Homestead Credit 266-8641
Individual Income 266-2486
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District Offices

Appleton .....(414) 832-2727
Eau Claire .....(715) 836-2811
Milwaukee .....(414) 227-4000

NEW IS&E DIVISION RULES AND RULE AMENDMENTS IN PROCESS

Listed below, under Part A, are proposed new administrative rules and amendments to existing rules that are currently in the rule adoption process. The rules are shown at their state in the process as of January 1, 1992. Part B lists Rules adopted in 1991 but not yet effective. ("A" means amendment, "NR" means new rule, "R" means repealed, and "R&R" means repealed and recreated.)

A. Rules at or Reviewed by Legislative Council Rules Clearinghouse

11.05 Governmental units-A
11.33 Occasional sales-A
11.34 Occasional sales exemption for sale of a business or business assets-A
11.50 Auctions-A
11.69 Financial institutions-A
11.83 Motor vehicles-A
11.84 Aircraft-A
11.85 Boats, vessels and barges-A
11.86 Utility transmission and distribution lines-A
11.88 Mobile homes-A

B. Rules Adopted in 1991 But Not Yet Effective

11.01 Sales and use tax return forms-A
11.47 Commercial photographers and photographic services-A

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 last paragraph of each WTAC decision in which the department's determination has been reversed will indicate one of the following: (1) "the department has appealed", (2) "the department has not appealed but has filed a notice of nonacquiescence", or (3) "the department has not appealed" (in this case the department has acquiesced to the WTAC's decision).

The following decisions are included:

Individual Income Taxes

George J. and Pauline T. Edler (p. 10)
Itemized deductions— credit - investment interest limitation

Corporation Franchise or Income Taxes

Consolidated Freightways Corporation of Delaware (p. 11)
Apportionment—motor carriers

Fort Howard Corporation (p. 12)
Pollution abatement equipment—1986 and prior

Ins. Serv. Liquidating, Inc. et al. (p. 12)
Liquidating corporations

Sales/Use Taxes

Grant, Iowa, Lafayette Shopping News, Inc. (p. 12)
Use tax—sale, destined for

Luetzow Industries (p. 13)
Parking and storage—aircraft
Containers, packaging and shipping materials—plastic garment bags

MRC Industries, Inc. (p. 14)
Use tax—collection by retailers

Wisconsin Bell, Inc. et al. (p. 14)
Telecommunication services—billing and collection services

Other

J. Gerard Hogan, et al. (p. 15)
Administrative remedies—declaratory and injunctive relief

INDIVIDUAL INCOME TAXES

Itemized deductions — credit — investment interest limitation. *George J. and Pauline T. Edler vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 25, 1991). The issue in this case is whether interest paid by the taxpayer during the years 1986, 1987, and 1988 is deductible in full or subject to the $1,200 investment interest limitation.

In 1971, the taxpayers purchased commercial real estate property in Lake Delton, Wisconsin. The taxpayers operated the property themselves and leased them out to other operators prior to 1984. The taxpayers sold portions of their commercial real estate on land contract in 1983 and 1984, reporting certain gains from these transactions on their tax returns for the relevant periods. Subsequent to the sale by land contract in 1984, the taxpayers did not operate any business on the subject property.

The interest payments in question were paid on notices to purchase and improve the realty which was sold on land contract in the years 1983 and 1984. The interest expenses involved were not paid on a loan to purchase or refinance a residence and were not paid on a land contract.

On October 23, 1989, the department issued an income tax assessment against the taxpayers, disallowing the claimed interest expenses for three years based on its allegation that interest expense on investment income is limited to $1,200 for purposes of the Wisconsin itemized deduction credit for 1986, 1987, and 1988.

The Commission concluded that the interest incurred and paid by the taxpayers constituted investment, not business, expense, and the department properly applied the $1,200 interest limitation.

The taxpayers have not appealed this decision.

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CORPORATION FRANCHISE OR INCOME TAXES

Apportionment — motor carriers. *Consolidated Freightways Corporation of Delaware vs. Wisconsin Department of Revenue* (Wisconsin Supreme Court, November 14, 1991). This is a review of a decision of the Court of Appeals. The department assessed additional franchise taxes against Consolidated Freightways Corporation of Delaware (Consolidated) for years 1974-77. The Wisconsin Tax Appeals Commission and the Dane County Circuit Court upheld the tax assessment. The Court of Appeals reversed the Circuit Court. See *Wisconsin Tax Bulletin* 69, page 9, *Wisconsin Tax Bulletin* 65, page 13, and *Wisconsin Tax Bulletin* 46, page 13, for summaries of the prior decisions.

There are three issues in this case:

A. As applied to Consolidated, whether the formula provided in sec. Tax 2.47, Wis. Adm. Code, violates sec. 71.07(2)(e), Wis. Stats., (1985-86), which limits the taxable income to income derived from business transacted within this state.

B. As applied to Consolidated, whether the formula violates the Commerce Clause of the United States Constitution.

C. As applied to Consolidated, whether the formula violates the Due Process Clause of the United States Constitution.

Consolidated is incorporated in Delaware with its main offices in California. It is a general commodity common motor carrier operating in interstate commerce typically hauling small shipments - less than truckload size. It consolidates numerous small loads into fewer large loads and transports the consolidated loads through a system of terminals and established routes. Consolidated owns 14,000 trailers and 2,400 tractors. It maintains 410 terminals nationwide with thirteen terminals in Wisconsin, including one regional consolidation center.

In 1966, the department adopted sec. Tax 2.47, Wis. Adm. Code, which contains a formula for apportioning franchise taxes assessed against motor carriers doing business in Wisconsin. The two factor formula adds (a) the ratio of gross receipts from carriage of goods first acquired in Wisconsin — the "originating" or "outbound" revenues — to gross receipts from carriage of property everywhere, and (b) the ratio of ton miles of carriage in Wisconsin to ton miles of carriage everywhere, and then (c) divides the total by two to average the results. The final figure is the percentage of the company's income subject to the Wisconsin franchise tax.

During the years 1974 through 1977, Consolidated apportioned its Wisconsin income using a different formula than the two factor formula in sec. Tax 2.47, Wis. Adm. Code.

In 1979, the department audited Consolidated and assessed an additional franchise tax and interest against Consolidated for the 4-year period in the amount of $115,002.98. The department used the formula provided in sec. Tax 2.47, Wis. Adm. Code, to arrive at the assessment.

Several steps are involved when analyzing interstate motor carrier tax cases. The first question is: were the operations of the interstate motor carrier such as to subject it to taxation under sec. 71.07(2)(e), Wis. Stats.? That is answered by inquiring whether the interstate motor carrier is being taxed on its income for transacting business within this state. If so, the statute applies and the question becomes: does Wisconsin's tax upon such income violate either the Commerce or Due Process Clauses?

The Wisconsin Supreme Court concluded as follows:

A. The statute applies. The income taxed by the formula provided in sec. Tax 2.47, Wis. Adm. Code, is income "derived from" Consolidated's business transactions within Wisconsin and thus is subject to taxation under sec. 71.07(2)(e), Wis. Stats. Consolidated's activities in Wisconsin produce income for Consolidated which is derived from its business transactions in this state.

B. The tax assessment upon Consolidated's Wisconsin income does not violate the limits of the Commerce Clause. Under recent Commerce Clause cases, a state tax does not offend the Commerce Clause if the tax:

1. is applied to an activity with a substantial nexus with the taxing state,

2. is fairly apportioned,

3. does not discriminate against interstate commerce, and

4. is fairly related to services provided by the state.

Commonwealth Edison Co. vs. Montana, 453 U.S. 609, 617 (1981) (citing *Complete Auto Transit, Inc. vs. Brady*, 430 U.S. 274 (1977)).

First, both parties agree that there is a sufficient nexus between Consolidated's activities and Wisconsin to meet the nexus factor.

Second, the tax assessment against Consolidated is fairly apportioned. The parties agree the formula provided in sec. Tax 2.47 Wis. Adm. Code taxes approximately an additional 1.1% of Consolidated's income averaged for the years 1974 through 1977.

A 1.1% variance during a select time span does not clearly and cogently show that the appportionment under the formula provided in sec. Tax 2.47 Wis. Adm. Code was out of all proportions to business transacted within this state, nor that it has led to a grossly distorted result.

Third, the formula provided in sec. Tax 2.47, Wis. Adm. Code, is not discriminatory. Consolidated argues that the formula has the effect of taxing non-Wisconsin transportation companies more heavily than Wisconsin companies.

The formula provided in sec. Tax 2.47, Wis. Adm. Code, contains no exemptions, credits, or provisions that treat in-state carriers differently than out-of-state

carriers. The distinction between intrastate and interstate business is the issue.

Complete Auto Transit's fourth element, that the tax be fairly related to services provided by the state, was also satisfied. The income earned by Consolidated through its transportation of goods to, from, and through Wisconsin, and through its thirteen terminals in Wisconsin, reasonably and fairly relates to Wisconsin for taxation purposes under the Commerce Clause.

C. Because the Commerce Clause is not violated, the Due Process Clause also is not violated.

As of December 15, 1991, it was not known whether the taxpayer will appeal this decision to the United States Supreme Court.

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Pollution abatement equipment — 1986 and prior. *Fort Howard Corporation vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, September 18, 1991). The issue in this case is whether the taxpayer, which on its original 1981 return had written off part of the cost of certain waste treatment facilities, could by a timely amended return revoke that treatment and fully deduct those costs, or whether the original 1981 treatment was irrevocable.

In 1981, the taxpayer incurred expenses for pollution abatement equipment that later qualified as "waste treatment property" under Wisconsin law. A portion of that property was put in service in 1981, and the balance was put in service in 1982.

In January 1982, the taxpayer applied to the department to have the expenses for the waste treatment property qualified for property tax exemption. On March 4, 1982, the taxpayer signed its 1981 Wisconsin franchise tax return showing depreciation on the property put in service in 1981. This treatment was repeated on the 1982 returns for the property put in service in 1982. On March 11, 1982, the taxpayer received the department's approval for the property tax exemption. On March 15, 1982, the department received the taxpayer's 1981 franchise tax return.

In 1986, by a timely amended return, the taxpayer claimed a deduction for all the property purchased in 1981, seeking a refund that the department denied. The department argued that, by its original reporting, the taxpayer made an irrevocable election to depreciate the property. Without conceding that it took depreciation on its original 1981 return, the taxpayer argued that Wisconsin law explicitly allowed it to change the original treatment from depreciation to deduction by timely amendment.

The Commission concluded that the original 1981 return was mailed or sent after the approval notice was received, in the absence of proof showing otherwise. With the post-approval 1981 and 1982 returns, the taxpayer made irreversible elections to depreciate the property, and was precluded from deducting the costs of the property on the amended return for 1981.

The taxpayer has not appealed this decision.

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Liquidating corporations. *Wisconsin Department of Revenue vs. Ins. Serv. Liquidating, Inc. and Insurance Services, Inc.* (Circuit Court for Dane County, July 23, 1991). The issue in this case is whether sec. 71.337(1), Wis. Stats. (1983-84), requires a corporation to recognize any gain on the liquidating sale of its assets, when such gain was participated in by a Wisconsin resident shareholder who received an installment note at the time of distribution and who subsequently moved out of state before the note was completely paid off. This dispute focuses on the correct interpretation of the phrase, "to the extent that such gain or loss is participated in by Wisconsin resident shareholders."

The Commission held that because all the shareholders of the taxpayer were Wisconsin residents at the time of liquidation and distribution of corporate assets, the requirements of the statute had been met, and the corporation need not recognize any gain or loss from the sale of its assets pursuant to a liquidation plan. The department requests a reversal of the Commission's decision because one of the shareholders moved out of Wisconsin before the distribution was complete and was not subject to Wisconsin taxation on distributions made to him after he moved. See *Wisconsin Tax Bulletin* 71, page 9, for a summary of the prior decision.

Both the department and the taxpayer rely on the same definition of the word "participate". The taxpayer argues that participation in gain or loss occurs on the date of first distribution only, while the department suggests that participation occurs each time payment is made over a period of time.

The Court concluded that the statute itself simply does not address the question of what point in time is to be used to measure participation in gain or loss. Because the statute can be understood by reasonable people in more than one way, it is unclear and ambiguous. In construing ambiguous statutes, it is the duty of the Court to search for the true legislative purpose and identify the wrong that the statutory amendment was meant to remedy; the "literal meaning" approach to statutory construction cannot be used to avoid obvious legislative purpose. Ambiguity in revenue laws is generally resolved against the taxing authority, but statutes conferring tax privilege on the taxpayer are strictly construed against the taxpayer. Section 71.337 (1), Wis. Stats., is a revenue law that invokes a privilege against taxation; it allows that if, and only if, a corporation meets all the conditions set forth in the statute, the corporation need not recognize gain or loss as it normally is required to do under other tax statutes. Therefore, because the statute on which the taxpayer relies in asserting that no tax is owed is a tax *exemption* statute, the statute must be strictly construed in favor of the department.

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

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SALES/USE TAXES

Use tax — sale, destined for. *Grant, Iowa, Lafayette Shopping News, Inc. vs. Wisconsin Department of Revenue, Mark Bugher, and Kurt Kaspar* (Circuit Court for Dane

County, July 25, 1991). The issues in this case are:

A. Whether the taxpayer's action, alleging that the department's finalized computation of use tax owing was contrary to a Circuit Court order, is barred by prior proceedings under the doctrine of *res judicata.*

B. Whether fees and costs should be awarded to the department.

In August 1974, the department assessed additional sales tax on the taxpayer's gross receipts for providing printing services to other publishers. Additional use tax was assessed on supplies and materials the taxpayer used in the printing of its own publication, the Shopping News.

The taxpayer's petition for redetermination was denied by the department, and the taxpayer appealed the sales and use tax assessments to the Wisconsin Tax Appeals Commission. The Commission held that 1) the gross receipts the taxpayer received for printing services it provided other publishers were not for the printing of "newspapers" within the meaning of sec. 77.54(15), Wis. Stats. (1973); 2) the taxpayer's use of supplies and materials to print its own publication, the Shopping News, was not in the manufacture of an article "destined for sale" within the meaning of sec. 77.54(2), Wis. Stats. (1973); and 3) the Commission did not have the authority or jurisdiction to rule on any constitutional questions.

The taxpayer petitioned the Circuit Court for review of the Commission's determination. The Circuit Court reversed and held that 1) the publications the taxpayer printed for other publishers were "newspapers" within the meaning of sec. 77.54(15), Wis. Stats. (1973); and 2) the taxpayer's publication, the Shopping News, was "destined for sale" within the meaning of sec. 77.54(2), Wis. Stats. (1973).

The department appealed that decision to the Court of Appeals, which reversed the Circuit Court on the "destined for sale" issue and affirmed the Circuit Court insofar as it reversed the Commission's decision that the publications were not newspapers but remanded the issue back to the Commission to explain the reasoning behind its conclusion that the publications were not newspapers. The Court of Appeals decision was dated December 22, 1988. The "destined for sale" determination was not appealed by either party.

The Commission, on remand, issued a second decision, explaining that the publications at issue were shoppers guides, that shoppers guides were not newspapers, and therefore, the publications at issue were not newspapers.

The taxpayer petitioned the Circuit Court for review of this second Commission determination. The Circuit Court decision, dated May 21, 1990, reversed the Commission's determination that the publications at issue were not "newspapers" within the meaning of sec. 77.54(15), Wis. Stats. (1973). That decision was not appealed by either party.

On November 7, 1990, the department issued a finalized computation of tax it alleged the taxpayer still owed. The computation showed no sales tax owing but did show use tax owing. On January 8, 1991, the taxpayer commenced an action alleging that the use tax assessment was contrary to the May 21, 1990, Circuit Court order. The department filed a motion to dismiss on February 26, 1991, alleging that the taxpayer's action was barred by *res judicata.*

The Circuit Court concluded as follows:

A. The decision dated May 21, 1990, was a final determination on the merits of the "newspaper" issue, and the Court of Appeals decision dated December 22, 1988, was a final determination on the merits of the "destined for sale" issue. The taxpayer's action is barred by *res judicata.*

B. Because there has been no showing that this suit was brought in bad faith or that the taxpayer or the taxpayer's attorney knew or should have known that such claim was without reasonable basis in law or equity, fees and costs will not be awarded.

The taxpayer has not appealed this decision.

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Parking and storage — aircraft. Containers, packaging and shipping materials — plastic garment bags. *Luetzow Industries vs. Wisconsin Department of Revenue* (Circuit Court for Milwaukee County, May 15, 1991). This is a petition for review of a Wisconsin Tax Appeals Commission (Commission) decision, which affirmed the department's denial of the taxpayer's request for redetermination of a sales tax assessment. See *Wisconsin Tax Bulletin* 71, page 11, for a summary of the prior decision.

The issues in this case are:

A. Whether the taxpayer, the owner of an aircraft hangar it leased to an entity the taxpayer claims was a federally-certified air carrier of persons and property in interstate commerce, was liable for sales taxes on the hangar rental receipts it received in 1984-1986 under a statute that taxes gross receipts derived from "providing parking space for ... aircraft for a consideration" (sec. 77.52(2)(a), Wis. Stats. (1983-84)), or exempt under a statute that exempts "gross receipts from the sale of and the storage, use or other consumption of [a]ircraft ... sold to persons using such aircraft as certified ... carriers of persons or property in interstate ... commerce" (sec. 77.54(5), Wis. Stats. (1983-84)).

B. Whether the taxpayer, also in the business of manufacturing plastic garment bags, was liable for sales taxes on the gross receipts from its 1984-1987 sales of the bags to dry cleaning establishments which used the bags to return clean laundry to their customers, or exempt under a statute that exempts "gross receipts from the sale of ... bags ... used by the purchaser to transfer merchandise to customers" (sec. 77.54(6), Wis. Stats. (1983-84)).

The Circuit Court affirmed the Commission's decision with respect to the hangar rental receipts. It held that sec. 77.54(5)(a), Wis. Stats. (1983-84), and sec. Tax 11.84 (3)(a), Wis. Adm. Code, do not exempt the taxpayer from the sales tax for the lease of an airplane hangar.

The Circuit Court reversed the Commission's decision with respect to the plastic

garment bags. It found that the common usage of the words "customer" and "merchandise," as used in sec. 77.54(6)(b), Wis. Stats., applies to the taxpayer's sale of the plastic garment bags and brings the taxpayer within the exemption.

This decision has been appealed to the Court of Appeals.

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Use tax — collection by retailers. *MRC Industries, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, September 9, 1991). The issue in this case is whether the taxpayer is entitled to a refund of what it characterized as Wisconsin sales tax which the taxpayer collected, reported, and paid during the period January 1985 through September 1986.

The taxpayer is a corporation incorporated in Illinois in 1975, with main offices located in Elk Grove, Illinois. The taxpayer operated a branch office in Wauwatosa, Wisconsin during the period 1979-84 for the purpose of selling and repairing computer equipment and obtained its initial Wisconsin seller's permit in 1979. It was not established that such permit was ever surrendered.

The basis for the taxpayer's refund claim is its contention that it had withdrawn from doing business in Wisconsin during the period in question, and that sales and use tax returns and payments for that period were filed in error.

After closing its Wauwatosa branch office in 1984 the taxpayer had no office, agency, warehouse or other place of business in Wisconsin. No employes were stationed here thereafter. Most of the equipment sold by the taxpayer to Wisconsin customers was shipped in by UPS or other common carriers. The taxpayer, in one or two situations, may have repaired its products in Wisconsin. The taxpayer's service department generally utilized company vehicles in traveling and would have done so in traveling to Wisconsin in those instances where repairs or pickup of equipment was made.

The department denied the claim on the grounds the taxpayer would be liable for use tax, if not sales tax, on its Wisconsin sales, and also because the taxpayer had voluntarily registered and paid the Wisconsin sales and use tax under sec. 77.53(9m), Wis. Stats. While the taxpayer charged and reported the tax as a sales tax on its Wisconsin sales and use tax returns, it was in effect collecting and reporting a Wisconsin use tax.

The Commission affirmed the department's denial of the refund claim. No allegation was presented that the underlying transactions generating the tax were *not* taxable under use tax provisions, or that they were sales or use tax exempt. The taxpayer offered nothing to prove that the taxes paid were not substantively due and owing as "use" taxes, as contended by the department. The taxes presumably having been collected from purchasers as sales tax, the department has a valid basis for keeping them as use taxes even if the department could not have properly *imposed* use tax collection duties on the taxpayer in the first place for lack of jurisdictional nexus, an issue which the Commission found no need to address.

The taxpayer has not appealed this decision.

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Telecommunication services — billing and collection services. *Wisconsin Bell, Inc., American Telephone & Telegraph Co., and AT&T Communications of Wisconsin, Inc. vs. Wisconsin Department of Revenue, and Mark D. Bugher* (Court of Appeals, District IV, July 25, 1991). The taxpayers (Bell) appeal from an order of the Circuit Court for Dane County, dismissing their action for declaratory judgment. They had sought a judgment declaring that certain billing and collection services provided by Bell to the AT&T companies were not subject to the Wisconsin sales tax. The Court dismissed the action in deference to the administrative remedy available to the taxpayers before the department under sec. 227.41(1), Wis. Stats., which provides the department with declaratory ruling authority.

The dispositive issue is whether the Court abused its discretion when it dismissed Bell's action "in deference" to the department's declaratory ruling authority.

AT&T provides interstate and long-distance telephone service to residents of Wisconsin. Bell is the "local" telephone company providing intrastate service in many areas of the state. Pursuant to an agreement with AT&T, Bell bills and collects the charges due AT&T for the long distance services AT&T provides to Wisconsin customers.

In 1988, the department published a statement in a tax "newsletter" indicating its belief that fees Bell charges AT&T for providing the long-distance billing and collection services were subject to the Wisconsin sales tax as "telephone services" under sec. 77.52(2)(a)4, Wis. Stats. The statement was not fact-specific.

Despite the newsletter statement, the department has not assessed Bell for sales tax on the gross receipts from its billing and collection services, nor has Bell paid any such taxes.

In 1990, the taxpayers brought the declaratory judgment action in Circuit Court, seeking a declaration that Bell's billing and collection activities were not "telephone (or telecommunications) services" within the meaning of the statute. The department moved to dismiss on grounds that the Court cannot acquire subject matter jurisdiction until the Wisconsin Tax Appeals Commission (Commission) first rules on the matter, and that the controversy was not ripe for adjudication. Alternatively, the department argued that the Court should defer to the Commission under the primary jurisdiction doctrine.

The Circuit Court granted the motion. It concluded that although the Commission did not have "initial jurisdiction" in the matter - that it could not rule on the controversy until the case had gone through the department - the taxpayers could seek a declaratory ruling from the department under sec. 227.41(1), Wis. Stats. The Court then stated that it would "in its discretion defer to the [department's] expertise" and dismissed the action, leaving the taxpayers to their declaratory relief remedies before the department and the Commission.

The taxpayer complains that because sec. 227.41(1), Wis. Stats., says that the agency "may" issue a declaratory ruling upon peti-

tion, there is no guarantee that the department will actually rule on the issue.

The taxpayer's assertion that the Circuit Court erred in not asserting its jurisdiction because the procedures for seeking and appealing an agency declaratory ruling under sec. 227.41, Wis. Stats., are "poorly defined" is similarly unavailing. The statute outlines the form a petition for a ruling should take and states where and how it should be filed. It also requires the agency to act upon the petition within a reasonable time after receipt and specifically provides that the agency's ruling "shall be subject to review in the Circuit Court in the manner provided for the review of administrative decisions."

The taxpayer's final reason for judicial intervention is that the case does not involve "complex factual issues" but only a simple question of "statutory interpretation," which, presumably, it feels the Court is equally, if not more, able to resolve.

The Court of Appeals affirmed the Circuit Court's judgment, concluding that whether the factual issues are complex or simple, the agency has a role in the formation of tax policy and the application and administration of the tax laws that deserves deference in a case such as this.

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

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OTHER

Administrative remedies — declarataory and injunctive relief. *J. Gerard Hogan, Delores M. Hogan, Jerome S. Poker, Margaret H. Poker, on behalf of themselves and all residents of the State of Wisconsin who were paid retirement benefits by the United States government in any one or all of the years 1982 through 1988, similarly situated, vs. Wisconsin Department of Revenue* (Wisconsin Supreme Court, June 26, 1991). This is a review of a decision of the Court of Appeals affirming an order of the Circuit Court for Dane County. The primary issue presented is whether these plaintiffs (retirees) must exhaust their state administrative remedies before filing an action in a state court under 42 U.S.C. section 1983 (a provision of federal law which deals, in part, with civil actions for deprivation of rights). This case does not involve the question of whether these retirees are entitled to a tax refund. Nor does it involve the question of the amount of such refund. It involves only the question of what route these retirees must take in pursuing their claim for refund.

The retirees brought this action in state court under 42 U.S.C. sec. 1983 alleging that the department had violated, and was continuing to violate, their federal statutory and constitutional rights by exacting taxes that discriminate against retired federal employes. The named retirees, J. Gerard Hogan, Dolores M. Hogan, Jerome S. Poker, and Margaret H. Poker, have been Wisconsin residents from at least 1982 through the present. Mr. Poker and Mr. Hogan are former federal employes. As a result of their federal employment, Poker and Hogan received federal retirement benefits that were taxed by the State of Wisconsin.

The retirees commenced this sec. 1983 action on April 17, 1989, in the wake of the United States Supreme Court's decision in *Davis v. Michigan Dept. of Treasury*. The Michigan tax statutes exempted from taxation all retirement benefits paid by Michigan and its political subdivisions, while levying an income tax on federal retirement benefits. The Court held that Davis was entitled to a refund of taxes paid because the Michigan tax scheme was contrary to sec. 111 and violated principles of intergovernmental tax immunity.

The retirees allege that the Wisconsin tax system has similarly discriminated against federal retirees. From 1963 until 1988, Wisconsin exempted the benefits of many retired employes of only certain state and local governments from income taxation. During this same period, federal retirement benefits were not exempt from income taxation.

The retirees sought declaratory and injunctive relief against the department pursuant to 42 U.S.C. sec. 1983, in the Circuit Court for Dane County. They also sought damages under a pendent state law claim of money had and received.

The Department filed a motion to dismiss, asserting numerous defenses including the defense that the retirees had not exhausted their state administrative remedies. On May 19, 1989, the retirees moved for a declaration that sec. 71.05(1)(a), Stats., is unconstitutional, for certification of the class of federal retirees, and for injunctive relief precluding the enforcement of sec. 71.05(1)(a), Stats., and establishing a constructive trust.

The Circuit Court enjoined the department "from collecting, asserting, imposing or otherwise attempting to collect, assert, or impose any tax or liability upon or against any [Plaintiff] ... from June 13, 1989 forward pending the resolution of this action on the merits," because the continuation of these activities would cause irreparable injury to the retirees. In addition, the Court ordered the department to hold any money collected from the retirees in a constructive trust and certified the class of federal retirees. The Court did not hear or decide the issue of whether funds already collected by the department should be returned to the retirees.

On August 9, 1989, 1989 Wisconsin Act 31, section 1817m, went into effect exempting for 1989 and subsequent tax years the pension income of the federal retirees in the certified class. This provision of sec. 71.05, Stats. (1989-90), does not affect the liability of federal retirees for pre-1989 tax years.

The Court of Appeals affirmed the Circuit Court's order. In addition, the Court held that the action had not been rendered moot by 1989 Wisconsin Act 31, section 1817m.

The Wisconsin Supreme Court concluded that:

1. Because sec. 111 protects federal retirees from discriminatory taxation, violations of sec. 111 regarding intergovernmental immunity claims are actionable under 42 U.S.C. sec. 1983.

2. Federal law does not require state courts to entertain sec. 1983 actions in tax matters where the plaintiff has not exhausted established state administrative remedies if such remedies are plain, adequate, and complete.

3. Wisconsin's administrative remedies are plain, adequate, and complete.

4. Wisconsin law requires these retirees to exhaust available state administrative remedies before commencing a sec. 1983 action in the Wisconsin courts.

The Wisconsin Supreme Court, therefore, reversed the Court of Appeals' decision which affirmed the Circuit Court's order granting injunctive relief to the plaintiffs and denying the department's motion to dismiss.

The taxpayer has appealed this decision to the United States Supreme Court.

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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 are included:

Corporation Franchise or Income Taxes

Sales/Use Taxes

CORPORATION FRANCHISE OR INCOME TAXES

1. Authority to Audit Federal Tax Return Information

Statutes: Sections 71.26(2) and (3) and 71.74, Wis. Stats. (1989-90), and 71.11(7)(b) and (20), Wis. Stats. (1985-86)

Background: For the 1987 taxable year and thereafter, the computation of Wisconsin net income of a corporation is determined under the Internal Revenue Code, with certain modifications (sec. 71.26(2) and (3), Wis. Stats. (1989-90)). The Wisconsin corporation franchise and income tax returns (Forms 4 and 5) utilize federal taxable income before net operating losses and special deductions, which has been reported on federal Form 1120 or 1120-A, as the starting point for the determination of Wisconsin net income.

Question: Does the Wisconsin Department of Revenue have the authority to audit the information on the federal Form 1120 or 1120-A which has been utilized in determining the federal net income reported on the Wisconsin Form 4 or 5?

Answer: Yes. Section 71.74(2), Wis. Stats. (1989-90), provides that the department, for the purpose of ascertaining the correctness of any return or for the purpose of making a determination of the taxable income of any corporation, may examine any books, papers, records or memoranda bearing on the income of the corporation. It also provides that upon such information as it may discover, the department shall determine the true amount of income received during the year or years under investigation. Therefore, the department has authority to examine all supporting documentation regarding the computation of federal net income before net operating losses and special deductions as reported on federal Form 1120 or 1120-A.

In addition, sec. 71.74(6), Wis. Stats. (1989-90), provides that whenever a corporation which is required to file a franchise or income tax return with Wisconsin is affiliated with or related to any other corporation through stock ownership by the same interests or as parent or subsidiary corporations, or whose income is regulated through contract or other arrangement, the department may require such consolidated statements as in its opinion are necessary in order to determine the taxable income received by any one of the affiliated or related corporations.

Note: Prior to the 1987 taxable year, the department had the same authority to audit and examine such return information (sec. 71.11(7)(b) and (20), Wis. Stats. (1985-86)).

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2. Wisconsin Treatment of Alaska Native Corporation Losses

Statutes: Section 71.26(3)(x), Wis. Stats. (1989-90), and sec. 71.04, Wis. Stats. (1985-86).

Background: Section 1501 of the Internal Revenue Code (IRC) provides that an affiliated group of corporations, as defined in sec. 1504(a), may file consolidated federal income tax returns. Under the consolidated return rules, the losses and tax credits generated by one corporation may be offset against income earned by another member of the affiliated group.

Section 60(b)(5) of the Deficit Reduction Act of 1984 (P.L. 98-369) amended IRC sec. 1504(a) to alter the general requirements for affiliation and add an 80 percent equity ownership test. Thus, two corporations are not eligible to file a consolidated return for a taxable year unless, at the beginning of the taxable year, one owns stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of the fair market value of all outstanding stock of the other. Under the prior federal rules, one corporation could possess 80 percent of the voting power of all classes of stock but a much smaller percentage of the value of another corporation and still file a consolidated return.