

## REPORT ON LITIGATION

*(This portion of the WTB summarizes recent significant Tax Appeals Commission 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:

### Income and Franchise Taxes

- Romain A. Howick vs. Wisconsin Department of Revenue
- Kelvinator Commercial Products, Inc. vs. Wisconsin Department of Revenue
- NCR Corporation vs. Wisconsin Department of Revenue
- Marilynn H. Schaefer vs. Wisconsin Department of Revenue
- Wisconsin Department of Revenue vs. Louis G. Shew
- Wausau Homes, Incorporated vs. Wisconsin Department of Revenue
- Louis Webster, Sr., Alex Askenette, Sr., Sue Askenette vs. Wisconsin Department of Revenue

### Sales/Use Taxes

- Chicago, Milwaukee, St. Paul and Pacific Railroad Company vs. Wisconsin Department of Revenue
- City of Racine vs. Wisconsin Department of Revenue
- Wisconsin Department of Revenue vs. Family Hospital, Inc.
- Fort Howard Paper Company vs. Wisconsin Department of Revenue
- Wisconsin Department of Revenue vs. Horne Directory, Inc.
- Miss Wisconsin Pageant, Inc. vs. Wisconsin Department of Revenue
- Wisconsin Department of Revenue vs. Gerhard Van Beck
- Steve Varese vs. Wisconsin Department of Revenue

### INCOME AND FRANCHISE TAXES

**Wisconsin Department of Revenue vs. Romain A. Howick** (Wisconsin Supreme Court, 100 Wis. 2d 274, February 2, 1981). This case involves the Department of Revenue's

treatment of loss on the sale of corporate stock for income tax purposes when stock is sold by a Wisconsin resident who purchased it while a resident of Iowa.

The taxpayer moved to Wisconsin on June 20, 1970 and immediately thereafter divested himself of certain shares of stock that he acquired while a nonresident. As a result of the stock sold in Wisconsin in 1970, he suffered a \$10,043.82 loss, having purchased the same for \$56,436.42. Thus, he reported the difference between \$56,436.42 and the sale price of \$46,392.60 or \$10,043.82 on his 1970 federal income tax return as a net long-term capital loss. Howick also reported this loss on his 1970 Wisconsin tax return and deducted \$1,000.00 each year thereafter from ordinary income through 1972 (3 years).

In 1973 Howick divested himself of more stock he acquired while a resident of Iowa. He purchased this stock for \$13,317.40 and suffered a \$4,875.57 loss at the time of sale. The taxpayer combined this 1973 loss (\$4,875.57) with the balance of a loss carry over from 1970 and thus offset a long-term gain realized from other 1973 stock transactions. This netting process (offsetting long-term gains by long-term losses) yielded a \$516.10 loss that the taxpayer deducted from ordinary income in 1973.

On October 6, 1975, the department made an additional income tax assessment against Howick in the amount of \$978.96 plus interest. The department determined that he had erred in calculating his losses for the years 1970 and 1973 for sales of stock acquired while he was a nonresident. The department's determination was based on the following administrative rule set forth in a Revenue Department Memorandum dated April 1, 1966:

"... in determining the gain or loss on capital assets disposed of by a resident individual who had acquired such assets prior to the time such individual became a Wisconsin resident, the basis of the asset to be used would be: (1) if gain is realized, the difference between the sell-

ing price and the higher of the fair market value or the adjusted basis of the asset at the time Wisconsin residency was established, or (2) if a loss was sustained, the difference between the selling price and the lower of the fair market value or adjusted cost basis of the asset at the time Wisconsin residency was established. If no gain is determined under (1) and no loss determined under (2), no gain or loss would be reportable on the Wisconsin income tax return in the year of sale."

In essence, the rule provides for an adjustment in some circumstances to the federal cost basis of a capital asset (corporate stock). If applicable, the adjustment is based on the value of the asset on the date the taxpayer established residence in Wisconsin. Its net effect is to minimize both gains and losses recognized on the sale of stock purchased before the taxpayer became a resident of this state. Only subsec. two (2) of the Revenue Department's Memorandum dated April 1, 1966, referred to above, is involved in this case. The department explained its application of this rule to the taxpayer herein as follows:

"1. If the selling price after moving into Wisconsin was less than the original cost of the stock when purchased out of state and its fair market value on June 20, 1970, when the taxpayer first moved into Wisconsin, the loss recognized was the difference between the selling price and the lesser of either the original cost or its fair market value."

The department applied this rule to each of the taxpayer's stock sales in 1970 and 1973. As a result, the department reduced Howick's reported net long-term loss for the 1970 stock transactions from \$10,043.82 to \$596.80 and converted the \$4,875.57 loss realized on the 1973 sales of stock which were acquired while he was a nonresident to a \$123.18 gain.

The department's calculations for 1970 are set forth in the following table:

	Federal Cost Basis	Fair Market Value on June 20, 1970 When Moving Into Wisconsin	Selling Price in 1970 After Moving to Wisconsin	Wisconsin Gain or Loss
1.	\$ 5,691.01	\$ 2,913.75	\$ 2,404.82	\$ (508.93)
2.	4,175.63	4,462.50	4,531.50	69.00
3.	1,762.05	2,937.50	3,717.04	779.54
4.	1,660.88	1,649.65	2,044.97	384.09
5.	1,297.23	1,562.50	1,450.77	0
6.	2,499.06	2,650.00	2,896.19	246.19
7.	4,893.25	6,201.50	6,625.70	424.20
8.	27,243.45	21,262.50	19,928.47	(1,334.03)
9.	2,745.66	487.50	381.86	(105.64)
10.	1,152.45	900.00	750.10	(149.90)
11.	2,379.60	1,600.00	1,327.82	(272.18)
12.	991.15	462.50	333.36	(129.14)
			Net Loss	\$ (596.80)

The department's calculations regarding the 1973 sales were as follows:

	Federal Cost Basis	Fair Market Value on June 20, 1970	Selling Price in 1973	Wisconsin Gain or Loss
1.	\$ 6,222.00	\$ 3,037.50	\$ 2,707.39	\$ (303.11)
2.	4,089.25	2,275.00	1,758.14	(516.86)
3.	3,006.15	3,000.00	3,976.30	970.15
			Net Gain	\$ 123.18

The department disallowed the loss deductions from ordinary income in 1971 through 1973 and a portion of the loss offset for 1973 as well as \$403.20 of the loss deduction taken in 1970. Therefore, the department assessed the additional income taxes noted above.

The Court of Appeals affirmed the Circuit Court's decision upholding the action of the WTAC in ruling that it could find no authority in the Wisconsin Statutes or case law for the Revenue Department's rule that had the "ultimate effect" of creating an artificial gain where a loss was actually incurred. The department then appealed to the Wisconsin Supreme Court.

The Supreme Court indicated that ss. 71.02 (2) (d) and (e), Wis. Stats., provide the key to the resolution of this case. Section 71.02 (2) (d), Wis. Stats., defines Wisconsin taxable income for individuals as "... Wisconsin adjusted gross income less itemized deductions or less the Wisconsin standard deduction." Wisconsin adjusted gross income means "... federal adjusted gross income, with the modifications prescribed in s. 71.05 (1) and (4)." (Section 71.02 (2) (e), Wis. Stats.) Thus, it must be determined: (1) how federal adjusted gross income is calculated, and (2) whether any of the

ss. 71.05 (1) and (4) modifications are applicable in this case.

The Internal Revenue Code provides that the income tax basis of stock purchased by the taxpayer is its cost at the time of purchase. The gain or loss from the sale of stock is the difference between the amount realized, i.e., selling price, and the taxpayer's cost. Net long-term loss is computed by subtracting the long-term gains for the taxable year from the long-term losses. Given that Howick calculated the long-term losses resulting from his stock transactions for the years 1970 and 1973 according to these rules, and that the department does not contest the taxpayer's federal calculations, the question becomes whether the Wisconsin income tax statutes, specifically ss. 71.05 (1) and (4), permit the department to modify and alter Howick's federal adjusted gross income for taxing purposes by reducing the basis of the stock acquired before he became a resident.

The department contended that its rule is supported by the reasoning in three court decisions, to-wit: Appeal of Seisel, 217 Wis. 661, 259 N.W. 839 (1935); Falk v. Wisconsin Tax Comm., 201 Wis. 292, 230 N.W. 64 (1930) and State ex rel. Bundy v. Nygaard, 163 Wis. 307, 158 N.W. 87 (1916). The Court stated that

these cases are not applicable and not in point.

Although the Supreme Court affirmed the decision of the Court of Appeals, which ruled in favor of Howick, it expressed a reservation about that opinion. The Court of Appeals announced a rule that is applicable to the calculation of a gain on the sale of stock acquired while the taxpayer was a nonresident. This case is concerned with the proper treatment of a loss on the sale of such stock, and thus the Appellate Court's analysis of gains on the sale of such stock is obiter dicta (a statement in an opinion having no actual bearing on the issues involved). Therefore, the Supreme Court disavowed this analysis and concluded that the dicta does not have any precedential value.

**Kelvinator Commercial Products, Inc. vs. Wisconsin Department of Revenue** (Wisconsin Tax Appeals Commission, March 10, 1981). Kelvinator Commercial Products, Inc. (taxpayer), a Delaware corporation, is engaged in the business of manufacturing and selling refrigeration equipment for commercial uses. It has its manufacturing plant in Manitowoc, Wisconsin. The issue to determine was whether taxpayer was within the jurisdiction for income tax purposes of Tennessee

during the years 1973 through 1976 and Florida and North Carolina during the years 1974 through 1976 solely because it had certificates of authority to transact business in such states.

During the audit period, taxpayer was authorized as a foreign corporation to do business in Florida, North Carolina and Tennessee. It was also authorized to do business in other states. During the same period, taxpayer sold and shipped its products from Wisconsin to destinations in Florida, North Carolina and Tennessee.

The sales in question involve taxpayer's shipments of products from Wisconsin to destinations in Florida, North Carolina and Tennessee. If, during the applicable years, taxpayer was not "within the jurisdiction, for income tax purposes" of such states pursuant to s. 71.07(2)(c)2, Wis. Stats., then such sales are "thrown back" to Wisconsin and included in the numerator of the sales factor.

The Commission concluded that the taxpayer's qualification to do business in such states was not sufficient to bring it within the jurisdiction of such states for income tax purposes. Its business activities must exceed the minimum standards set by P.L. 86-272.

The taxpayer has the burden of proving that it was taxable in the states of Florida, North Carolina and Tennessee during the years in question. It failed to prove its claim. Therefore, during the years 1973 through 1976, taxpayer was not within the jurisdiction for income tax purposes of the state of Tennessee, and during the years 1974 through 1976, taxpayer was not within the jurisdiction for income tax purposes of the states of Florida or North Carolina.

The Commission ruled that the taxpayer's shipments of products to destinations in those states were properly thrown back or attributed to Wisconsin under the provision of s. 71.07(2)(c)2, Wis. Stats.

The taxpayer has not appealed this decision.

**NCR Corporation vs. Wisconsin Department of Revenue** (Wisconsin Tax Appeals Commission, January 30, 1981). NCR Corporation

(taxpayer) became the successor to the business of Appleton Papers, Inc. by reason of the merger of that corporation into the taxpayer. The taxable year involved is the 1972 calendar year of Appleton Papers.

The sole issue was whether Appleton Papers acted properly in deducting, pursuant to s. 71.04(15)(c), Wis. Stats., the balance of the net difference between the Wisconsin and federal adjusted basis of its depreciable property on its Wisconsin franchise tax return for the calendar year 1972.

Section 71.04(15)(c) reads in part: "If a corporation is dissolved, or merged into or consolidated with another corporation before the termination of the 5-year period, any remaining balance of the net difference between the Wisconsin and federal adjusted basis of such depreciable property as of the end of such corporation's 1971 taxable year shall be deducted from gross income or used to reduce otherwise allowable deductions from gross income, as the case may be, in the year of dissolution, merger or consolidation."

As additional findings of fact, the Commission adopted the following:

1. Appleton Papers, Inc. used the calendar year for reporting purposes. On December 31, 1972 the unamortized balance of the amount by which the Wisconsin adjusted basis of Appleton Papers, Inc.'s depreciable assets exceeded the federal adjusted basis of said assets was \$1,947,303. Appleton Papers, Inc. deducted this entire balance on its Wisconsin tax return for the calendar year 1972.

2. Appleton Papers, Inc. had no tax year subsequent to 1972 and was not required to nor did it file Wisconsin or federal tax returns for years subsequent to 1972. It conducted no business in years subsequent to 1972.

3. The Articles of Merger merging Appleton Papers, Inc. into NCR Corporation, signed on December 14, 1972, provide that "the merger shall become effective on January 1, 1973". Appleton Papers, Inc. and NCR Corporation remained separate and distinct corporations until midnight of December 31, 1972. The year of merger between Appleton Papers, Inc. and NCR Corporation was 1973.

4. The Department of Revenue disallowed four-fifths of the \$1,947,303 basis adjustment claimed by taxpayer in 1972, allowing one-fifth for that year based on its determination that the year of merger was 1973 and not 1972.

The Commission concluded that taxpayer is not entitled to deduct the remaining balance of the net difference between the Wisconsin and federal adjusted basis of depreciable property in the year 1972, but may deduct only one-fifth of such difference in the year 1972. The proper year for the deduction of the remaining balance of the net difference between the Wisconsin and federal adjusted basis of depreciable property was 1973, the year of the merger between Appleton Papers, Inc. and NCR Corporation.

Taxpayer has appealed this decision to Circuit Court.

**Marilynn H. Schaefer vs. Wisconsin Department of Revenue** (Wisconsin Tax Appeals Commission, February 23, 1981). Taxpayer's husband, Ben G. Schaefer, died on October 27, 1969 and his will was filed in Kenosha County Court on November 7, 1969. Since the will made no provision for an allowance to taxpayer during the period of probate, the court directed the Estate of Ben G. Schaefer to make monthly payments and other payments to taxpayer. These payments totaled \$24,000 in each of the years 1973, 1974, 1975 and 1976. The payments have been characterized as a "widow's allowance" under s. 313.15(2), 1967 Wis. Stats.

In filing its Wisconsin fiduciary income tax returns for the years 1973 through 1976, the Estate of Ben G. Schaefer claimed the payments made to taxpayer of \$24,000 each year as deductible distributions and deducted the payments from the distributable net income of the estate. In each of these years, the amounts paid to taxpayer were less than the total distributable net income available in the estate, so the full \$24,000 paid in each year was claimed as a deductible distribution and not taxed as income to the estate. These amounts were properly deducted by the estate.

Taxpayer did not include the \$24,000 annual amounts in her income for individual income tax purposes for the years 1973 through

1976. The issue to determine was whether the amounts received by taxpayer in 1973, 1974, 1975 and 1976, under court order as a widow's allowance from the estate of her deceased husband, constitute taxable income to her.

The Commission concluded that the amounts received by taxpayer in each of the years 1973 through 1976, under court order as a widow's allowance from the estate of her deceased husband, constitute deductible items to the estate under section 661 (a) of the Internal Revenue Code, and taxable income to taxpayer under section 662 of the Internal Revenue Code as adopted for Wisconsin income tax purposes by s. 71.02 (2) (intro.) and (c) to (e), Wis. Stats.

The taxpayer has appealed this decision to Circuit Court.

**Wisconsin Department of Revenue vs. Louis G. Shew** (Wisconsin Court of Appeals, District IV, February 20, 1981). Taxpayer purchased securities prior to becoming a Wisconsin resident. For Wisconsin income tax purposes, taxpayer contended that the loss should be the difference between the stocks' purchase price and their sale price (i.e., the same as the federal loss). The department contended that the loss should be the difference between the stocks' value at the time the taxpayer became a Wisconsin resident and their sale price.

The Tax Appeals Commission ruled in favor of the taxpayer. The Circuit Court sustained the conclusion of the Commission. (See summary of Circuit Court decision in Wisconsin Tax Bulletin #15.)

The department initially appealed the Circuit Court decision to the Court of Appeals, but on February 20, 1981 the department dismissed its appeal of this case.

**Wausau Homes, Incorporated vs. Wisconsin Department of Revenue** (Wisconsin Court of Appeals, District III, February 3, 1981). This is an appeal of a Circuit Court of Marathon County judgment which affirmed in part and reversed in part a Wisconsin Tax Appeals Commission decision.

Wausau Homes, Inc. is a Wisconsin corporation and has its principal of-

fice and main plant in Wisconsin. It also maintains a plant in Iowa. The corporation markets its homes by entering into dealer franchise agreements with dealers throughout the country.

The Department of Revenue issued an assessment for the years 1968-1973. The issues on appeal were: (1) whether sales transacted by Wausau Homes' dealers located outside of Wisconsin should be considered as sales made by the home office in Wisconsin for purposes of apportioning income under s. 71.07 (2) (c), 1969 Wis. Stats., and (2) whether the costs of engineering services done at Wausau Homes' plant in Wausau for the benefit of its plant in Iowa should be allocated to Wisconsin for purposes of calculating the manufacturing ratio under s. 71.07 (2) (b), 1969 Wis. Stats.

The department contended that all sales made by dealers throughout the United States are sales that should be considered as sales made by the Wisconsin office. The department also contended that the costs of engineering services that were performed in Wisconsin but were needed for the plant in Iowa should be allocated to Wisconsin.

The Court ruled that sales made by dealers located in other states were not allocable to Wisconsin. It found that the majority of the sales activity (e.g., contract negotiations, buyer contact and financing arrangements) took place outside of Wisconsin.

With regard to the costs of the engineering services, the Court ruled that such costs are properly allocable to Wisconsin. It stated that since the Wausau plant expanded its facilities to accommodate the Iowa plant's needs, the engineering services should be considered for tax purposes as a special manufacturing process of the Wausau plant.

Neither party has appealed this decision.

**Louis Webster, Sr., Alex Askenette, Sr., Sue Askenette vs. Wisconsin Department of Revenue** (Court of Appeals, District IV, April 7, 1981). Taxpayers are Menominee Indians who resided and worked in Menominee County in 1972 and 1973.

Prior to 1961, the Menominee Tribe held its reservation lands and other assets in tribal ownership under the supervision of the federal government. Neither the assets nor the income of tribal members were subject to state taxation. In 1961, the Menominee Termination Act was passed ending tribal status and federal supervision. The Termination Act was repealed by the Menominee Restoration Act, which became effective on December 22, 1973. The question is whether the Termination Act gave the state authority to impose state income tax on the taxpayers for 1972 and 1973.

The Court of Appeals affirmed the Circuit Court decision. (See summary of Circuit Court decision in Wisconsin Tax Bulletin #20.) It concluded that Wisconsin was authorized to collect state income tax from the Menominees during the time the Termination Act was in effect. Therefore, the taxpayers were liable for state taxes on income earned in 1972 and on income earned in 1973 received prior to December 22, 1973.

The taxpayers have appealed this decision to the Wisconsin Supreme Court.

## SALES/USE TAXES

**Chicago, Milwaukee, St. Paul and Pacific Railroad Company vs. Wisconsin Department of Revenue** (Wisconsin Tax Appeals Commission, March 20, 1981). Taxpayer, Chicago, Milwaukee, St. Paul and Pacific Railroad Company, contended that the use of lubricants in conjunction with its rolling stock was not taxable under Chapter 77. The Wisconsin Department of Revenue contended that lubricants are not included in the statutory words ". . . accessories, attachments, parts or fuel . . ." in s. 77.54 (12), Wis. Stats.

The findings of fact in this case indicated that taxpayer's locomotives and rolling stock simply cannot operate without lubricants. Not only are lubricants required to lubricate and cool other operational portions of the locomotives but they are also integrally linked to the governor in such a manner that their absence automatically brings to a halt the rolling stock of the taxpayer and precludes any operation.