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

Corporate liquidations — sec. 333. *Keith Breyer vs. Wisconsin Department of Revenue* (Court of Appeals, District III, January 15, 1991). See *Wisconsin Tax Bulletin* 71, page 8, for a summary of the January 15, 1991, decision.

The taxpayer appealed the Court of Appeals decision to the Wisconsin Supreme Court in February 1991. The Supreme Court denied the taxpayer's petition for rehearing on April 2, 1991. □

Gain or loss — corporate liquidation. *Oliver G. and Jeanne K. Berge and Wilmer E. and Marijean Trodahl vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, March 11, 1992). The issue in this case is whether the distribution of real property resulted in a taxable gain to the taxpayers.

The taxpayers were equal 50% shareholders in Hearthstone, Inc., a Wisconsin corporation formed in 1963 to own and rent out apartments. The taxpayers dissolved the corporation on January 2, 1988, transferring the apartment building to themselves as equal 50% individual owners.

The taxpayers argue that a mere change in the form of ownership had taken place which did not require recognition of gain in the year of distribution. Section 336 of the Internal Revenue Code (IRC) provides as a general rule that gain or loss shall be recognized to a liquidating corporation on the distribution of property

in complete liquidation as if such property were sold to the distributee at fair market value. Under sec. 633(a)(1) of the Tax Reform Act of 1986, the amendments to sec. 336, IRC, apply to any distribution in complete liquidation made by a corporation after July 1, 1986, unless such corporation is completely liquidated before January 1, 1987.

The Commission concluded that the 1988 liquidating distribution from Hearthstone, Inc., to the taxpayers resulted in recognized taxable gain.

The taxpayers have appealed this decision to the Circuit Court. □

Gain or loss — transitional adjustments — federal basis differs from state; Gain or loss — sales price of stock; Interest income — constructive; Penalties — negligence — incorrect return. *Martin and Ingeborg Kraninger vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 7, 1992). The issues in this case are:

A. What was the taxpayer's sale price of the stock?

B. What was the taxpayer's basis in the stock sold?

C. Did the taxpayer have constructive interest income, and if so, was he entitled to claim a bad debt expense for unpaid accounts receivable repurchased?

D. Was the taxpayer liable for the 25% negligence penalty in respect to the above issues?

The taxpayer's installment payment stock sale on December 31, 1985, called for a maximum price of $1,341,671 and a minimum price of $1,250,000. The final price was dependent upon the extent to which the taxpayer would, after the 1985 closing, be obliged to reimburse the buyer for various contingent corporate liabilities the taxpayer had contractually assumed. In 1986, the final price was brought down to the minimum of $1,250,000.

The taxpayer acquired the stock from his father-in-law and mother-in-law in 1977 for a price of $23.48 per share. The father-in-law died three months after the sale and the IRS subsequently asserted that the sale was a bargain sale and that the true value was $63.50 per share.

The taxpayer paid a federal gift tax on the gift component ($40.02) of the bargain sale. For the shares purchased from the father-in-law, the IRS included the gift component of the transfer in the father-in-law's taxable estate as a gift in contemplation of death, crediting the estate tax for the gift tax paid.

In lieu of including the gift component in the father-in-law's Wisconsin taxable estate and in lieu of assessing an inheritance tax on that component, the department accepted the taxpayer's payment of a Wisconsin gift tax based on a compromise value of $50 per share.

In 1986, the stock buyer unilaterally took setoffs against the interest it owed the taxpayer. These setoffs were for certain corporate accounts receivable, which the taxpayer had contractually agreed to "repurchase" if they remained unpaid for more than 180 days following the stock sale.

The accounts receivable were six months old at the time of the stock sale, the accounts remained unpaid through 1986, the three companies that owed on the accounts went into Chapter 11 bankruptcy in 1986, and the taxpayer made no bad debt claim for these accounts on his 1986 return.

The Commission concluded as follows:

A. As of the closing date of December 31, 1985, the sales price is deemed to be the contractual maximum of $1,341,671. The minimum price of $1,250,000 was not known until 1986, the year after the sale contract was signed.

B. The federal basis applies for the stock. This includes the sale price, the gift component, and gift tax paid.

C. Because the sales contract provides that setoffs for the accounts receivable will be offset against *any amounts owed* by the buyer to the taxpayer, the constructive interest adjustment was proper. Interest is part of "any amounts owed" under a note.

   The accounts were legally worthless in 1986. The fact that the taxpayer made no bad debt claim on his 1986 or subsequent returns does not disqualify the claim now. The taxpayer's claim for bad debt recognition is in essence an equitable recoupment claim offsetting the assessment of tax due to the constructive interest.

D. At the time the taxpayer filed his 1985 return, he had a reasonable basis and good, though legally mistaken, cause to believe that the sale price was no greater than the minimum. This satisfies the "good cause" standard and the penalty is abated.

The department filed a petition for rehearing with the Wisconsin Tax Appeals Commission, which was denied on June 25, 1992. The department has not appealed but has adopted a position of nonacquiescence in regard to issue B of this decision.

The taxpayer has not appealed the decision. □

FARMLAND PRESERVATION CREDIT

Farmland preservation credit — zoning certificate erroneously prepared. *Delbert E. and Margaret Rentmeester vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 5, 1992). The issue in this case is whether the department properly disallowed the taxpayer's 1986 through 1989 farmland preservation credit claims. Although the taxpayer's farmland in those years was not zoned for exclusive agricultural use, the zoning certificate filed with the claims, erroneously prepared by the Brown County Land Conservation Department, stated that the farmland was located within exclusive agricultural zoning.

On April 3, 1990, the Land Conservation Department issued a letter to the taxpayers informing them that, although they had received a zoning certificate for 1986 through 1989, the Land Conservation Department would be unable to issue that zoning certificate to them in the future because their land was not in an exclusive agricultural zoning district.

At the October 30, 1991, meeting of the Town of DePere Plan Commission, a request by the taxpayers to change the zoning of these parcels from agriculture to exclusive agriculture passed on a vote of 5 to 0.

The Commission concluded that:

A. Because the taxpayer's land was not properly zoned exclusive agricultural use for 1986 through 1989 the taxpayers were not eligible for the credits received for such years.

B. In filing their 1986 through 1989 farmland preservation credit claims, the taxpayers reasonably relied upon the zoning certificate. Such reliance was detrimental in that it induced them to substantially restrict use of this property during the credit years to satisfy the farmland preservation credit eligibility requirements even though eligibility was impossible given the improper zoning. Under the circumstances, it would result in a manifest injustice to require the taxpayers to repay such credits. The doctrine of equitable estoppel must be applied to prevent such an injustice.

The department has not appealed but has adopted a position of nonacquiescence in regard to the conclusion that the doctrine of equitable estoppel applies. □

Service of process; Appeals — Tax Appeals Commission. *John R. Steenlage and Roberta M. Steenlage vs. Wisconsin Tax Appeals Commission and Wisconsin Department of Revenue* (Circuit Court for Trempeleau County, May 7, 1992). This is a petition for judicial review of a decision of the Wisconsin Tax Appeals Commission (Commission), which had dismissed the taxpayer's petition for review for lack of jurisdiction.

The issues in this case are:

A. Whether the Commission's finding that the taxpayers received the department's notice of redetermination is proper and supported by substantial evidence in the record.

B. Whether the Commission legally and properly concluded that it lacked jurisdiction to review the department's redetermination because the taxpayers failed to timely file their petition for review with the Commission.

C. Whether the Commission is an improper respondent in this judicial review proceeding.

The department issued a farmland preservation tax credit adjustment to the taxpayers on August 17, 1987, assessing taxes and interest. On October 19, 1987, the taxpayers filed a petition for redetermination, and, on April 14, 1988, the department issued a decision denying the petition for redetermination. The department sent a notice of its decision to the taxpayers, by certified mail, informing them that the tax and interest assessed against them would become final if they did not file an appeal within 60 days of receiving the notice. The certified mail return receipt shows that the notice was delivered to the taxpayers' address on April 5, 1988, and was signed by Bill Eilers, a person who was living with the taxpayers at that time. The taxpayers then sent a letter, by ordinary mail, postmarked June 3, 1988, to the Commission, seeking review of the department's redetermination. The Commission received the letter on June 7, 1988, after the expiration of the 60-day limit for filing a petition with the Commission under sec. 73.01(5)(a), Wis. Stats.

The taxpayers argue that they were not aware of the arrival of the notice until several days after Bill Eilers signed for it. Testimony in the record by Ms. Steenlage, however, indicates that the notice was received on April 5, 1988, and the taxpayers introduced no evidence in the record before the agency to show that they did not personally receive the notice of redetermination on April 5, 1988.

The applicable statutes provide that if an individual cannot be served personally, service can be accomplished by leaving a copy of the summons at

the individual's usual place of abode, with someone other than the individual.

The taxpayers attached brochures to their brief concerning appeals to the Commission, and make various arguments concerning the failure of these brochures to define the word "file." There is no indication in the record that these brochures were before the agency, and the court will not, therefore, consider the brochures nor the arguments based on the brochures.

The taxpayers also argue that their appeal was placed in the mail prior to the expiration of the 60-day time limit, and that the Commission should have deemed the appeal "filed" as of the postmark on the envelope. The taxpayers cite as authority for their argument, the IRS procedure for allowing the filing of income tax returns by placing them in the mail by midnight on the date of the tax filing deadline.

The Circuit Court approved and affirmed the Commission's ruling and order, concluding as follows:

A. The Commission's finding that the taxpayers received the department's notice of redetermination on April 5, 1988, is proper and supported by substantial evidence in the record.

B. The Commission legally and properly concluded that it lacked jurisdiction to review the department's redetermination because the taxpayers failed to file their petition for review with the Commission within the 60-day time limit.

C. The Commission is improperly named a respondent in this proceeding. Section 227.53(1)(b)1, Wis. Stats., clearly provides that in petitions for review of a decision of the Commission, the department shall be the named respondent.

The taxpayers have not appealed this decision. □

WITHHOLDING OF TAX

Penalties — negligence — late — 5-25% graduated. *William Pagel vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 3, 1992). The issue in this case is whether the taxpayer's late filing of tax returns was due to "reasonable cause" rather than "wilful neglect."

The taxpayer is a carpenter contractor doing business as Birch Enterprises. Currently, Birch Enterprises has approximately 37 employes and annual sales of more than $1 million.

The taxpayer's principal activities as business owner include dealing with homeowners and builders, scheduling and overseeing work crews, and estimating. When he first started in business, he also handled the bookkeeping and tax accounting, including the filing of annual tax withholding statements. At that time he had no employes.

Since 1977, the taxpayer has delegated his business bookkeeping and tax accounting. At first these tasks were handled by a small bookkeeping firm for whom his daughter worked. A year later, his daughter left that firm to work exclusively for Birch Enterprises, and she handled these tasks until the taxpayer fired her in 1989 following the disclosures which led to the assessment at issue here.

The evidence showed that the respondent's various tax notices were sent to the taxpayer at his home address in Colgate, Wisconsin until 1983, when, at the taxpayer's request, the department began sending them to the Birch Enterprises office at the taxpayer's daughter's home. The taxpayer had a history of numerous late tax report filings, delinquencies, and penalties dating back to 1979 and continuing through March 1989, including at least one estimated assessment. It was not clear from the evidence if the taxpayer himself had actual knowledge of any of these defaults even though all notices were sent to him at Colgate until 1983.

For the period under review, January 1988 to March 1989, there were 11 delinquencies resulting in the imposition of $5,886.61 in penalties.

The taxpayer testified that he was unaware of any tax filing problems or delinquencies during the period under review until he learned from the Internal Revenue Service (IRS) that no W-2 forms had been filed with the IRS from 1985 through 1988 and that his daughter had been embezzling funds from the business. At that point, the taxpayer fired his daughter.

Upon learning he had federal tax problems, Pagel initiated contact in April 1989, with the department, learned there were outstanding delinquencies, and set up a monthly schedule to pay the state delinquencies, which was accomplished in about six months.

The apparent cause of both the federal and state tax delinquencies was the embezzlement by the taxpayer's daughter/bookkeeper of business funds which should have been used to pay those taxes.

The taxpayer testified that he delegated the entire tax accounting responsibility to his daughter and believed she was handling it properly.

The Commission concluded that the taxpayer produced sufficient evidence to show that his tax filing delinquen-