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:

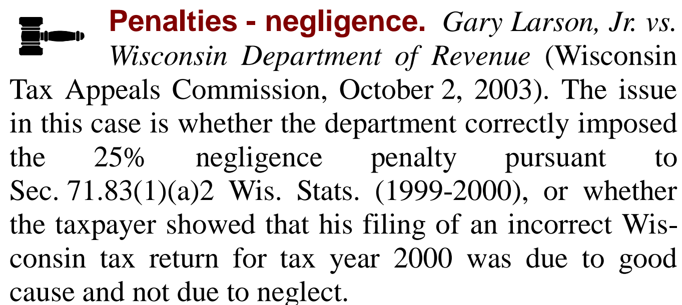
Individual Income Taxes
Penalties - negligence
Gary Larson, Jr. 27

Sales and Use Tax
Aircraft – taxable use
G & G Trucking, Inc. 28

Computer software – taxability (canned vs. custom programs
Menasha Corporation. 29

Leases and rentals - real vs. personal property
All City Communication Company, Inc. and Waukesha Tower Associates. 29

INDIVIDUAL INCOME TAXES



Penalties - negligence. *Gary Larson, Jr. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 2, 2003). The issue in this case is whether the department correctly imposed the 25% negligence penalty pursuant to Sec. 71.83(1)(a)2 Wis. Stats. (1999-2000), or whether the taxpayer showed that his filing of an incorrect Wisconsin tax return for tax year 2000 was due to good cause and not due to neglect.

Under date of April 15, 2001, the taxpayer filed a Wisconsin tax form for the year 2000 on which he either entered "0.00" or made no entry on almost every line. He attached his 2000 federal Form 1040 to his Wisconsin tax form. Again, he entered zeros on most lines of the Form 1040 and requested a refund of $3,074.59, the entire amount of federal income tax withheld by his employer. Attached to the federal tax form was a statement in which he generally asserted that no Internal Revenue Code provision imposed a tax liability on him; that he was only filing his federal return so he would not be prosecuted by the IRS for failure to file; and 10 other arguments which he believes prove that no income tax is due on his wage income.

Subsequent to the filing of the taxpayer's 2000 Wisconsin return, the department contacted the taxpayer's employer for 2000. The employer provided information to the department that the taxpayer had been paid $26,724.88 that year. They also provided the department with a form captioned "Reciprocity Exemption/Affidavit of Residency" on which the taxpayer stated that he was a resident of Wisconsin, not Minnesota, so no Minnesota income tax was withheld.

Under date of January 2, 2002, the department issued an income tax assessment for tax year 2000 against the taxpayer for $1,695.56, consisting of tax, interest, and the 25% negligence penalty pursuant to Sec. 71.83(1)(a)2 Wis. Stats. (1999-2000). Under date of March 12, 2002, the taxpayer wrote to the department, enclosing a check for the assessed tax and interest but objecting to the $311.50 negligence penalty. The department treated the objection as a petition for redetermination by the taxpayer of the assessment of the negligence penalty. The department denied the petition for redetermination, and the taxpayer filed a timely petition for review with the Commission solely on the issue of the 25% negligence penalty.

The taxpayer argued that: (1) he was instructed to enter on line 1 of his Wisconsin tax return ("Wages, salaries, tips, etc.") the amount reported on line 7 of the federal Form 1040; (2) line 7 on his federal tax return had "0" entered, so therefore (3) the correct entry on his Wisconsin tax return, line 1 was "0"; and (4) he did what he was required. He also argued that the penalty was not properly imposed, as he "made an offer to pay the penalty" if certain documents were provided to him. These included a copy of the "written determination" as to how the penalty was imposed and "the background file documents"; the department's regulation that requires him to pay the penalty; identification of the department's employee or employees who imposed the penalty and a copy of the Secretary of Revenue's written delegation of authority to that person or persons; and a copy of the "JUDGE'S ORDER" or the "JURY'S VERDICT" under which he was convicted.

The Commission concluded that the department correctly imposed the 25% negligence penalty, and the taxpayer did not show that his filing an incorrect Wisconsin tax return for 2000 was due to good cause and not due to neglect. The taxpayer's argument that his

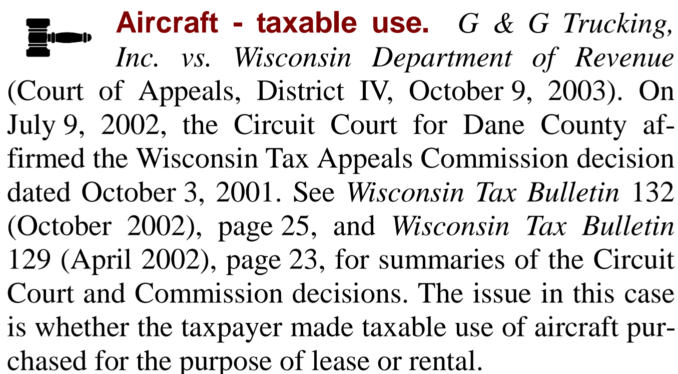
Wisconsin return was correctly filed is flawed in that his federal return was incorrect. Carrying the information from the incorrect federal tax return to the Wisconsin return also resulted in an incorrect Wisconsin tax return. His demand for documents from the department has no support in the law and improperly tries to reverse the burden of proof, requiring the department to prove that its imposition of the negligence penalty is correct.

The Commission also imposed an additional assessment of $250.00 against the taxpayer, as his position was frivolous or groundless. He had filed a similar 1999 Wisconsin income tax return and advanced many of the same arguments. Following a May 10, 2001 Commission trial, he filed a post-hearing brief. About two weeks later, he paid the assessment, and the case was resolved.

The taxpayer has not appealed this decision.

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

SALES AND USE TAXES



Aircraft - taxable use. *G & G Trucking, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, October 9, 2003). On July 9, 2002, the Circuit Court for Dane County affirmed the Wisconsin Tax Appeals Commission decision dated October 3, 2001. See *Wisconsin Tax Bulletin* 132 (October 2002), page 25, and *Wisconsin Tax Bulletin* 129 (April 2002), page 23, for summaries of the Circuit Court and Commission decisions. The issue in this case is whether the taxpayer made taxable use of aircraft purchased for the purpose of lease or rental.

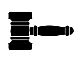
The taxpayer is a Wisconsin corporation engaged in the business of interstate trucking. During the period under review, the taxpayer purchased aircraft and related maintenance services and supplies without paying sales or use tax or providing exemption certificates.

Because the taxpayer lacked facilities to store the aircraft, and had no employees to fly them, the taxpayer entered into oral lease agreements to lease the aircraft to aircraft charter companies. Under the terms of the agreements, the charter companies had possession of the aircraft and were responsible for all insurance, registration, licensing, cleaning and maintenance, although the charter companies could bill certain costs, such as maintenance, to the taxpayer. In addition, the charter companies provided and paid the pilots, and were required to keep the aircraft in a safe and secure location. The charter companies had the sole responsibility for scheduling the use of the aircraft. In return, the taxpayer received payments from the charter companies based on the number of hours each aircraft was chartered. Any of the parties could terminate a lease agreement upon providing 30 days notice.

A third party that chartered an aircraft paid an initial charter fee, a pilot fee and a per-hour fee, the latter including gasoline for the aircraft. In contrast, when the taxpayer chartered aircraft, it paid no initial charter fee and paid a lower hourly rate. However, the taxpayer did pay a pilot fee and the cost of the fuel for the flight. If one of its own aircraft was not available, the taxpayer did not have "bumping rights" under the lease agreement; the taxpayer had to find either alternative transportation or cancel the trip. Alternative transportation could include "trading hours" with the owner of other aircraft leased to the charter company. When trading hours, the taxpayer paid the same lower hourly rate the owner of the aircraft paid when chartering its aircraft from the charter company. The charter company did not separately charge the taxpayer for chartering aircraft but offset that amount against the monthly rental fee the charter company paid to the taxpayer. During the period at issue, the taxpayer chartered its own aircraft for 10.8 percent to 20.5 percent of the total hours those aircraft were chartered each year.

The Court of Appeals affirmed the Circuit Court's conclusion that the taxpayer made use of the aircraft as that term is defined in sec. 77.51(22)(a), Wis. Stats., because the taxpayer owned the aircraft and chartered them for business purposes on more preferential terms than any other charter customer. The taxpayer exercised its right or power over the aircraft by using its ownership of the aircraft under these preferential terms to its economic advantage when it chartered the aircraft for its own business transportation for as much as twenty per cent of the total charter time. Exerting a right or control over property does not require that the taxpayer physically possess or control the property for there to be a taxable use under sec. 77.51(22)(a), Wis. Stats.

The taxpayer has appealed this decision.



Computer software - taxability (canned vs. custom programs). *Menasha Corporation vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 1, 2003). The issue in this case is whether computer software purchased by the taxpayer was tangible personal property and subject to sales or use tax. The following summarizes the Commission's findings of fact and conclusions of law.

The taxpayer is a worldwide corporation based in Wisconsin that produces packaging, paperboard, material handling, plastics, promotional materials, and printing.

During the period under review, the taxpayer purchased integrated business application software as a result of an evaluation of its business and accounting software systems. After approximately two years of evaluation and a demonstration of one of the recommended vendors' software, the taxpayer purchased the software at a cost of $5.2 million.

The software consisted of the taxpayer's selection from more than 70 software modules, each of which were designed to provide a rudimentary business and accounting computer software system for a segment of the taxpayer's business. The basic modules required customization using a specific programming language in order for the software system to serve the taxpayer's business and accounting needs.

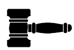
The software was delivered to the taxpayer on multiple CD-ROM disks, which were installed over a two day period onto the taxpayer's computer hardware by a former employee of the software vendor. The customization and testing of the software took approximately nine months, and was done by an implementation team and a programming team consisting of employees of the taxpayer as well as employees of the software vendor and third party consultants. The total cost of customizing and implementing the new software added approximately $17.8 million to the initial cost of the software.

When the software went on-line for the first time, employees of the taxpayer were required to attend training classes of two to five days to learn how to use the new software in performing their jobs.

The taxpayer purchased from the software vendor yearly maintenance for technical support, upgrades, new releases, and patches to the software.

Using the factors for determining whether a program is a custom program listed under sec. Tax 11.71(1)(e), Wis. Adm. Code, the Commission concluded the software was custom software, because there had been: (1) significant presale consultation, (2) extensive testing, (3) substantial training and written documentation, (4) enhancement and maintenance support, (5) a cost greater than $10,000, and (6) the software was not "prewritten" software because of the significant efforts required to bring it on-line for the taxpayer under factors 1-4. The Commission determined that Factor 7—preexisting programs which need to be significantly modified by the vendor to be usable—was not applicable here as the Commission already had concluded that the software was custom. The Commission awarded summary judgement to the taxpayer.

The department has appealed this decision. ⮸



Leases and rentals - real vs. personal property. *All City Communication Company, Inc. and Waukesha Tower Associates vs. State of Wisconsin Department of Revenue* (Court of Appeals, District IV, March 27, 2003). On March 18, 2002, the Circuit Court for Dane County affirmed the Wisconsin Tax Appeals Commission decision dated August 6, 2001. See *Wisconsin Tax Bulletin* 130 (July 2002), page 27, and *Wisconsin Tax Bulletin* 127 (October 2001), page 24, for summaries of the Circuit Court and Commission decisions. The issue in this case is whether Waukesha Tower's broadcast tower and equipment building are tangible personal property, making the lease or rental of the tower and equipment building subject to Wisconsin sales or use tax.

The determination of whether property, otherwise considered personal property, becomes real property is dependent upon the following three factors:

1. Actual physical annexation to the real estate;

2. Application or adaptation to the use or purpose to which the realty is devoted; and,

3. An intention on the part of the person making the annexation to make a permanent accession to the realty.

The lease agreement between the land owner and Waukesha Tower provided that "Improvements and per-

sonal property" on the land were the property of Waukesha Tower, which could remove them at the end of the 10-year lease. The lease permits the surrounding land to continue to be used as farmland. Waukesha Tower erected a 480 foot tower on a concrete foundation, secured by thirty guy wires that were also anchored in concrete. The Court of Appeals found the attachment of the tower to the ground sufficient to consider the tower to be *annexed* to the real property.

Although inconclusive as to whether the tower and equipment building were *adapted* to the use of the realty, because the realty could be considered equally suited for farming or as a base for the tower, the Court of Appeals determined the *intent* to make a permanent accession to the land was a more important factor.

The Court of Appeals determined it was not Waukesha Tower's *intention* to make a permanent accession to the realty because Waukesha Tower retained the right to remove the tower and equipment building at the expiration of the lease, and the landowner had the right to terminate the lease at the end of the lease term.

The Court of Appeals gave due weight to the Commission's determination that the tower and equipment building were tangible personal property because a market existed for the sale and purchase of used towers, and the tower could be disassembled and reassembled at another site.

The Court of Appeals concluded the Commission's determination that the tower and equipment building were tangible personal property was reasonable and thus subject to Wisconsin sales or use tax.

The taxpayer has not appealed this decision.