



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

Bad debts - nonbusiness <i>John and Frances (deceased) Debelak</i>	34
Capital losses - substantiation Nonbusiness bad debts <i>Kevin J. and Jennifer T. Amys</i>	35
Delinquent taxes - delinquent account fee Interest - delinquent <i>Andre O. Hastings</i>	35
Settlement agreement - taxable portion <i>Randall Schwartz and Gayle J. Nelson</i>	36
Statute of limitations - assessments <i>Dale W. and Cindy L. Kimmons</i>	37

Corporation Franchise and Income Taxes

Delinquent interest on underpayment interest <i>General Casualty Company of Wisconsin and Regent Insurance Company</i>	37
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Sales and Use Taxes

Refunds, claims for - timeliness <i>Terry E. Knope</i>	38
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INDIVIDUAL INCOME TAXES

Bad debts - nonbusiness. *John and Frances (deceased) Debelak vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 22, 2002). The issue in this case is whether it was proper for the department to disallow all or a portion of the taxpayers' bad debt deduction, which they claimed on their 1996 Wisconsin income tax return.

On their 1996 Wisconsin income tax return, the taxpayers reported a capital loss of \$730,118 from the sale of Debelak Brothers, Inc. ("Debelak Brothers"). In March 1998, they filed an amended 1996 Wisconsin tax return,

along with an amended 1996 federal return. The sale was reported on the federal Schedule D as a short-term capital loss, and described on an attachment as a short-term capital loss, a "Non Business Bad Debt," a "Demand laon [sic] to debtor," and as a "Debt written off as worthless."

In November 1999, the department issued an assessment to the taxpayers for tax years 1996 through 1998. Referring to the claimed bad debt deduction, the department concluded that the debt was not worthless, and that the proper way to characterize the amount claimed as a bad debt was as a long-term capital loss on the taxpayers' 1996, 1997, and 1998 income tax returns.

The taxpayers filed a petition for redetermination with the department objecting, in part, to the assessment. The department denied the petition for redetermination, stating that the taxpayers had not established that the nonbusiness debt was completely worthless in 1996, and that a voluntary cancellation of a debt does not give rise to a bad debt deduction. The taxpayers then filed a timely petition for review with the Commission.

Between December 31, 1993, and December 31, 1996, Mr. Debelak ("the taxpayer") made cash advances to Debelak Brothers totaling \$1,731,039. In 1995 and 1996 he received repayments totaling \$300,407, leaving a balance due him of \$1,430,632 as of December 31, 1996. In 1997 the taxpayer received cash and a promissory note totaling \$700,514, resulting in the \$730,118 balance still owed him.

The Commission concluded that the department properly disallowed the entire nonbusiness bad debt deduction that the taxpayers claimed on their 1996 Wisconsin income tax return. To qualify as a nonbusiness bad debt deduction, the entire debt must be worthless, under Internal Revenue Code sec. 166 and its regulations, adopted for Wisconsin law by sec. 71.01(6)(k), Wis. Stats. The debt was not entirely worthless as of December 31, 1996.

The taxpayers have not appealed this decision. [✍](#)

**Capital losses - substantiation; Nonbusiness bad debts.**

Kevin J. and Jennifer T. Amys vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, November 1, 2002). The issues in this case are:

- A. Whether the taxpayers have adequately substantiated the terms of Jennifer T. Amys' ("the taxpayer's") advance to a construction company and subsequent losses resulting from partial write-offs in 1996 and 1997.
- B. Whether the taxpayers are entitled to deduct the losses on their 1996 and 1997 tax returns, even though the losses did not become worthless until after 1997.

In August 1993, the taxpayer advanced \$78,170 to Whei Gen Construction Company ("Whei Gen"), a Taiwanese company formed to build a commercial office building in Taiwan. The only documentation of the advance was a receipt from The International Bank of China, evidencing the transfer of funds. Rather, the advance was a "handshake" deal and the terms of the arrangement were oral, which is common with respect to small companies in Taiwan.

The terms of the arrangement provided that Whei Gen was to use the funds to leverage conventional financing for the project, and the debt would accrue 10% interest on the balance until repaid.

By the time the project got off the ground in 1996, construction costs had inflated considerably. In need of additional funding, Whei Gen required investors to write off a portion of the amounts it owed to them. The taxpayer was required to write off \$13,000 of the amount she had advanced in 1993. Continually plagued by problems, Whei Gen told the investors in 1997 that the

remainder of the advances would have to be written off. The taxpayer negotiated an agreement by which \$14,170 of the initial advance would be repaid. Whei Gen provided the taxpayer with a statement regarding each partial write-off.

The construction project failed sometime after 1997, and Whei Gen became insolvent and went out of business, leaving no assets against which the taxpayer could recoup the amounts she had advanced.

The taxpayers claimed capital losses associated with the partial write-offs of \$13,000 and \$51,000 on their 1996 and 1997 Wisconsin income tax returns, respectively. The department issued an income tax assessment against the taxpayers, part of which consisted of denying the capital losses. The taxpayers filed a petition for redetermination, objecting only to the capital loss denials. The department denied the petition for redetermination, and the taxpayers then filed a timely petition for review with the Commission.

The Commission concluded as follows:

- A. The taxpayers adequately substantiated the terms of the taxpayer's advance to Whei Gen Construction Company and subsequent losses resulting from partial write-offs in 1996 and 1997.
- B. The taxpayers are not entitled to deduct the losses on their 1996 and 1997 tax returns. Section 166(d)(1) of the Internal Revenue Code, which is part of Wisconsin tax law, provides that a non-business bad debt may be deducted as a short-term capital loss only when it has become worthless, which did not occur until after 1997.

Neither the department nor the taxpayers have appealed this decision. [↗](#)

**Delinquent taxes - delinquent account fee; Interest - delinquent.**

Andre O. Hastings vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, November 19, 2002). The issue in this case is whether the department properly imposed (1) a delinquent account fee under sec. 73.03(33m), Wis. Stats., and (2) delinquent interest under sec. 71.82(2), Wis. Stats. The department made a motion that the petition for review be dismissed on several grounds, including that the petition for review fails to state a claim upon which relief can be granted.

In December 2000, the department issued an income tax assessment to the taxpayer, covering tax years 1997 and 1998, consisting of income tax, underpayment interest, regular interest, and penalties. The assessment was not appealed or paid and went delinquent in February 2001.

In May 2001, the taxpayer made a full payment of the delinquent assessment, which now also included a delinquent account fee and delinquent interest. The delinquent account fee and all of the interest charges were "Paid Under Protest." The letter accompanying the

payment requested a refund of the underpayment interest, delinquent account fee, regular interest, and delinquent interest. The department deemed the request a claim for refund, which it denied. The taxpayer filed a petition for redetermination, and the department denied it. The taxpayer then filed a timely petition for review with the Commission, appealing only the denial of his claim for refund of the delinquent account fee and the delinquent interest.

The Commission granted the department's motion to dismiss the petition for review on the ground that it fails to state a claim upon which relief can be granted. It concluded that the department properly applied sec. 73.03(33m), Wis. Stats., when it imposed the delinquent account fee, and that sec. 71.82(2), Wis. Stats., clearly requires the department to impose the delinquent interest.

The taxpayer has not appealed this decision. [☞](#)



Settlement agreement - taxable portion.

Randall Schwartz and Gayle J. Nelson vs. Wisconsin Department of Revenue and Wisconsin Tax Appeals Commission (Court of Appeals, District II, September 11, 2002). This is an appeal from an order of the Circuit Court for Waukesha County dated November 8, 2001, which affirmed a February 7, 2001, decision and order of the Wisconsin Tax Appeals Commission. See *Wisconsin Tax Bulletin* 125 (July 2001), page 14, for a summary of the Commission's decision (the Circuit Court decision was not summarized in the *Wisconsin Tax Bulletin*). The issue on appeal is whether the Commission properly determined the taxable portion of a \$175,000 settlement payment received by Randall Schwartz ("the taxpayer").

The Commission determined that \$112,278 of a \$175,000 payment the taxpayer received for the sale of his interest in Global Fastener & Supply, Inc. ("Global") was taxable income paid in exchange for a covenant not to compete. The Commission further determined that the remainder of the payment was nontaxable income paid in exchange for a release of the taxpayer's personal injury claims.

The taxpayer was one of three shareholders in Global. In 1990, he came to believe the other two shareholders were acting improperly, and as a result he suffered anxiety and panic attacks. In January 1991, the three shareholders and Global entered into a settlement and purchase agreement that was dated and effective September 15, 1990. Under the terms of the agreement, the taxpayer sold his interest in Global for \$350,000. Global paid him \$100,000 and executed a promissory note for the \$250,000 balance. The agreement provided that \$175,000 of the \$350,000 was allocated to his personal injury claims and his covenant not to compete. It did not specifically state how much of the \$175,000 was allocated for the release of the personal injury claim and how much for the covenant not to compete.

Global satisfied the \$250,000 note to the taxpayer by payments to the taxpayer of \$8,000 per month, consisting of \$6,139 of principal and \$1,861 of interest.

On his 1991 Wisconsin income tax return, the taxpayer attributed \$10,000 of the \$175,000 payment to the covenant not to compete and reported it as taxable income. He contended that the remainder represented nontaxable compensation for his personal injury claims.

In April 1994, the department issued an income tax assessment against the taxpayer for 1989 through 1992, in which, among other adjustments, it determined that all of the \$175,000 payment was fully taxable as payment for the covenant not to compete. The taxpayer filed a petition for redetermination, which the department denied, and he then filed a petition for review with the Commission.

The Commission held that the entire portion of the payment received prior to March 1, 1991 (the date the covenant not to compete expired) was attributable to the covenant not to compete. This included the \$100,000 initial payment plus two months of principal payments.

The Court of Appeals concluded that the Circuit Court's order upholding the Commission's decision and order is correct. It held that when, as in this instance, an agreement is silent as to the allocation of a payment between a covenant not to compete and other claims or compensation, the Commission may make a reasonable allocation, and it further held that the Commission's allocation was reasonable.

The taxpayers have not appealed this decision. [☞](#)

**Statute of limitations - assessments.**

Dale W. and Cindy L. Kimmons vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, October 7, 2002). The issue in this case is whether the department may issue an assessment against the taxpayers within six years after their 1996 Wisconsin income tax return was filed, under sec. 71.77(7)(a), Wis. Stats., or whether the four-year limitation under sec. 71.77(2), Wis. Stats., applies. Both the department and the taxpayers filed motions for summary judgment.

The taxpayers filed a timely 1996 Wisconsin income tax return by its April 15, 1997, due date. On May 7, 2001, the department issued an assessment against the taxpayers, for tax years 1996 through 1998. The assessment for 1996 adjusted the taxpayers' reported income of \$40,132 to \$65,162; the income reported was 62% of the amount as adjusted by the department.

The taxpayers filed a petition for redetermination with the department. The department granted in part and denied in part the petition for redetermination, making no change to its adjustment of the taxpayers' income for 1996. The taxpayers then filed a timely petition for review with the Commission, contesting only the adjustments to their 1996 income tax return.

The Commission concluded that the department properly assessed the taxpayers under sec. 71.77(7)(a), Wis. Stats., beyond the four-year statute of limitation in sec. 71.77(2), Wis. Stats., because the taxpayers reported less than 75% of the net income they should have reported. The Commission denied the taxpayers' motion for summary judgment and granted the department's motion for summary judgment.

The taxpayers have not appealed this decision. [↗](#)

CORPORATION FRANCHISE AND INCOME TAXES

**Delinquent interest on underpayment interest.**

General Casualty Company of Wisconsin and Regent Insurance Company vs. Wisconsin Department of Revenue (Court of Appeals, District IV, September 19, 2002). This is an appeal from a September 4, 2001, order of the Circuit Court for Dane County, which reversed a January 25, 2001, decision of the Wisconsin Tax Appeals Commission. See *Wisconsin Tax Bulletin* 128 (January 2002), page 29, for a review of the Circuit Court's decision.

The dispute in this case arises from a department audit that resulted in assessment against the taxpayers of, among other amounts, normal interest on underpaid estimated taxes and delinquent interest on the underpayment interest under sec. 71.84(2)(a), Wis. Stats. (1997-98). The taxpayers appealed the assessment of delinquent interest to the Commission, which held that the department correctly imposed the interest. The taxpayers petitioned the Circuit Court for judicial review, and the Circuit Court reversed the Commission.

The taxpayers were acquired by a third party in 1990. As a result, certain intangible assets of the companies were amortized over periods ranging from one to seven years. In 1997, the Internal Revenue Service increased the amortization period to 15 years, thus creating addi-


tional federal taxable income, which in turn increased the taxpayers' Wisconsin tax liability. A department field audit resulted in an assessment against the taxpayers for tax years 1990 through 1995.

The taxpayers had not reported the increased tax liability, and their estimated tax payments were therefore insufficient for those tax years. For each year in the audit period, the department assessed normal (12%) interest on the underpaid estimated taxes from their due date until March 15 of the following year, in addition to other assessments. The department then imposed delinquent (18%) interest on the underpayment interest from March 15 of the year following each tax year to the date the taxpayers made a final payment to the department. The taxpayers contend that normal, rather than delinquent, interest should apply on the underpayment interest after March 15.

The Court of Appeals concluded that sec. 71.84(2)(a), Wis. Stats. (1997-98), authorizes the department to impose delinquent interest on the underpayment interest after March 15, even though the tax shown on the return as filed has been modified by an audit. The Court of Appeals reversed the order of the Circuit Court and affirmed the decision of the Commission.

The taxpayers appealed the decision to the Wisconsin Supreme Court. The Supreme Court denied the petition for review on December 10, 2002. [↗](#)

SALES AND USE TAXES

 **Refunds, claims for - timeliness.** *Terry E. Knope vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, September 6, 2002). The issue in this case is whether the taxpayer is entitled to a refund of sales taxes overpaid for the period of May, June, and July 1997.

On May 15, 2001, the taxpayer filed a claim for refund of sales taxes paid for the period of May, June, and July 1997, which the department denied as being beyond the two-year limit for refunds that are not to be passed on to the customer. The department also denied the taxpayer's subsequent petition for redetermination, and the taxpayer appealed to the Commission stating he was ill and unable to determine he was eligible for a refund "until the spring of 2000."

The Commission concluded the taxpayer is not entitled to a refund of sales taxes paid for the period of May,

June, and July 1997. For the period of May, June, and July 1997, a refund claim would have to have been filed no later than 1999. There is no dispute that the taxpayer did not file a refund claim within the two-year limit, and the taxpayer did not claim that the refund was passed on to the customers. The Commission awarded summary judgment to the department as there was no genuine issue as to any material fact and the department is entitled to summary judgment as a matter of law.

The taxpayer's claim that a refund claim was submitted in June of 2000 is not supported by any documents, and even if such a claim was found, it also would have been filed after the expiration of the two-year limit to file such claims. Because the Commission lacks jurisdiction over late filed claims, the department's motion for summary judgment is granted.

The taxpayer has not appealed this decision. 