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

Assessments – due process; Assessments – jurisdiction; Assessments – writ of mandamus; Tax Appeals Commission – powers; Bankruptcy – false claim. *William E. Currier vs. Wisconsin Department of Revenue* (Court of Appeals, District I, April 9, 1996). This is an appeal from an order of the Circuit Court for Milwaukee County, dated April 6, 1995. For a summary of that decision, see *Wisconsin Tax Bulletin* 92 (July 1995), page 13. The issues on appeal are:

A. Whether the department lacked jurisdiction to assess taxes against the taxpayer, and the Tax Appeals Commission (Commission) lacked jurisdiction to review the assessment.

B. Whether the department's action was barred by claim preclusion.

C. Whether the taxpayer was denied due process.

D. Whether the department filed a false claim against the taxpayer in his bankruptcy action.

This case arises out of the taxpayer's failure to file Wisconsin income tax returns for the tax years 1982 through 1990. In February 1992, the department issued an estimated income tax assessment for those years. The taxpayer filed a petition for redetermination and requested an informal conference. The department denied both the petition and the request for an informal conference.

The taxpayer filed a petition for review with the Commission. The Commission affirmed the department's denial of the taxpayer's petition for redetermination and determined that he had failed to establish that the department's tax assessment was incorrect. The taxpayer appealed to the Circuit Court, which affirmed the Commission's order.

The taxpayer claims that the department did not have jurisdiction to assess taxes against him, and the Commission did not have jurisdiction to review the assessments. He also claims that this action was barred by the doctrine of claim preclusion, alleging that a writ of mandamus sought by the department in 1984 to compel him to file his 1982 and 1983 Wisconsin income tax returns precludes the department from enforcing the assessment at issue in this case. The taxpayer next claims that he was denied due process when the department denied his request for an informal conference, and that the Commission evidenced bias towards him in rendering its decision. Finally, the taxpayer claims the department filed a false claim for a tax lien against him in his bankruptcy action.

The Court of Appeals concluded as follows:

A. Both the department and the Commission had proper jurisdiction. The department is expressly authorized by statute (secs. 71.74(3) and 71.80(1)(a), Wis. Stats.), to assess taxes against the taxpayer under the circumstances present in this case. The Commission's statutory authority to review the assessment (sec. 73.01(5), Wis. Stats.), was invoked when the taxpayer filed his petition for review.

B. Claim preclusion does not apply. Claim preclusion bars relitigating the same cause of action when a valid, final judgment on the merits is rendered. The cause of action in the two cases is different. The 1984 action sought to compel the taxpayer to file tax returns. The action at issue here assessed taxes against him for the years 1982 through 1990. Further, there was no final judgment rendered in the 1984 action.

C. The taxpayer was not deprived of his due process rights.

   In arguing he should have been granted an informal conference, the taxpayer relies on sec. Tax 3.91(5), Wis. Adm. Code, which he interprets to mean that an informal conference is mandatory. The only mandatory language relates to the time and place of the conference if the department decides to grant the taxpayer's request.

   In arguing that the Commission was biased against him, the taxpayer cites the following paragraph from the Commission's decision:

   "Each year, the respondent, Wisconsin Department of Revenue, endures untold numbers of appeals filed by pro se taxpayers who, in the tortured logic of their discourse, imagine that they have scoured the statutes, cut the Gordian knot, and magically freed themselves from state income tax liability. This is such a case."

   This quotation is a conclusion regarding the position fo the parties based on the evidence in the record; it does not display evidence of bias.

D. The claim filed by the department in the bankruptcy action was not false. It does not represent that a tax lien has been filed but shows that it is an unsecured claim and that liability is contested.

The taxpayer appealed this decision to the Wisconsin Supreme Court, which denied the petition for review. □

Compensation for services; Penalties — fraud. *Edward and Patricia Mulloy vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, March 19, 1996). The issues in this case are:

A. Whether the department properly included amounts received from Advance Consulting, Inc., in the taxpayers' taxable income for 1984, 1985, and 1986, or whether the amounts were nontaxable loans.

B. Whether the department properly assessed penalties pursuant to sec. 71.11(6)(b), Wis. Stats. (1985-86) and sec. 71.83(1)(b)1, Wis. Stats. (1987-88), for intentionally attempting to defeat or evade the tax for the period under review.

Taxpayer Edward Mulloy ("the taxpayer") was a 50% shareholder, vice president, and secretary of Advance Consulting, Inc. ("the corporation") during the entire period under review, which includes calendar years 1984 through 1988. The taxpayers filed no income tax returns with the department for 1982, 1983, 1984, 1985, or 1986 until after the department began collection action on delinquent estimated (doomage) assessments against them for those years. The

department then began a formal investigation and audit of the taxpayers as non-filers, and they filed their 1987 and 1988 returns in 1990.

The late-filed returns all showed no taxable income, due to substantial claimed losses and loss carryforwards from prior years, most of which were disallowed on audit and ultimately conceded by the taxpayers. The audit further determined that substantial additional income had not been reported, including gains on sales of stock in 1982 and 1983, as well as wages received from the corporation in each of the years under review, as follows: $11,349.96 in 1984; $22,801.20 in 1985; $20,000.00 in 1986; $1,000.00 in 1987; and $3,500.00 in 1988. Although the years 1982 and 1983 are not at issue, the conceded gains for those years substantially decreased claimed losses carried forward into the period under review, which were disallowed.

As a result of the investigation and audit findings, the department assessed the taxpayers not only additional taxes but also the statutory penalties provided for by sec. 71.11(6)(b), Wis. Stats. (1985-86) and sec. 71.83(1)(b)1, Wis. Stats. (1987-88), for intentionally attempting to defeat or evade the tax for each of the five years during the period under review.

The taxpayers have conceded all of the department's additional tax assessments for the period under review except the following amounts paid to the taxpayer by the corporation, which the taxpayer maintains were loans: $11,349.96 paid in 1984; $11,400.00 paid in 1985; and $16,000.00 paid in 1986. No promissory notes were signed for any of the 1984 or 1985 payments, nor were there any repayments of these amounts or collection efforts undertaken by the corporation. Although the taxpayer did sign a promissory note for the 1986 payment he received in a lump sum, it was not paid on the due date nor at any time thereafter, and no efforts were made by the corporation to collect on the note. The payment in 1986 was apparently first recorded as a "bonus" in the corporation's check register but later crossed out and replaced with the word "loans." Furthermore, the taxpayer acknowledged that the $20,000 was "to bring me up to where I should have been in compensation."

The taxpayers further dispute the imposition of penalties for attempting to defeat or evade the tax assessed.

The Commission concluded as follows:

A. The department properly included the amounts received from Advance Consulting, Inc., in the taxpayer's taxable income for 1984, 1985, and 1986, because those amounts were taxable compensation rather than nontaxable loans.

B. The department properly increased the assessments for 1984, 1985, 1986, and 1988, pursuant to sec. 71.11(6)(b), Wis. Stats. (1985-86), and sec. 71.83(1)(b)1, Wis. Stats. (1987-88), because the taxpayer first failed to make any income tax report and subsequently made an incorrect income tax report, both with intent to defeat or evade the income tax assessment required by law for each of the years during the period under review.

The taxpayers have not appealed this decision. □

Itemized deduction credit — contributions; Itemized deduction credit — interest. *Thomas C. and Dixie Yakes vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, March 7, 1996). The issues in this case are:

A. Whether the taxpayers are entitled to claim an itemized deduction credit under sec. 71.07(5), Wis. Stats., based upon a federal charitable contribution deduction taken with respect to the conveyance of a right of way to the State of Wisconsin.

B. Whether the taxpayers are entitled to claim an itemized deduction credit under sec. 71.07(5), Wis. Stats., based upon a federal interest deduction taken with respect to interest payments made under an installment purchase agreement for a motor home.

During 1984, the taxpayers acquired approximately 155 acres of land in the Town of Delavan. They operated a farm on the parcel until 1990.

During 1989, the taxpayers began to pursue alternate applications of land use for the parcel. They had a formal land use plan prepared, which was subsequently approved by the Town of Delavan. One of the areas of concern to the taxpayers in pursuing possible sale or development of the parcel related to securing access points along the highway. They already possessed four or five access points which may roughly be described as agricultural use access points to the parcel, but different types of access points would be required to realize the higher residential or commercial use contemplated in the land use plan.

In 1989, the taxpayers initiated discussions with the Wisconsin

Department of Transportation ("DOT"), relating to the granting of residential or commercial access points. The discussions culminated in the conveyance of a right of way consisting of 1.49 acres of property to the DOT, in the area planned for residential or commercial use. The explicit language of the June 1990 conveyance set forth that the transaction was executed for the mutual benefit of the parties, i.e., the DOT received title in and interest to the conveyed acreage, and the taxpayers were conferred authorized and reserved access points from the DOT.

Also during June 1990, the taxpayers acquired a motor home under a retail installment agreement financed over fifteen years. The motor home included a queen bed, a range, toilet and bath facilities, and other amenities. The taxpayers used the motor home on weekends and extended trips, at times parking the vehicle for periods of up to one month while out of state.

In July 1993, the department assessed the taxpayers for additional income taxes and interest due. The department disallowed the itemized deduction credit taken on the taxpayers' 1990 and 1991 income tax returns which were associated with a contribution deduction for the June 1990 conveyance of land to the State of Wisconsin, and a deduction for interest payments relating to the motor home installment purchase agreement.

The Commission concluded as follows:

A. The taxpayers are not entitled to claim an itemized deduction credit under sec. 71.07(5), Wis. Stats., based upon a federal charitable contribution deduction taken with respect to the conveyance of the 1.49 acre right of way to the State of Wisconsin, because the conveyance was entered into for the mutual benefit of the grantor and grantee. The taxpayers received in return for their conveyance a significant property right in the form of the conferred access points, which were necessary for commercial development under their land use plan.

B. The taxpayers are entitled to claim an itemized deduction credit under sec. 71.07(5), Wis. Stats., based upon a federal interest deduction taken with respect to interest payments made under the installment purchase agreement for the motor home, because the motor home qualifies as a "second residence" under the applicable federal regulations interpreting Internal Revenue Code section 163. In particular, Treas. Reg. 1.163-10T(p)(3)(ii), indicates that a qualifying "residence" generally contains sleeping space, cooking facilities, and toilet facilities, features present in the taxpayers' mobile home.

Neither the department nor the taxpayers have appealed this decision.

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

Retirement funds exempt. *James R. and Zoe E. Connor vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, November 14, 1995). The issue in this case is whether James R. Connor was a member of the State Teachers Retirement System (STRS) as of December 31, 1963. If Mr. Connor is a member of the STRS as of December 31, 1963, then the annuity income received from the STRS is exempt from the Wisconsin income tax.

The taxpayer, James E. Connor, was employed by the University of Wisconsin-Madison beginning in July of 1962, up until his termination from employment on August 23, 1963. By virtue of his employment, Mr. Connor became a member of the STRS beginning in July of 1962. Mr. Connor was a member of the "combined group."

Shortly after his termination, on September 6, 1963, Mr. Connor filed with the STRS an Application for Withdrawal of Members Deposits With Interest ("Withdrawal Application"). The Withdrawal Application executed by Mr. Connor provided, in part: "I hereby apply for the accumulation from my members deposits ... and agree that payment of said accumulation shall constitute a full and complete discharge and release of all right, interest and claim on my part to state deposit accumulations based on teaching service performed after June 30, 1957."

The Withdrawal Application was granted and payment approved on November 1, 1963. Upon the withdrawal of his member accumulation, Mr. Connor had no credit in the STRS retirement deposit fund and no reserve in the STRS annuity reserve.

On July 1, 1974, Mr. Connor returned to teaching in Wisconsin, became a member of the STRS, and, as required by law, became a member of the "formula group." Upon his return, the STRS did not grant any credit to Mr. Connor for his employment in 1962 and 1963.

In 1982, the STRS was succeeded by the Wisconsin Retirement system (WRS).

In 1989, the Wisconsin Supreme Court held that sec. 42.245(1)(c), Wis. Stats. (1965-66), required the Department of Employe Trust funds (DETF) to credit one-half of their creditable service to STRS members of the combined group between 1957 and 1965 who subsequently took withdrawal of their member deposits. *Schmidt v. Wisconsin Employe Trust Funds Board,* 153 Wis. 2d 35, 49, 449 N.W.2d 268 (1990).

Mr. Connor was a member of the class affected by the *Schmidt* decision. Despite the *Schmidt* decision, DETF did not initially credit Mr. Connor with his pre-1965 creditable service. DETF believed that sec. 40.08(10), Wis. Stats., required persons in Mr. Connor's position to submit a written challenge to DETF's annual retirement account statement containing the DETF summary of the amount of creditable service within seven years of first having notice of DETF's failure to grant credit for pre-1965 service. Mr. Connor did not file a written challenge to the DETF summary of his creditable service within this seven-year period.

On April 5, 1991, Mr. Connor filed a Forfeited Service Purchase Estimate/Application with DETF seeking the purchase of years of creditable service based upon his public employment in 1962 and 1963 under the STRS. Mr. Connor's public employment in 1962 and 1963 translated into 1.32 years of creditable service. Mr. Connor paid $5,228.63 for the purchase of this service.

Mr. Connor terminated his teaching employment on June 30, 1991 and became an annuitant under the WRS on July 1, 1991.

In 1994, the Wisconsin Court of Appeals held that the statute of limitations under sec. 40.08(10), Wis. Stats., commences on the date DETF calculates and pays retirement benefits to the plan beneficiary. *Benson v. Gates*, 188 Wis. 2d 389,405,525 N.W.2d 278 (Ct. App. 1994). The Court of Appeals rejected DETF's policy of requiring a written challenge within seven years of first having notice of DETF's failure to grant credit for pre-1965 service.

As a result of the *Benson* decision, on September 6, 1995, DETF refunded a portion of the amount Mr. Connor paid for the purchase of his forfeited service. This amount was calculated as the cost for one-half year of forfeited service purchased, plus interest.

When the taxpayers filed their state income tax returns for 1990, 1991, and 1992, they failed to include in their Wisconsin adjusted gross income the annuity payments Mr. Connor received during those years from the WRS.

On October 25, 1993, the department assessed the taxpayers $4,201.89 for income taxes during 1990 to 1992. The taxpayers filed a timely petition for redetermination.

The taxpayers assert that because Mr. Connor purchased creditable service based on his employment with the University of Wisconsin in 1962 and 1963, and because of the *Schmidt* and *Benson* cases, he should be considered a member of the STRS as of December 31, 1963. The department argues that Mr. Connor does not qualify for the exemption under sec. 71.05(1)(a), Wis. Stats., because he did not have a STRS member account as of December 31, 1963.

The exemption at issue in this case was enacted by the Legislature in Chapter 267, Laws of 1963. At the time of its enactment, the term "member" for purposes of the STRS had the following meaning:

> "Member" means a person who, as a result of having been engaged in Wisconsin teaching, has a credit in the retirement deposit fund or a reserve in the annuity reserve fund, or who is or may be entitled to a present or future benefit under the teachers' insurance and retirement laws as provided by s. 42.51.

Section 42.20(6r)(a), Wis. Stats. (1963-64). There is neither an assertion nor evidence by the taxpayers that Mr. Connor was entitled to a benefit under sec. 42.51, Wis. Stats., in 1963. There is no dispute that Mr. Connor was engaged in Wisconsin teaching. Therefore, Mr. Connor falls within this definition of "member" only if he had a credit in the retirement deposit fund or a reserve in the STRS annuity reserve fund.

Mr. Connor did not have a reserve in the annuity reserve fund because he had not used his member's deposits or state deposits to purchase an annuity or annuities. Moreover, Mr. Connor did not have a credit in the retirement deposit fund because he had taken his members accumulation and waived "all right, interest or claim ... to state deposit accumulations." Therefore, the Commission concluded that Mr. Connor cannot be considered a member of the STRS as of December 31, 1963.

By virtue of Mr. Connor's return to public service (and the mandatory membership in the formula group that accompanied his return), the impact of the *Schmidt* decision is that he is entitled to one-half of the creditable service to which he would otherwise be entitled based on his public employment in 1962 and 1963.

This effect, however, does not make Mr. Connor a member of the STRS as of December 31, 1963. The enactment of sec. 42.245, Wis. Stats. (1965-66), simply granted to him credit under the formula group plan for his prior service upon his return to the STRS. This grant by the Legislature two years after he left the STRS does not make him a member of the STRS as of December 31, 1963 because it did not reinstate his credit in the retirement deposit fund. In fact, the Wisconsin Supreme Court in *Schmidt* specifically held that this statute does not reinstate any right to state money he forfeited when he withdrew his members accumulation in 1963.

This result was not affected by Mr. Connor's purchase of 1.32 years of creditable service. Again, all this purchase accomplished was adding 1.32 years to his years of creditable service. It did not reinstate his credit in the retirement deposit fund.

The *Benson* decision likewise had no effect on Mr. Connor's status as a member of the STRS as of December 31, 1963. The *Benson* decision dealt only with the statute of limitations for persons who wanted to challenge DETF's denial of their creditable service contrary to sec. 42.245(1), Wis. Stats., and the *Schmidt* decision. The *Benson* court merely held that the statute of limitations commences on the date DETF calculates and pays retirement benefits to the plan beneficiary, not when the participant first has notice of DETF's failure to grant credit.

This decision did not make Mr. Connor a member of the STRS as of December 31, 1963 because it did not reinstate his credit in the retirement deposit fund.

The taxpayer has not appealed this decision.

Note: This decision does not affect the department's position regarding the taxable status of retirement benefits as expressed in the tax release titled "Eligibility for the Wisconsin Income Tax Exemption for Members of the Wisconsin State Teachers Retirement System," which appears on page 30 of this Bulletin. □

Retirement funds exempt — other state's retirement system. *Arthur A. and Betty L. Van Aman vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, March 13, 1996). The issue in this case is whether sec. 71.05(1)(a), Wis. Stats., impermissibly discriminates against persons receiving payments from public employe retirement systems sponsored by other states.

The taxpayers have been Wisconsin residents since February 1990. Prior to their retirement and their move to Wisconsin, both were employed as public school teachers in Illinois.

During the years 1990 through 1993, the taxpayers received annuity payments from a public employe retirement system in Illinois ("Illinois annuity payments"). When filing their 1990 through 1993 Wisconsin income tax returns, they included their Illinois annuity payments and paid tax on those payments.

In November 1994, the taxpayers filed a claim for refund for tax years 1990 through 1993, asserting that the Illinois annuity payments are exempt pursuant to sec. 71.05(1)(a), Wis. Stats. The department denied their claim for refund.

Section 71.05(1)(a), Wis. Stats., exempts payments from certain public employe retirement systems to persons who were members of these systems as of December 31, 1963. This exclusion does not apply to any public employe retirement system sponsored by the State of Illinois. The taxpayers argue that failure of this exclusion to apply to payments from Illinois public employe retirement systems is invalid.

The Commission concluded that the taxpayers do not qualify for the exclusion under sec. 71.05(1)(a), Wis. Stats. There is no evidence that they were members of any retirement system on December 31, 1963. In addition, the failure of sec. 71.05(1)(a), Wis. Stats., to exclude payments from an Illinois public employe retirement system is neither unconstitutional under *Davis v. Michigan*, 489 U.S. 803 (1989), nor a violation of equal protection.

The intergovernmental immunity that is the subject of the *Davis* decision is between the federal government and the state governments. There is nothing in *Davis* that requires one state to tax its own public employe annuitants in the same manner it taxes public employe annuitants deriving payments from other jurisdictions.

The taxpayers have not appealed this decision. □

Tax Appeals Commission — class action claims; Petition for judicial review — timeliness. *Wisconsin Department of Revenue vs. J. Gerard and Delores M. Hogan, et al.* (Court of Appeals, District IV, December 21, 1995). This decision was summarized in *Wisconsin Tax Bulletin* 96 (April 1996), page 15. That summary indicated the taxpayers had appealed the decision to the Wisconsin Supreme Court.

The Wisconsin Supreme Court denied the taxpayers' petition for review. The taxpayers have filed a