# 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

**Gross income – membership pledges.** *Minocqua Country Club, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, November 7, 2007). The issue in this case is whether Minocqua Country Club, Inc. (MCC) is liable for Wisconsin franchise and sales tax on the amounts that it received from pledges (deposits) that its members were required to pay for membership to the club.

See summary below under "Sales and Use Taxes."

## SALES AND USE TAXES

**Admissions.** *Minocqua Country Club, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, November 7, 2007). The issue in this case is whether Minocqua Country Club, Inc. (MCC) is liable for Wisconsin franchise and sales tax on the amounts that it received from pledges (deposits) that its members were required to pay for membership to the club.

The department asserts that the deposits paid to MCC by its members during the years at issue were includable in MCC's gross income for purposes of calculating its Wisconsin franchise tax, and also constituted admission fees that are subject to sales tax. MCC argues that these payments were instead capital contributions under IRC § 118 and not includable in its gross income. MCC also contends that the payments were not receipts subject to Wisconsin sales tax.

MCC is a private country club that owns and operates an 18-hole golf course. The use of MCC's facilities is limited to its members, their guests and invitees. Golf facilities offered by MCC to its members, their guests and other invitees both before and during the period under review include the golf course, a driving range, a practice green, and a pro shop. During the period under review, MCC added a chipping range.

In addition to its golf facilities, MCC offered a range of social and recreational facilities and amenities to its members, their guests and other invitees, before, during and subsequent to the period under review, including tennis courts, a private dock and beach on Lake Minocqua, a dining room and bar, and rooms for members to host parties and other social gatherings. Non-golf programs offered by MCC before, during and subsequent to the period under review included social events, and bridge leagues and tournaments.

Members of MCC generally were required to own 10 shares of MCC stock, which sold for $100 per share. The stock ownership requirement applied to all membership classes, except honorary members and associate members.

Memberships were not limited to golfers. Social members were those members who enjoy all privileges of MCC facilities other than regular use of the golf course.

In the late 1990's, MCC had fewer than 100 members. MCC concluded that in order to remain viable, it had to attract more members and determined that its existing nine-hole golf course was an obstacle to growth. In addition to the limitations of a nine-hole course, the condition of the existing golf course was substandard. In order to attract more members, MCC concluded that much of the existing nine-hole golf course had to be renovated, the course had to be expanded to an 18-hole

course, and the clubhouse had to be updated. MCC concluded that these plans were necessary to ensure the long-term financial viability of MCC.

On July 1, 1998, MCC's shareholders authorized a renovation and expansion project. The project plans were contingent upon MCC raising $2 million to finance the Project. In an effort to raise this $2 million, MCC asked its members to make deposits. Each member was required to sign a "Pledge Agreement." A member who failed to pay his/her pledge or make a deposit would be terminated as a member and his/her shares of stock surrendered. The pledge amounts ranged from $2,000 to $25,000. The level of dues depended in part upon the type of membership. For example, regular members paid more than social members. (Social members were asked to make deposits of $2,000 each.) The use of these funds was restricted to use only for capital improvements related to the renovation and expansion of the golf course, clubhouse and related facilities.

During the period under review, a number of classes of people were allowed to use the MCC golf course who were not required to pay a deposit. However, if an existing regular member did not sign a pledge agreement or make a deposit in accordance with his/her agreement, he/she could not continue as a regular member of MCC and lost continuing rights to use the golf course and other MCC facilities.

Making a deposit alone did not allow a person to become a member of MCC or have access to MCC's facilities, including the golf course. (For example, one individual made a deposit of $12,500, but never paid dues. That person did not become a member and was not allowed to use MCC's facilities, including its golf course.)

***Income/Franchise Tax***

MCC argued that the deposits were capital contributions made by the members to MCC and were properly excluded from MCC's gross income under IRC § 118. The department claims that the deposits were not contributions to capital, but were instead includable in MCC's gross income.

The department included the deposit amounts in MCC's gross income for purposes of calculating MCC's income/franchise tax. The amount that the department included in MCC's gross income included MCC's receipts from the special assessments, pledges, and deposits from both its golfing members and social members.

***Sales/Use Tax***

The department added the deposits and proceeds from stock sales from all regular (but not social) members to the sales tax base as taxable admission services. The department did not include in MCC's taxable gross receipts or assess any sales tax on the monies from the pledges/deposits that MCC received from its social members for renovation of MCC's clubhouse, because social members did not have access to the recreational facilities of MCC's golf course. In addition, the department deducted from the sales tax base the dues paid by social members.

Section 77.52(2)(a)2., Wis. Stats., imposes sales tax on the "…admissions to amusement, athletic, entertainment or recreational events or places ... and the furnishing, for dues, fees or other considerations, the privilege of access to clubs or the privilege of having access to or the use of amusement, entertainment, athletic or recreational devices or facilities, including the sale or furnishing of use of recreational facilities on a periodic basis or other recreational rights, including but not limited to membership rights, vacation services and club memberships."

MCC's primary objection to the sales tax assessment is the department's application of sales tax to the golfing members' deposits. MCC's position is that the deposits are not properly included in the sales tax base.

The Commission determined that the department correctly assessed both franchise and sales taxes. The Commission also ruled in favor of the department's assessment of penalties.

With respect to franchise tax, the Commission looked to the case of *Board of Trade of the City of Chicago v. Comm'r*, 106 T.C. 369 (1994). In this case, the Tax Court analyzed a number of prior cases that concern this issue. The Tax Court identified "three objective factors whose presence tends to support the existence of an investment motive: (1) the fee in question is earmarked for application to a capital acquisition or expenditure; (2) the payors are the equity owners of the corporation and there is an increase in the equity capital of the organization by virtue of the payment; and (3) the members have an opportunity to profit from their investment in the corporation." The Commission also looked to the language of the regulations under IRC § 118. It was determined by the Commission that the deposits at issue did not qualify as capital contributions and were includable in MCC's gross income for the years at issue.

To obtain access to MCC's new golf course, golfing members were required to pay the deposits at issue here (and sustaining members, the increased dues), and, as in every prior Wisconsin case, those payments were subject to sales tax.

The taxpayer has appealed this decision to the Circuit Court.

**Estoppel.** *Rodney A. Sawvell d/b/a Prairie Camper Sales. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 12, 2007).

The main issues in this case are as follows:

1. Does Wisconsin sales tax apply to the taxpayer's sales of campers and trailers to nonresidents of Wisconsin where such campers and trailers were delivered to buyers in Wisconsin?

2. Is the taxpayer entitled to any credit for Iowa sales or use tax that some of his customers paid to the State of Iowa when they registered the campers and trailers in Iowa, where Iowa refunded a portion of the taxes to the taxpayer?

3. Does the assessment by the Wisconsin Department of Revenue result in any impermissible double taxation?

4. Is the Wisconsin Department of Revenue estopped from imposing tax on the taxpayer's sales at issue based on (a) alleged information provided by the Iowa Department of Revenue, the Iowa Department of Transportation, or the Wisconsin Department of Transportation; and (b) the Wisconsin Department of Revenue's alleged lack of action or failure to act prior to the audit or period at issue?

The taxpayer's business is located in Wisconsin, about one mile from the Iowa border. Approximately 95% of the taxpayer's business consists of sales of non-motorized recreational vehicles, including campers, travel trailers, 5th wheel campers, and park campers. The taxpayer's other business activities include servicing such vehicles and selling parts and supplies. The taxpayer holds a Wisconsin seller's permit.

Many of the taxpayer's sales, including all of the sales at issue, were made to residents of Iowa. Prior to the department's audit of the taxpayer, the taxpayer's standard practice had been to collect and remit Wisconsin sales tax on its sales of campers and trailers to Wisconsin residents. When selling to customers from other states, such as Iowa, the taxpayer did not collect any sales tax, but typically advised the purchasers to pay any sales or use tax due on their purchases to the state where the vehicle would be titled, registered, and licensed.

At various times before, during, and after the period at issue, the taxpayer contacted personnel at the Wisconsin Department of Revenue, the Wisconsin Department of Transportation, the Iowa Department of Revenue, and the Iowa Department of Transportation requesting advice about state sales and use taxes.

The Wisconsin Department of Revenue assessed the taxpayer sales tax on his sales of non-motorized campers and trailers to nonresidents where transfers occurred in Wisconsin. The Wisconsin Department of Revenue has consistently taken the position in its publications that sales of non-motorized recreational vehicles to residents and nonresidents are taxable when the transfer takes place in Wisconsin and that the exemption in sec. 77.54(5)(a), Wis. Stats., does not apply.

As a result of the Wisconsin Department of Revenue's audit, and with the consent of his affected Iowa customers, the taxpayer applied for a refund of the Iowa use tax that its customers had paid to Iowa when they had registered the campers and trailers at issue in Iowa. While the Iowa Department of Revenue granted the taxpayer a partial refund of taxes, including interest, the Iowa Department of Revenue did not grant refunds for years that were outside the applicable Iowa statute of limitations. The taxpayer received and retained the refunds from the Iowa Department of Revenue and stated that he intends to pay the refund either to the Wisconsin Department of Revenue or back to Iowa.

*Issue 1:* The taxpayer conceded that his sales of campers and trailers to nonresidents were subject to Wisconsin sales tax. The sales occurred in Wisconsin and the vehicles were delivered to the purchasers in Wisconsin. Under Wisconsin law, these sales were taxable.

*Issue 2:* The Commission ruled that there was no basis in Wisconsin law to require the Wisconsin Department of Revenue to allow credit to the taxpayer for taxes that were paid to Iowa nor for the department to request refunds from the Iowa Department of Revenue on behalf of the taxpayer.

*Issue 3:* The Commission also determined that the taxpayer had not been double-taxed. By paying the taxpayer the Iowa refund, Iowa has agreed that Wisconsin was the proper state to tax the transactions at issue. By refusing to pay the portion of the taxpayer's refund

that is barred by Iowa's statute of limitations, Iowa is not asserting a right to tax these transactions.

*Issue 4:* The Commission also determined that the Wisconsin Department of Revenue cannot be held responsible for any inaccurate or conflicting advice that the taxpayer received from the Iowa Departments of Revenue or Transportation. Estoppel may only be asserted against the party whose action or non-action induced reliance, and the Commission determined that there is no identity of interest between the Wisconsin Department of Revenue and any branch of the Iowa state government.

The Commission also stated that the taxpayer's main source for information regarding Wisconsin sales tax should have been the Wisconsin Department of Revenue, and any reliance that the taxpayer placed on advice given by Iowa agencies regarding Wisconsin taxes was unreasonable. The taxpayer also did not provide any evidence of oral or written advice provided by the Wisconsin Department of Transportation personnel.

Additionally, the Commission in *Spickler Enterprises, Ltd. V. Wisconsin Department of Revenue* (WTAC December 21, 1995, which was affirmed by Dane County Circuit Court and Court of Appeals, District IV, on January 22, 1997 and November 20, 1997, respectively), previously addressed this question and determined that the petitioner's alleged reliance on oral advice given by Wisconsin Department of Transportation personnel regarding Wisconsin sales tax did not estop the Wisconsin Department of Revenue in a similar action.

It was not known at the time of publication whether the taxpayer would appeal this decision.

**Real property construction activities versus manufacturing.** *Visu-Sewer Clean & Seal, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals District IV, October 4, 2007). See *Wisconsin Tax Bulletin* 146 (February 2006), page 37, and *Wisconsin Tax Bulletin* 148 (July 2006), pages 31-32 for summaries of the Wisconsin Tax Appeals Commission and Dane County Circuit Court decisions, respectively.

The taxpayer appealed the Circuit Court's order affirming the Wisconsin Tax Appeals Commission's decision that the Department of Revenue properly classified Visu-Sewer's work as a real property construction activity, thus disallowing sales and use tax exemptions for raw materials, machinery, and equipment.

The taxpayer is a Wisconsin corporation engaged in various lines of business, including sewer cleaning and inspecting and re-lining underground sewer pipes that are in disrepair. All of the taxpayer's sewer re-lining work is for underground sewer pipes made of such materials as clay, reinforced concrete, non-reinforced concrete, case iron, steel, and transite. Sewer pipes have a design life of 50 years. The liners at issue that the taxpayer used have a design life of 50 years.

The issue addressed by the Wisconsin Tax Appeals Commission and subsequently reviewed by the Circuit Court was whether the taxpayer was engaged in real property construction activities when it installed sewer liners. The taxpayer contended that its installation of the National Liners and U-Liners into a customer's host sewer pipes is a manufacturing process, and that the raw materials, equipment, and equipment repair and maintenance were exempt from Wisconsin sales and use tax.

The Court of Appeals determined that the Commission reasonably concluded that Visu-Sewer meets the definitions provided by statute and regulation of "contractor" and was engaged in "real estate construction activities." The law then provides that Visu-Sewer is not a manufacturer and cannot claim the sales and use tax exemption for machines and equipment, regardless of whether Visu-Sewer's activities might also satisfy the definition of "manufacturing" provided in sec. 77.54(6m), Wis. Stats., which would allow Visu-Sewer to claim that exemption.

Therefore, the Court of Appeals concluded that the taxpayer is liable for sales or use tax on its purchase of the raw materials, equipment, and machinery that it used in the real property construction activity.

The taxpayer has not appealed this decision.