these same reasons, the denial of the deduction for dividends received from the FRB does not amount to state taxation of a federal obligation, which is prohibited under 31 U.S.C. sec. 3124(a).

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

SALES AND USE TAXES

Common or contract carriers. *J&M Transportation Specialists, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 28, 1999). The issue in this case is whether the taxpayer's purchase of a vehicle qualifies for exemption as a common or contract carrier under sec. 77.54(5)(b), Wis. Stats.

The taxpayer purchased a *Winnebago* motor home in 1995. Upon registration, the taxpayer claimed the sales tax exemption for common or contract carriers using its LC authority number on the application. The taxpayer subsequently changed the application to indicate that the vehicle was a 1994 Ford truck. It was registered as such, without payment of any sales tax.

In order to qualify for exemption under sec. 77.54(5)(b), Wis. Stats., the following qualifications must be met: 1) the vehicle must be a motor truck, truck tractor, road tractor, bus, trailer, or semitrailer; 2) the taxpayer must be a common or contract carrier; and 3) the taxpayer must "use" the vehicle exclusively as a common or contract carrier. The taxpayer stated that the vehicle's purpose was to move "time sensitive freight requiring team drivers" and that it "felt that this vehicle has nicer accommodations for team drivers."

The Commission concluded that the vehicle, as used, did not fit the statutory definition of motor truck, truck tractor, road tractor, bus, trailer, or semitrailer. The vehicle was not used in common motor carriage, and the taxpayer did not "use" its vehicle "exclusively as a common or contract carrier."

The taxpayer has not appealed this decision. ☐

Containers, packaging, and shipping materials - delivery of newspapers. *Madison Newspapers, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, June 10, 1999). On September 1, 1998, the Circuit Court for Dane County affirmed the Wisconsin Tax Appeals Commission's January 28, 1998 decision. See *Wisconsin Tax Bulletin* 112 (January 1999), page 24 and *Wisconsin Tax Bulletin* 107 (April 1998), page 16, for summaries of the Circuit Court and Commission decisions. The issue is whether the taxpayer's carriers are its "customers" for purposes of the exemption from sales tax for packaging materials in sec. 77.54(6)(b), Wis. Stats.

The taxpayer produces and distributes two newspapers. For the period in question, when the taxpayer distributed the newspapers to its carriers, it bundled them using string, strap, and other wrapping and packaging materials. After receiving the newspaper bundles, the carriers would remove and discard the packaging materials before delivering the newspapers to subscribers.

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.)

The department assessed the taxpayer for sales and use tax on the packaging and shipping materials that the taxpayer used when it distributed newspapers. The Commission and the Court both held that the materials were not exempt because the carriers did not qualify as "customers" under sec. 77.54(6)(b), Wis. Stats. The taxpayer argues that, because carriers entered into an agreement to purchase newspapers from the taxpayer to resell to subscribers, the carriers qualified as the taxpayer's customers.

The Court of Appeals concluded that the totality of the evidence demonstrated more of an agency type relationship because the taxpayer retained a substantial amount of control over the carriers and the taxpayer bore a significant amount of the expense and risk associated with the sale of the newspapers. These characteristics are uncommon in a vendor-customer relationship. The Court gave due weight to the Commission's conclusions and was satisfied that the Commission's findings were both reasonable and consistent with the law's mandate to interpret and apply the exemption strictly.

The taxpayer has not appealed this decision. ☐

Manufacturing. *Parkview Sand & Gravel, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 22, 1999). The issues in this case are:

A. Whether the taxpayer's 1991 purchase of a backhoe (and safety attachments and repair or replacement parts), which it used in its gravel business, was exempt from use tax under sec. 77.54(6)(a), Wis. Stats.

B. Whether the taxpayer was negligent in failing to report use tax and filing incorrect use tax returns during the period under review, and if so, whether the taxpayer filed an incorrect return for "good cause."

The taxpayer is a Wisconsin corporation that operates a sand and gravel pit involving manufacturing operations. The taxpayer purchased a backhoe in 1991. No sales or use tax was paid. The backhoe was used for:

- Developing new settling ponds (30.8%),
- Excavating silt from settling ponds (35.2%),
- Stripping and restoration (33.0%), and
- Loading customers' trucks (1.0%).

The department assessed the taxpayer use tax on its purchase of the backhoe and parts. The department also imposed the 25% negligence penalty under sec. 77.60(3), Wis. Stats.

The Commission concluded as follows:

A. The taxpayer's purchase of a backhoe and safety attachments and repair or replacement parts is not exempt from use tax under sec. 77.54(6)(a), Wis. Stats.

B. The taxpayer is liable for penalty under sec. 77.60(3), Wis. Stats., because it negligently filed incorrect returns for the four fiscal years in the period under review, and the errors on the returns were not due to "good cause."

For the taxpayer's backhoe and parts to be exempt under sec. 77.54(6)(a), the backhoe must be: 1) a machine or specific processing equipment; 2) used by a manufacturer; 3) used "exclusively" in manufacturing tangible personal property; ***and*** 4) used "directly" in manufacturing tangible personal property. The taxpayer used its backhoe in activities that the Commission concluded *are not* covered in the definition of "manufacturing" and, therefore, are not exempt from use tax under sec. 77.54(6)(a), Wis. Stats. These activities include stripping and restoration of land before and after extracting stone (33%), excavation of earth and materials to create new settling ponds (30.8%), and loading silt onto customers' trucks (1%).

The taxpayer had previously been audited and assessed use tax. The taxpayer also had no system of recording or reporting use tax. It relied on its suppliers to collect sales tax on its purchases. A taxpayer has the duty of complying with the sales and use tax laws, and the Commission concluded that the taxpayer should have known of its statutory obligation.

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

Printing - advertising materials sent out-of-state. *Sax Arts & Crafts, Inc. vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, May 24, 1999). The Wisconsin Tax Appeals Commission issued a decision on August 12, 1998, which was appealed to the Circuit Court. See *Wisconsin Tax Bulletin* 112 (January 1999), page 25, for a summary of the Commission's decision. The issue in this case is whether the Commission was correct in its decision that the department properly imposed sales and use tax on certain purchases and services relating to the taxpayer's catalog printing and distribution.

The taxpayer is a Delaware corporation whose principal place of business is in New Berlin, Wisconsin. The taxpayer is a direct seller of arts and crafts supplies and of school supplies. It sells by direct mail through catalogs distributed nationwide. The taxpayer did not charge its institutional customers, which were the overwhelming majority of its customers, for its catalogs.

The taxpayer's catalogs were printed in Wisconsin by Wisconsin printers. The taxpayer purchased the paper to be used in the printing from both a Wisconsin and an out-of-state supplier. The paper was shipped directly to the Wisconsin printers. The taxpayer retained title to the paper. The catalogs were shipped, at the direction of the taxpayer, directly to the taxpayer's customers.

The Circuit Court concluded that the Commission had correctly determined that:

1) A sales tax was properly imposed upon the taxpayer for its purchase in Wisconsin of unprinted paper stock to be used by third party Wisconsin printers for the printing and producing of the taxpayer's catalogs for distribution out-of-state, when catalogs were distributed without charge and thus not "destined for sale;"

2) A use tax was properly imposed on the taxpayer for its storage, use, or other consumption in Wisconsin of unprinted paper

stock when it purchased the paper out-of-state for catalogs which were printed in Wisconsin and then distributed without charge in Wisconsin; and

3) A sales tax was properly imposed upon the taxpayer for its purchase in Wisconsin of "finished art" which were used or consumed in the printing and production of the taxpayer's advertising catalogs, by independent Wisconsin printers, and subsequently distributed without charge to customers and potential customers throughout the country.

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

WITHHOLDING OF TAXES

Officer liability. *Irvin L. Hougom vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 28, 1999). The issue in this case is whether the taxpayer is a responsible person under sec. 71.83(1)(b)2, Wis. Stats., liable for the unpaid withholding taxes of Scenic Trailways, Inc. ("the corporation").

The taxpayer was an officer of the corporation since 1971, when the corporation first applied for a withholding tax employer identification number from the department. During 1991-1995 the taxpayer held the office of president and was personally involved with the day-to-day operations of the corporation. The taxpayer was a signer on the corporate checking account and personally issued checks on that account. The taxpayer also entered into agreements with the department agreeing to pay delinquent withholding taxes. Prior to the personal liability issue at question, the taxpayer received and paid three personal liability assessments for prior periods.

The Commission concluded the taxpayer was a responsible person under sec. 71.83(1)(b)2, Wis. Stats., and was personally liable for the unpaid withholding taxes. The taxpayer had the corporate **authority** to direct the payment of taxes and did not do so; he had a **duty** to direct payment and did not do so; and he **intentionally breached that duty**.

The taxpayer has not appealed this decision. ☐

Tax Releases

"Tax releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. In situations where the facts vary from those given herein, the answers may not apply. Unless otherwise indicated, tax releases apply for all periods open to adjustment. All references to section numbers are to the Wisconsin Statutes unless otherwise noted.

The following tax releases is included:

Sales and Use Taxes

SALES AND USE TAXES

Note: The following tax release interprets the Wisconsin sales and use tax law as it applis to the 5% state sales and use tax. The 0.5% county and 0.1% stadium sales and use taxes may also apply. For information on sales or purchases that are subject to the county or stadium sales and use tax, refer to Wisconsin publication 201, *Wisconsin Sales and Use Tax Information.*

1 Purchases of Building Materials by Exempt Entities for Use by Contractor in Real Property Construction

Note: This tax release replaces the tax release by the same title that appeared in *Wisconsin Tax Bulletin 74* (October 1991), pages 22 to 30. This tax release applies prospectively and retroactively to all periods open to adjustment under the statute of limitations. Revisions from the previous tax release include the addition of exempt entities in the section titled "Background" as a result of laws enacted, and changing Answer B in Facts and Questions 1 and 2 and the rationale for Answer B in Facts and Questions 3, 4, and 5.

Statutes: Sections 77.51(2) and (14), 77.54(9a), and 77.55(1), Wis. Stats. (1997-98)