with tax-exempt interest and dividend income. By reducing the loss reserves deduction by 15% of the interest and dividend income, the Tax Reform Act of 1986 prevented insurance companies from receiving a double deduction on that portion of its loss reserves which is funded with tax-exempt income.

The Court of Appeals concluded that when changes in federal law produce a corresponding effect in Wisconsin tax procedures, it is for the legislature, not the courts, to consider whether such change represents good policy. Oftentimes, the legislature has responded to federal law by directing the taxpayer to deviate from the federal law. However, in this instance it has not. Unless and until it does, the Court properly follows the clear and unambiguous language of sec. 71.45(2), Wis. Stats. (1987-88). Therefore, the Court of Appeals affirmed the Circuit Court's order upholding the Commission's decision.

The department has not appealed this decision. □

Insurance companies — addback of exempt or excluded interest and dividends received deduction; Insurance companies — interest from United States government obligations; Insurance companies — loss carryovers. *American Standard Ins. Co. of Wisconsin and American Family Mutual Ins. Co. vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, February 21, 1997). The taxpayers seek judicial review of two decisions and orders of the Wisconsin Tax Appeals Commission affirming certain franchise tax determinations made by the department against the taxpayers. See *Wisconsin Tax Bulletin* 98 (July 1996), pages 21 and 23, for summaries of the Commission's decisions.

The issues presented are the following:

A. Was the tax imposed on the taxpayers under chapter 71, Wis. Stats., a "nondiscriminatory franchise tax" within the meaning of 31 U.S.C. §3124(a)(1), permitting calculation of taxes owed based on the taxpayers' interest earned from U.S. government obligations?

B. Did the department properly and constitutionally adjust American Family's loss carryforward for 1986 under sec. 71.06(1), Wis. Stats. (1985-86), and for 1991 under sec. 71.45(4), Wis. Stats. (1989-90), by not allowing the taxpayer to include in its loss carryforward the amount of its dividend received deduction in each loss year?

Treatment of U.S. Government Interest

The "franchise tax" in question was imposed by the department pursuant to sec. 71.01(2), Wis. Stats. (1985-86), and sec. 71.43(2), Wis. Stats. (1987-88). The substance of these successor statutes is the same and has been in existence since first enacted as sec. 71.01(2), Wis. Stats. (1965-66).

The Wisconsin franchise tax has remained essentially the same until amended by sec. 1 of 1985 Wisconsin Act 261, effective for tax year 1986 and thereafter, to subject a corporation that ceases doing business in Wisconsin to a "special franchise tax" according to or measured by its entire Wisconsin net income for the taxable year during which the corporation ceases doing business in the state.

The constitutionality of the franchise tax as created and maintained between 1965 and 1986 was upheld in *Savings League v. Revenue Dept.*, 141 Wis. 2d 918 (Ct. App. 1987), *review denied*, 144 Wis. 2d 956, *appeal dismissed*, 488 U.S. 806 (1988) adopting the test for determining what is a true franchise tax set forth in *Educational Films Corporation v. Ward*, 282 U.S. 379 (1931).

The department maintains that the "special franchise tax" was not applied to the taxpayers, and that even if it were invalid, it is severable under sec. 990.001(11), Wis. Stats. However, the taxpayers maintain that the character of the franchise tax was irrevocably altered into a tax on income by the addition of the "special franchise tax" in 1986 because the so-called franchise tax could apply to a taxpayer ceasing to exercise its franchise of doing business in the state and permitting the tax to be measured by the current income (including interest earned on U.S. obligations) of the withdrawing corporation.

The taxpayers' brief purports to set forth a list of Wisconsin state and local securities whose interest is exempt from the Wisconsin franchise tax. Since the listed local securities are not listed as franchise tax adjustments to federal taxable income under sec. 71.44(2)(a)1-13, Wis. Stats., the listed securities are not excluded from the statutory calculation of Wisconsin net income for franchise tax purposes.

Loss Carryforward

In 1985 and 1991 when American Family claimed business losses, the department required the taxpayer to add back its Wisconsin dividends deductions under sec. 71.01(4)(a)7, Wis. Stats. (1985-86), and under

sec. 71.45(2)(a)8, Wis. Stats. (1991-92), respectively. The denial of the "dividend received" deduction effectively reduced the amount of business loss available to be carried forward. The authority relied on by the department and Commission for removing the "dividend received" deduction from the calculation of business losses available for the carryforward provisions is sec. 71.06(3), Wis. Stats. (1985-86), and sec. 71.45(4), Wis. Stats. (1991-92). American Family argues that the department has improperly interpreted the statutory provisions, and that the interpretation denies the taxpayer equal protection of the law.

The Circuit Court reached the following conclusions:

A. The "special franchise tax" enacted by 1985 Wisconsin Act 261 is invalid, because it imposes an income tax on the "entire Wisconsin net income" from which the interest income from U.S. government obligations is not excluded in violation of 31 U.S.C. §3124(a) and the Supremacy Clause of the U.S. Constitution. The "special franchise tax" is severable, and the remaining statutory framework is workable and enforceable. As severed, the tax imposed on the taxpayers under chapter 71, Wis. Stats., by the department is a "nondiscriminatory franchise tax" within the meaning of 31 U.S.C. §3124(a)(1), permitting calculation of taxes owed based on the taxpayers' interest earned from U.S. government obligations.

B. The department properly and constitutionally adjusted American Family's loss carryforward for 1986 under sec. 71.06(1), Wis. Stats. (1985-86), and for 1991 under sec. 71.45(4), Wis. Stats. (1989-90), by not allowing the taxpayer to include in its loss carryforward calculation the amount of its dividend received deduction for the loss year.

The taxpayers have appealed this decision to the Court of Appeals.

Note: The department and the taxpayer agreed to a dismissal of the appeal of the remaining issues that had been heard by the Wisconsin Tax Appeals Commission. These issues related to add modifications for federally nontaxable interest and dividends and the Wisconsin dividends received deduction. They were settled based on the Court of Appeals' decision in the *Heritage Mutual Insurance Company* case and the settlement between the department and NCR Corporation, respectively. The Circuit Court dismissed the case involving these two issues with prejudice on March 11, 1997. □

Manufacturer's sales tax credit. *Wausau Paper Mills Company vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 23, 1997). The issue in this case is whether the sales and use tax paid by the taxpayer on the electricity consumed in the operation of its wastewater treatment plant is eligible for the manufacturing sales tax credit against the Wisconsin franchise tax, pursuant to sec. 71.28(3), Wis. Stats. (1989-90) [formerly sec. 71.043, Wis. Stats. (1985-86)], and sec. Tax 2.11, Wis. Adm. Code.

The taxpayer is a Wisconsin corporation engaged in the business of the manufacture of fine printing and writing papers in Wisconsin.

The taxpayer manufactures pulp and paper in its mill. Water is added to and mixed with other raw materials (pulpwood, wood pulp, chemicals, mineral fillers) and extracted and collected at various stages throughout the manufacturing process. Large quantities of water are used in the manufacturing process as a transportation medium, as raw material, and for various other manufacturing uses.

The water that is extracted throughout the paper manufacturing process is "collected" by a series of U-drain and closed sewers, which convey the wastewater from the taxpayer's pulp mill, paper machines, stock preparation area, starch kitchen, and finishing areas to a sump at the head end of the wastewater treatment plant, which is adjacent to the rest of the taxpayer's facility.

Federal and Wisconsin laws require the taxpayer to satisfy certain environmental standards before discharging water into the Wisconsin River. The taxpayer satisfies these requirements by processing the water in its wastewater treatment plant. The wastewater treatment plant itself is a standalone, separate and distinct set of buildings and equipment from the rest of the taxpayer's facility.

Over 98% of the water processed in the taxpayer's wastewater treatment plant is water that has been used by the taxpayer in its paper manufacturing process.

The use of water is essential to the taxpayer's continuance of its paper making business. Its subsequent treatment in the wastewater treatment plant is essential to the taxpayer's continuance of its paper making business in order to comply with the environmental standards.

The department has accepted the taxpayer's wastewater treatment plant as an industrial waste treatment

facility eligible for property tax exemption under sec. 70.11(21), Wis. Stats., and for sales and use tax exemption under sec. 77.54(26), Wis. Stats.

The taxpayer consumes electricity in the operation of its wastewater treatment plant. The taxpayer pays sales and use tax on such electricity under ch. 77, Wis. Stats.

The Commission concluded that the sales and use tax paid by the taxpayer on the electricity consumed in the operation of the taxpayer's wastewater treatment plant is not eligible for the manufacturing sales tax credit against the Wisconsin franchise tax pursuant to sec. 71.28(3), Wis. Stats. (1989-90) [formerly sec. 71.043, Wis. Stats. (1985-86)].

The taxpayer has appealed this decision to the Circuit Court. □

SALES AND USE TAXES

Estoppel. *Spickler Enterprises, Ltd., vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, January 22, 1997). This is an appeal from the December 21, 1995 decision of the Wisconsin Tax Appeals Commission ("Commission"). For a summary of that decision, see *Wisconsin Tax Bulletin* 99 (October 1996), page 21.

The issue is whether the Commission properly denied the imposition of the doctrine of estoppel against the Department of Revenue ("DOR"). The Commission determined that the elements of estoppel were not clearly present in this case.

The taxpayer argues that the Commission's decision should be afforded "due weight" rather than "great weight" since the application of estoppel is a legal doctrine and does not require any specialized, technical or superior knowledge by the Commission. The DOR argues that the Commission's interpretation is entitled to "great weight" because it has accumulated substantial expertise in the application of tax laws from which it can assess whether the taxpayer was reasonable in relying on the Department of Transportation's ("DOT") advice regarding a substantial tax liability, and those findings must stand because they are supported by substantial evidence in the record.

The elements of estoppel are (1) action or non-action, (2) on the part of one against whom estoppel is asserted, (3) which induces reasonable reliance thereon by the other, and (4) which is to his detriment. The party asserting estoppel must prove all four elements by clear and convincing evidence.

A. Action or Non-action.

The Circuit Court concluded that the Commission properly denied the imposition of estoppel. The Commission properly found that the taxpayer failed to provide clear and convincing evidence that applicable action was taken.

B. Action by DOR.

The Commission properly determined that the evidence in the record does not support the taxpayer's claim that the agency relationship between the DOR and the DOT gave the DOT the "apparent authority" to act on behalf of the DOR. Rather, the evidence shows that if the alleged tax advice was in fact furnished by clerical employees at the DOT, they were acting outside the scope of their internal authority and in the absence of any authority from the DOR.

The Commission properly found that the DOT was not an agent of the DOR.

C. Reasonable Reliance.

The Commission was justified in determining that it was unreasonable for the taxpayer to rely for its tax advice upon undocumented oral statements to its clerical workers by clerical workers of the DOT, when tens of thousands of dollars in sales tax liability was at issue.

D. Detriment to Spickler.

Because the taxpayer fails to show the first three elements of estoppel by clear and convincing evidence, the fact that the taxpayer may have suffered a financial detriment as a result of DOR's assessment is irrelevant to the outcome of the case.

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

Landscaping. *Straight Arrow Construction Co., Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 28, 1996 and April 4, 1997). The issue in this case is whether the distinction drawn by the department, i.e., that the sales taxation status of certain services rendered by the taxpayer depends upon whether those services were performed in "developed" or "undeveloped" settings, is a valid interpretation of sec. 77.52(2)(a)20, Wis. Stats.

The taxpayer is a Wisconsin business corporation, with its principal

office in Cottage Grove, Wisconsin. The taxpayer is primarily a construction and landscaping contractor doing work in the private and government sectors. In recent years, the taxpayer's main focus has been government work on federal, state, and local highway projects. The taxpayer typically is a subcontractor to general contractors who have prime contracts with the land owners.

Depending on the topography, a typical contract will include the following items: fine grading; conditioning the soil by shredding, disking, and harrowing the soil, by the use of chain drags, rock rakes, box scrapers, and by hand raking; spreading specialized fertilizers and mulch; planting specialized seed mixtures (grasses and/or wild flowers), specialized sod, sod netting and reinforcement, specialized trees, specialized vines, and specialized bushes; and installing retaining walls, riprap (and grouting for riprap), erosion mats, bales and staples, topsoil, right-of-way fencing (woven wire or chain link), silt fences, guardrail posts and guardrail (rigid steel and cable), delineator posts, wooden and steel sign posts, portable crash barriers and related carts, landmark reference monuments, storm sewers, culverts, drains and associated inlets and covers, concrete block retaining walls, concrete aprons, concrete collars, curb, gutter and end walls, and rock retaining walls (decorative walls composed of specially placed rock, not riprap).

On any particular Department of Transportation (DOT) job, the project's typical work area generally included areas within "the right-of-way" in various townships, cities, and rural residential areas. The "right-of-way" (including rest areas and weigh stations) is the primary work area on any particular section of state, county, interstate, or local roadway. In addition, the taxpayer's services were also performed on real property adjacent to right-of-ways, including farm homesteads, rural homes, and other places such as these on any particular project.

The taxpayer's services, to varying degrees and in no particular order of importance, are performed 1) to beautify the area wherein its services are performed, and 2) to reduce and/or prevent the possibility of soil erosion.

The Commission concluded that the distinction drawn by the department in issuing its assessment, that the sales taxation status of certain services rendered by the taxpayer depends upon whether those services were performed in "developed" or "undeveloped" settings, is not a valid interpretation of sec. 77.52(2)(a)20, Wis. Stats., because such an interpretation is not supported by the plain meaning of the statute and impermissibly restricts the scope of the statute.

The department has not appealed this decision. □

Transportation charges. *Rhinelander Paper Company, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 19, 1996, and March 21, 1997). The issue in this case is whether amounts paid by the taxpayer to transport coal to its facility by rail after it was loaded onto rail cars is subject to use tax.

The taxpayer is a Wisconsin corporation primarily engaged in the business of manufacturing paper. During the period under review, September 1, 1988 through August 31, 1992, the taxpayer bought coal from three coal vendors for use in its facility in Rhinelander, Wisconsin.

Except for certain purchases of coal from River Trading Co., the purchase price paid by the taxpayer to the coal vendors included shipment of the coal to the coal vendor's dock and loading onto rail cars but did not include the cost to transport the coal after it had been loaded onto rail cars. With regard to those purchases of coal from River Trading Co., it is not clear whether the purchase price reflected the cost to transport the coal after it had been loaded onto rail cars, because there was no written contract between that company and the taxpayer.

Except for the coal purchased from River Trading Co. as described above, all coal purchased during the period under review was transported by rail under arrangements between the taxpayer and railroad companies. The taxpayer paid all of the cost of transporting the coal after it was loaded onto the rail cars. Details of the arrangements between the taxpayer and the railroad companies were confidential and not disclosed to the coal vendors.

Resolution of this matter hinges largely on whether sec. 77.51(15)(a)3, Wis. Stats., in conjunction with sec. 77.53(1), Wis. Stats., requires that the sales price, on which the use tax is imposed, include transportation charges paid separately by the purchaser of tangible personal property to a person other than the vendor of the personal property and which are not reflected in the actual price paid to the vendor of the personal property.

The Commission concluded that except for certain purchases of coal from River Trading Co., amounts paid by the taxpayer to transport

coal by rail after it was loaded onto rail cars are not subject to use tax because sec. 77.51(15)(a), Wis. Stats., does not subject to use tax transportation charges paid to persons other than the coal vendors. The plain language of the statutes involved makes it clear that the sales price does not include such separately paid transportation charges.

With regard to certain purchases of coal from River Trading Co., the taxpayer has not sufficiently shown that amounts incurred to transport this coal were incurred entirely by the taxpayer after the coal was placed in rail cars and was not reflected in the price paid to that company.

The department has appealed this decision to the Circuit Court. □

Transportation charges. *Trierweiler Construction and Supply Co. Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 30, 1997). The issue in this case is whether the transportation charges paid by the taxpayer to carriers for transporting cement from suppliers' facilities to the taxpayer's construction sites and manufacturing plant are part of the "sales price" of the cement and subject to use tax, and if so, whether the imposition of use tax on such charges violates the equal protection clauses of the United States and Wisconsin Constitutions.

During the years 1989 through 1992 ("the audit period"), the taxpayer was a corporation organized and existing under the laws of Wisconsin. It was engaged primarily in the business of constructing roads, highways, and other improvements. Beginning in 1990 and throughout the balance of the audit period, the taxpayer also manufactured ready-mix concrete at a plant in Marshfield, Wisconsin. Some of the concrete manufactured at the Marshfield plant was used by the taxpayer in its construction activities; the majority of the concrete the taxpayer manufactured at its plant was sold to other parties.

During the audit period, the taxpayer purchased cement from various suppliers located in Wisconsin. The cement was hauled by various trucking companies ("carriers") to the taxpayer's road construction sites located throughout Wisconsin or to the taxpayer's Marshfield manufacturing plant to be incorporated into concrete for later use at the taxpayer's construction sites. The taxpayer paid sales/use tax on its purchase and/or use of the cement.

The taxpayer's suppliers had no obligation to deliver the cement to the taxpayer's construction sites or to its manufacturing plant. The taxpayer did not hire the suppliers to provide such transportation. The cement was not transported to the taxpayer's construction sites or manufacturing plant by vehicles owned or leased by the suppliers, and the suppliers did not retain the carriers to transport the cement to such locations. The suppliers made the cement available for pickup at and loaded the cement into the carriers' vehicles at the suppliers' terminals and silos.

The amount that the suppliers charged the taxpayer and that the taxpayer paid to its suppliers for the cement did not include transportation charges from the suppliers' facilities to the taxpayer's construction sites or to its manufacturing plant. The suppliers added Wisconsin sales tax to the amount they charged the taxpayer for the cement.

The taxpayer arranged for the carriers to provide the service of transporting the cement from the suppliers' facilities to the taxpayer's construction sites and manufacturing plant. The taxpayer was free to select, and did select, the carriers to be used for these transportation services. The carriers hired by the taxpayer were not engaged in the sale of cement, but were only engaged in the business of hauling property for others.

The carriers invoiced the taxpayer directly for their transportation services, and the taxpayer paid the carriers for their services by checks drawn on the taxpayer's account and remitted directly to the carrier. The carriers did not charge the taxpayer — and the taxpayer did not pay the carriers — the Wisconsin sales tax on the charges for transportation services on the hauling of taxpayer's cement from the suppliers' facilities to taxpayer's construction sites and manufacturing plant.

Almost all of the construction projects performed by the taxpayer during the audit period lasted for a full construction season, approximately May to December. If the cost of transportation of the cement to the taxpayer's construction sites and manufacturing plant increased after the taxpayer purchased the cement, this increased cost would be borne by the taxpayer or absorbed by the carriers; the cement suppliers never bore the expense of such a rate increase.

Similarly, if the cost of transportation of the cement to the taxpayer's construction sites and manufacturing plant decreased after the time the taxpayer purchased the cement, the benefit of this reduced cost would be enjoyed by the taxpayer (through a reduction in the rates charged by the carriers) or by the carriers; no direct savings from reduced transportation

costs for the cement inured to the cement suppliers.

During the audit period, the taxpayer stored, used, and consumed in Wisconsin the cement it purchased from its suppliers. The suppliers were retailers of the cement they sold to the taxpayer. Neither the suppliers nor the carriers have given to the taxpayer receipts for the payment of the transportation services with the Wisconsin sales tax separately stated and shown to have been paid. Wisconsin sales tax has not been paid to the taxpayer by either the suppliers or the carriers on the subject transportation charges.

All of the suppliers who sold cement to the taxpayer and all of the carriers who hauled the cement for the taxpayer were engaged in business in Wisconsin. The taxpayer has not paid to the department use tax on the transportation charges it paid to the carriers who hauled the cement from the suppliers to the taxpayer's construction sites and manufacturing plant.

During the audit period, none of the taxpayer's suppliers had any ownership interest in the carriers. The taxpayer, not the taxpayer's suppliers, bore the risk of loss as the cement was transported by carriers and bore the risk of any increase in price charged by the carriers.

The Commission concluded that transportation charges paid separately to common carriers by the taxpayer for hauling cement purchased by the taxpayer from the taxpayer's suppliers are not included in or added to the cement's "sales price," as that term is defined in sec. 77.51(15)(a), Wis. Stats., and, therefore, not subject to the use tax under sec. 77.53(1), Wis. Stats.

The department has appealed this decision to the Circuit Court. □

DRUG TAXES

Drug tax – constitutionality. *State of Wisconsin vs. Darryl J. Hall* (Wisconsin Supreme Court, January 24, 1997). The Wisconsin Supreme Court held that the Wisconsin drug tax stamp law is in part unconstitutional (see *Wisconsin Tax Bulletin* 101, April 1997, page 18, for a summary of that decision).

The summary in *Wisconsin Tax Bulletin* 101 stated that it was not known whether the decision would be appealed to the United States Supreme Court. The State did not appeal the decision. □

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 release is included:

Sales and Use Taxes

SALES AND USE TAXES

Note: The following tax release interprets the Wisconsin sales and use tax law as it applies to the 5% state sales and use tax. The 0.5% county and 0.1% stadium sales and use taxes may also apply. For information on sales or purchases that are subject to the county or stadium sales and use tax, refer to Wisconsin Publication 201, *Wisconsin Sales and Use Tax Information.*