Report on Litigation

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INDIVIDUAL INCOME TAXES

Business expenses. *Jeff S. and Debra J. Elsoffer vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 2, 1997). The issue in this case is whether business expenses deducted by the taxpayers on their 1990 to 1992 income tax returns were proper deductions.

Taxpayer Jeff S. Elsoffer ("the taxpayer") and Charles Chvala incorporated Practical Publications, Inc., as a Wisconsin corporation in June 1990. In 1991, the name of the corporation was changed to Premiere Publishing, Inc. ("Premiere"). At the time of incorporation, the taxpayer and Mr. Chvala intended that Premiere would engage in three forms of business: (1) production of a magazine; (2) production of advertising copy for both the magazine and other publications; and (3) sales of the magazine. They planned to use the production of the magazine to develop an advertising agency.

The taxpayers were stockholders of Premiere. The percentage of the stock they owned varied during the period under review. Initially they were to own approximately 15 to 20% of Premiere's stock. As other investors, including Mr. Chvala, left the venture and returned their stock in Premiere, the taxpayers' percentage approached 40%, but at no time did they ever own more than 50% of the stock.

During the period under review, the taxpayer traveled in excess of 40 hours per week in Wisconsin, sell-

ing advertising in the magazine and selling advertising copy that was placed in other publications by Premiere's customers. He never received any wages, salary, reimbursements for expenses, or other compensation from Premiere, and Premiere never filed a Form W-2 on behalf of the taxpayer.

The Commission concluded that the taxpayers' business expenses disallowed by the department were not properly deducted during the years in which they were incurred, because the taxpayer was not compensated during any of the years at issue. Section 162(a), Internal Revenue Code (IRC). The expenses were also not deductible as employe business expenses, because the taxpayer was not a statutory employe within the meaning of sec. 3121, IRC, since he was not remunerated for his services.

The taxpayers have not 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. □

Domicile. *Konstantine and Marion George vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 21, 1997). The issue in this case is whether taxpayer Konstantine S. George ("Dr. George") was domiciled in Wisconsin during the years 1987 through 1991 (the period under review, to which all facts pertain unless otherwise stated), or whether he was a Florida resident and domiciled there.

This is the only issue involved in this appeal. There is no dispute concerning Dr. George's wife, Marion L. George ("Dr. M. George"), who was domiciled in Wisconsin during the period under review.

Dr. George was born, raised, and educated in Greece. He came to the United States for medical residency and post-graduate training in orthopedic surgery, eventually marrying Dr. M. George. They moved to Wisconsin in 1961. They jointly owned a residence in Elm Grove, Wisconsin prior to and throughout the period under review.

In the early 1980's Dr. George developed heart problems that ultimately required his retirement from orthopedic surgery in 1986 and the winding down and cessation of his medical practice. He performed only gratuitous services in 1988, the final year he practiced medicine. His Wisconsin license to practice medicine, which he held throughout the period under review, expired in 1993.

Dr. George did not dispose of his ownership interest in his medical practice until 1989 and in the building which housed it until 1991. He also held majority ownership interests in several other Wisconsin businesses, and he owned rental real estate in Milwaukee and real estate in Franklin, Wisconsin, which he intended to develop.

The taxpayers had a joint checking account in Wisconsin until 1990, which was used only by Dr. M. George. Their primary checking account was in Florida, at least since 1988, and Dr. George also had a money market account there. Dr. George also owned an automobile which he registered in Wisconsin for six months in 1991, prior to shipping it to Greece in January 1992.

In 1986 Dr. George took title to, and in 1987 decorated, furnished, and occupied a condominium home in St. Petersburg, Florida. He voted in elections there, acquired Florida driver's and motor vehicle licenses, made charitable contributions there in 1987, 1988, and 1989, and was granted a permanent resident homestead real estate tax exemption by Florida tax authorities. However, he did **not** file annual Florida Individual Intangible Tax Returns for the period under review, even though Florida residents are required by law to do so.

In each year during the period under review, Dr. George divided his time between Florida, Greece, Wisconsin, and Colorado. He testified that he spent the greatest portion in Florida, ranging from about 35% to 41%. His estimate of time spent in Wisconsin ranged from about 18% to 23%. He retained his Wisconsin driver's license during the period under review. When he was in Wisconsin he stayed at the Elm Grove residence he owned jointly with his wife. Whenever he traveled to his native Greece, Dr. George returned first to the Wisconsin family residence and then departed from Chicago.

At the time of the hearings in this matter, Dr. George was dying from a rare form of stomach cancer. He died in August 1996 at the family home in Elm Grove and was buried in Brookfield, Wisconsin in a family plot.

The Commission concluded that taxpayer Konstantine S. George remained domiciled in Wisconsin during the period under review.

Weighing in favor of a Florida domicile are Dr. George's Florida car insurance, his Florida homestead partial property tax exemption, his Florida voting registration and exclusive voting record there, his substantial Florida charitable contributions in 1987, 1988, and 1989, and the greater amount of time he spent there during the period under review.

Supporting the finding of a retained Wisconsin domicile are Dr. George's failure to file and pay the required tax on Florida Intangible Property, his retention of and continuing attention to substantial business and commercial real estate ownership interests in Wisconsin, his failure to surrender his license to practice medicine here, and his regularly returning to his Wisconsin family and businesses before traveling to his native Greece.

Dr. George' failure to file Florida Intangible tax returns for any of the years under review casts the most serious doubt on his claim of domicile there, particularly since such returns were filed for later years. Casting further doubt are the Wisconsin annual corporation reports filed by two of his businesses, one of which reports Dr. George's address as Elm Grove, Wisconsin, until 1991, when it was changed to his Florida address. On the other business' reports, Dr. George's address is shown as Elm Grove, Wisconsin until September 30, 1989, after which it was changed to Florida.

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

Late filed returns. *Gordon and Lynda Hoffmann vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 7, 1997). The issue in this case is whether the school property tax/rent credit and farmland tax relief credit for 1989 were properly disallowed because the taxpayers' 1989 income tax return was filed after the last date for claiming those credits, and whether the 25% negligence penalty on the late-filed 1989 return is appropriate.

The department issued a doomage assessment against the taxpayers on July 31, 1995, for calendar years 1988, 1989, and 1990. The taxpayers then filed Wisconsin tax returns for 1988, 1989, and 1990. All were received by the department on August 25, 1995.

On November 27, 1995, the department cancelled the doomage assessment and issued a "Notice of Amount Due" to the taxpayers, on their 1989 Wisconsin income tax return. The assessment included income tax, delinquent interest, a 25% negligence penalty, and a $30.00 late filing fee. The school property tax credit claimed on the 1989 return was disallowed because it was filed more than four years after the original due date, and the Wisconsin farmland tax relief credit claimed on the 1989 return was disallowed because it was not claimed by December 31, 1990.

Taxpayer Gordon Hoffmann testified that he was sure that he had filed returns for 1988, 1989, and 1990 before August of 1995, but his testimony was unsubstantiated. He was unable to show that he had previously filed these returns and was unable to estimate when he might have filed the returns. The taxpayer alleged in the petition for redetermination that the returns became part of an earlier audit file, but he did not testify regarding that allegation or that he had seen any of the returns in that audit file.

The department introduced as evidence, letters to the taxpayers dated February 23 and August 17, 1990, asserting that while the taxpayers had made estimated tax payments for 1988, the department had no record of their having filed a 1988 Wisconsin income tax return.

The Commission concluded that since it had no basis for finding that the taxpayers' 1989 return was filed prior to August 25, 1995, they were ineligible to claim the school property tax/rent credit for 1989 because the last date for claiming this credit was April 15, 1994. The taxpayers were also ineligible to claim the Wisconsin farmland tax relief credit for 1989, because the last date for claiming that credit was December 31, 1990.

The Commission also found that since the taxpayers' 1988, 1989, and 1990 Wisconsin income tax returns were filed late, without reasonable cause, a negligence penalty of 25% of the tax due is not unwarranted.

The taxpayers have not appealed this decision.

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Marital property. *Werner W. Brandt, and Werner W. and Elizabeth Brandt vs. Wisconsin Department of Revenue* (Circuit Court for Milwaukee County, March 25, 1997). This is a review of a May 23, 1996, decision of the Wisconsin Tax Appeals Commission ("Commission"). See *Wisconsin Tax Bulletin* 99 (October 1996), page 17, for a summary of the Commission decision. The issue is whether Werner Brandt had any ownership interest in stock inherited by his former wife Melitta Brandt and was thus entitled to capital loss carryforwards for 1979 through 1987 from the sale of this stock at a loss during their marriage.

In March 1989 and March 1990, the department assessed the taxpayers for additional taxes and interest for 1979 through 1987. The department deemed Continental stock shares to be the individual property of Melitta Brandt at the time of sales of the stock at a loss in 1969 through 1974,

and therefore not subject to capital loss carryforwards claimed on the taxpayers' tax returns for the years indicated. The department denied petitions for redetermination, and the taxpayers filed a Petition for Review to the Commission.

In 1991, the Commission held that Werner Brandt had not established that the beneficial stock ownership was joint. Werner Brandt then filed a Petition for Judicial Review in the Circuit Court for Milwaukee County, which remanded the case to the Commission for a full hearing on the issue of joint beneficial interest in the Continental stock. The Commission was also directed to consider the effect of *Brandt v. Brandt*, 145 Wis. 2d 394 (Ct. App. 1988). In May 1996, the Commission again held in favor of the department, and the taxpayers again appealed to the Circuit Court.

The facts in this case are taken from the Commission's findings of fact which largely parallel the Court of Appeals findings in *Brandt v. Brandt*. The issues presented to the Court of Appeals in *Brandt v. Brandt* involved the manner of division of the marital estate of Werner and Melitta Brandt as a result of their divorce in 1982.

The Circuit Court concluded that the Commission's finding that Melitta Brandt was the sole owner of the Continental stock was proper in the circumstances, that the Commission did properly follow the remand instructions and correctly interpreted and applied the Court of Appeals holding in *Brandt v. Brandt*, and that the Commission was correct in denying Werner Brandt's claim of joint beneficial ownership.

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

CORPORATION FRANCHISE AND INCOME TAXES

Deductions – state franchise or income taxes. *Delco Electronics Corporation vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 16, 1997). The issue to be decided is whether, during the period under review, the Michigan single business tax was deductible by a corporation from its gross income in calculating its liability under the Wisconsin franchise tax.

The taxpayer, Delco Electronics Corporation ("Delco"), is a corporation organized and existing under the laws of the State of Delaware, with its principal offices in Kokomo, Indiana. Delco is a second-tier subsidiary of General Motors Corporation ("GM").

Delco is the world's largest supplier of automotive electronics. Delco produces entertainment systems for GM vehicles, as well as anti-lock braking controllers, suspension and steering controllers, remote keyless entry systems, and computer products that include engine, transmission, power train, and vehicle control modules.

During the years 1986 through 1989 ("the period under review"), Delco had manufacturing facilities in Indiana, Michigan, and Wisconsin, and was engaged in business both inside and outside these states.

During the period under review, Delco incurred a liability for the Michigan single business tax ("MSBT") by reason of the business activities it conducted in the State of Michigan.

Delco is part of a consolidated group, the common parent of which is GM. During the period under review, Delco did not file a separate MSBT return but was included in GM's consolidated MSBT return.

During the period under review, Delco claimed a deduction on its federal corporate income tax return for its accrued, estimated liability for the MSBT. Because the MSBT liability for the consolidated group had not been finally determined at the time Delco filed its federal income tax returns for each of the years under review, the amounts claimed represented accruals of Delco's estimated MSBT liability.

In determining its MSBT liability, Delco calculated its Michigan adjusted tax base pursuant to Michigan Compiled Laws § 208.9 — by a modified addition method — as opposed to the optional gross receipts method provided for in Michigan Compiled Laws § 208.31(2).

Delco timely filed Wisconsin franchise tax returns on a calendar year basis during the period under review. In doing so, Delco claimed an MSBT deduction in an amount equal to the deduction claimed on each of its federal corporate income tax returns.

The department denied each MSBT deduction.

The Commission concluded:

1. Delco Electronics Corporation was not entitled to deduct the Michigan single business tax from its gross income under sec. 71.04(3), Wis. Stats. (1985-86), or sec. 71.26(3)(g), Wis. Stats. (1989-90), during the period under review because the MSBT is a state tax on or measured by all or a portion of Delco's net income.

2. Delco Electronics Corporation was not entitled to deduct the Michigan single business tax from its gross income under sec.

71.04(3), Wis. Stats. (1985-86), or sec. 71.26(3)(g), Wis. Stats. (1989-90), during the period under review because the MSBT is a state tax on or measured by all or a portion of Delco's gross receipts.

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

Leases – 1986 and prior – safe harbor rules. *Wisconsin Department of Revenue vs. Northern States Power Company* (Court of Appeals, District III, July 8, 1997). The department appealed the Circuit Court's order affirming a decision and order of the Wisconsin Tax Appeals Commission, which reversed a franchise tax assessment made by the department against Northern States Power Company (Northern). On appeal, the department asserts that Northern's amortization deduction for its safe harbor lease expenditures is not an allowable deduction for purposes of the Wisconsin franchise tax. For summaries of the prior decisions, see *Wisconsin Tax Bulletins* 98 (July 1996), page 23, and 101 (April 1997), page 14.

Northern is a public utility incorporated in Wisconsin and engaged in the business of producing, distributing, and selling electric power and distributing natural gas in Wisconsin. In 1982, Northern, as buyer/lessor, purchased and leased property in the form of safe harbor leases under Internal Revenue Code (IRC) sec. 168(f)(8), in order to acquire from the seller/lessee the federal income tax benefits related to the property, as well as the Wisconsin franchise tax benefits at issue here and Minnesota tax benefits for its parent corporation.

Northern's safe harbor leases covered approximately $50 million worth of equipment. In connection with the safe harbor leases, Northern paid $13,782,811 in cash to a number of corporations, and $262,886 for transactional costs, for a total 1982 expenditure of $14,045,697. The transactions involved a total of 13 safe harbor leases, with the majority being for a 15-year term.

In 1982, IRC sec. 168(f)(8) permitted "safe harbor leases," which would not have otherwise qualified as leases for federal income tax purposes, to be treated as leases to permit a "seller/lessee" of property to transfer to a "buyer/lessor" the benefit of federal depreciation deductions and federal investment tax credits. However, in 1982, the Wisconsin franchise tax was not federalized and did not include the provisions of IRC sec. 168(f)(8). Sec. 71.04(15)(b), Wis. Stats. (1981-82).

For federal income tax purposes, safe harbor leases were treated as bona fide purchases of equipment by Northern from the sellers/lessees, followed by the lease of the equipment back to the seller/lessee. Under Wisconsin law, safe harbor leases were not considered actual sales and leasebacks, and each seller/lessee remained as the true owner of the equipment at all times. Accordingly, for Wisconsin tax purposes, Northern did not claim any tax benefits attributable to equipment ownership. However, Northern did claim a $212,762 deduction in 1982 for the amortization of its $14,045,697 investment in the safe harbor leases, including the payments to sellers/lessees and transaction costs. For each lease, Northern's costs were amortized over the term of the respective lease.

The department disallowed $209,242 of the $212,762 Northern claimed in its taxable year 1982 for the amortization of its investment in the safe harbor leases, but allowed the remaining $3,520 for the amortization of Northern's transactional fees, including legal fees, for the safe harbor leases.

The Commission reversed the department's decision, and the Circuit Court affirmed the Commission.

The Court of Appeals agreed with the Commission's interpretation. The tax benefits purchased by Northern were income-producing property, held by Northern as an intangible asset for the fixed term of the duration of each lease. As such, the amounts paid by Northern for federal tax benefits were properly amortized and deducted under IRC sec. 167, as incorporated into Wisconsin's franchise tax.

The department has not appealed this decision. □

Nexus – business loss carryforward. *Extrusion Dies, Inc. vs. Wisconsin Department of Revenue* (Circuit Court for Chippewa County, May 29, 1997). The taxpayer appealed the Wisconsin Tax Appeals Commission's decision that during its taxable year ending January 31, 1989, EDC International Corp. was not "engaged in business" or "doing business" in Wisconsin within the meaning of secs. 71.22(11) and 71.23, Wis. Stats. See *Wisconsin Tax Bulletin* 100 (January 1997), page 23, for a summary of the Commission's decision.

During the proceedings before the Commission, the argument focused on the activities of EDC International Corp. prior to its merger with Extrusion Dies, Inc. The merger date was presented as February 1, 1989, but later determined to be January 18, 1989. The taxpayer did not argue that the change of the merger date should change the department's position.