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

Dependent credit. *Timothy C. de Werff, and Timothy C. and Terri L. de Werff vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 20, 1998). The issue in this case is whether the taxpayers are entitled to claim dependent credits for two of Mr. de Werff's children by a previous marriage, for 1992 through 1995, inclusive. This matter involves two separate assessments for additional income taxes, one against taxpayer Timothy C. de Werff and a second against both taxpayers.

Timothy C. de Werff and his former wife, Cynthia M. de Werff, were divorced by order of the Waukesha County Circuit Court (the "Court") as of April 7, 1989. However the judgment of divorce was not entered until January 31, 1992. At the time of the judgment, there were four minor children of the marriage: Christina, Sean, Michele, and Cassandra.

In an order entered September 4, 1991, and again in the divorce judgment, the Court, among other things, found that Timothy de Werff was current on his child support obligation, and awarded him dependent credits associated with Christina and Sean. On June 23, 1992, the Court entered an amended judgment of divorce which added the proviso that he could claim the exemptions only if all child support payments were paid on time in that year. However, following a hearing on July 28, 1992, the Court held that he was entitled to the dependent credits even if he was not current on his child support obligations. Further-more, during the years at issue, Timothy de Werff was never delinquent on his child support obligations.

During each of the years at issue, the amount of support provided by Timothy de Werff has never been less than $5,500 for the four minor children of the marriage. Timothy de Werff claimed dependent credits associated with Christina and Sean for 1993, and both taxpayers claimed the dependent credits for 1992, 1994, and 1995.

Cynthia M. de Werff claimed dependent credits for all four minor children of the marriage at issue for each of the four years at issue here. During each of the years at issue, she apparently refused to execute an IRS Form 8332 allocating to Timothy de Werff the dependent exemptions associated with Christina and Sean.

The department assessed both Cynthia M. de Werff and the taxpayers, in the alternative, for claiming dependent credits associated with Christina and Sean. Cynthia M. de Werff failed to appeal the assessment against her, and the assessment went delinquent. She may file a claim for refund until March 1999.

The assessments against the taxpayers disallowed dependent credits claimed by Timothy C. de Werff for 1993, and dependent credits claimed by both taxpayers for 1992, 1994, and 1995. The taxpayers filed a petition for redetermination objecting to both assessments, the department denied the petition for redetermination with regard to both assessments, and the taxpayers filed a timely petition for review with the Commission.

The Commission concluded that the taxpayers, Timothy C. and Terri L. de Werff, are entitled to claim the dependent credit for the years at issue for Christina and Sean because Timothy de Werff has paid more than $600 toward the support of both children in each of the years at issue, and because the judgment of divorce, as amended, permits him to claim dependent credits for both children.

The department has 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 the informational purposes only. □

Marital property. *Werner W. Brandt and Elizabeth Brandt vs. Wisconsin Department of Revenue* (Court of Appeals, District I, February 17, 1998). This is an appeal by the taxpayers from a March 27, 1997 judgment of the Circuit Court for Milwaukee County, which affirmed an earlier decision of the Wisconsin Tax Appeals Commission. See *Wisconsin Tax Bulletin* 103 (October 1997), page 14, for a summary of the Circuit Court decision.

The only issue on appeal is whether Werner Brandt ("the taxpayer") is entitled to a capital loss carryforward for 1979, the year preceding his divorce from Melitta Brandt, because he and Melitta Brandt filed a joint return for 1979.

The taxpayer appeals from the Commission's determination that he was not entitled to certain capital loss carryforwards he had claimed on his tax returns for the years 1979 through 1989. The primary issue before the Commission was whether stock inherited by the taxpayer's former wife, Melitta Brandt, was jointly owned or individually owned by her. The Commission held that the stock was individually owned by Melitta Brandt and disallowed the capital loss carryforwards.

On appeal, the taxpayer concedes that he was not entitled to the carryforwards from 1980 through 1987 but argues that he is entitled to the capital loss carryforward for 1979.

The Court of Appeals concluded that the taxpayer is not entitled to a capital loss carryforward for 1979. Because he did not raise this argument before the Commission, he has waived his right to raise the argument. Before the Commission, the taxpayer never attempted to distinguish 1979 from the other years at issue. Rather, he argued that he enjoyed beneficial joint ownership of the stock when the stock was sold.

The taxpayers have not appealed this decision. □

Native Americans — reservation of another tribe. *Joan La Rock vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 11, 1998).

This decision was summarized in *Wisconsin Tax Bulletin* 110 (July 1998), page 14. That summary incorrectly stated that the taxpayer had not appealed the decision, which affirmed the department's assessment. The taxpayer has appealed the decision to the Circuit Court. □

Nonresident alien — joint return, standard deduction. *Shan and Vatsula Sivakumaran vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 22, 1998). The issues in this case are:

A. Whether the United States-Canada Income Tax Treaty applies to taxes imposed by Wisconsin.

B. Whether Wisconsin statutes prohibiting nonresident aliens from filing a joint return and from claiming the standard deduction are unconstitutional under the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.

The taxpayers are husband and wife, as well as citizens of Canada. They came to the United States in 1993, so that Mr. Sivakumaran could pursue his doctoral studies at the University of Wisconsin-Milwaukee (UWM). Mr. Sivakumaran has been employed as a Graduate Assistant at UWM; Mrs. Sivakumaran has been working for a private organization. They have two children.

In 1994, Mr. Sivakumaran earned $10,616.31 income in Wisconsin, and Mrs. Sivakumaran earned $10,802 income in Wisconsin. They filed separate 1994 Wisconsin and federal income tax returns, claiming $10,000 exemptions under Article XV of the United States-Canada Income Tax Treaty. Each received a refund from the State of Wisconsin. Both taxpayers testified that their actions were based on advice from the Internal Revenue Service office in Milwaukee.

In 1995, Mr. Sivakumaran earned $12,524.24 income in Wisconsin, and Mrs. Sivakumaran earned $13,279.90. They filed separate returns, each claiming $10,000 exemptions. About four months after filing their state returns, the taxpayers inquired about their expected refunds and learned that their returns were being audited. Thereafter, in September 1996, the taxpayers received an assessment from the department, which included taxes and interest from April 1995. The taxpayers promptly paid the amounts assessed but filed joint returns for 1994 and 1995, claiming a refund. The refund requests were denied, and they individually filed petitions for review with the Commission.

The Commission concluded as follows:

A. The United States-Canada Income Tax Treaty does not apply to taxes imposed by the State of Wisconsin. Close examination of the text of the Treaty reveals that while the Treaty unquestionably affords protection to nonresident aliens subject to tax by either the United States or Canada, it does not apply to taxes imposed by American states or Canadian provinces unless those states or provinces have agreed to be bound by the terms of the Treaty. The taxes at issue here were not imposed by a Contracting State.

B. Section 71.03(2)(d)2, Wis. Stats., which deprives a married person whose spouse is a nonresident alien the ability to file a joint return for income tax purposes, does not violate the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution because it follows the federal law, is rationally-based, and applies to American citizens and resident aliens as well as nonresident aliens. In addition, sec. 71.05(22)(b)1, Wis. Stats., which deprives a nonresident alien of the ability to take the standard deduction for income tax purposes, does not violate that provision of the Constitution because it is rationally-based and follows federal law.

A presumption of constitutionality attaches to Wisconsin Statutes. The party challenging a legislative act must prove it unconstitutional beyond a reasonable doubt. All doubts as to an act's constitutionality must be resolved in favor of upholding the act.

The presumption of constitutionality is particularly strong in the area of taxation. In this matter, with respect to nonresident aliens, Wisconsin law follows federal law on both joint returns and the standard deduction. Inasmuch as Wisconsin follows the relevant provisions of federal law on joint returns and standard deductions, and inasmuch as the federal provisions are long-standing and rationally conceived, the Commission could not find the Wisconsin provisions to be unconstitutional under the United States Constitution or the Wisconsin Constitution.

The taxpayers have not appealed this decision.

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HOMESTEAD CREDIT

Household income — nontaxable individual retirement account distributions. *Beverly A. Yirkovsky, vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 23, 1998). The issue in this case is whether a nontaxable distribution from a nondeductible Individual Retirement Account must be included in household income for purposes of computing a Wisconsin homestead credit.

Beverly A. Yirkovsky ("the claimant") filed a 1996 Wisconsin income tax return which included Schedule H, indicating a homestead credit of

$516. The department disallowed the claimed homestead credit because the claimant had not included in her household income $6,827 of nontaxable distributions which she received in 1996 from a nondeductible Individual Retirement Account (IRA).

The 1996 instructions for Schedule H specified that the following items, among others, must be added to Wisconsin adjusted gross income to determine household income for homestead credit calculation purposes:

Line 5 of Schedule 1 – Contributions to Individual Retirement Arrangements (IRAs) which were deducted or excluded from income on an income tax return.

Line 11e – The gross amount of all pensions and annuities received in 1996, including nontaxable IRA distributions.

The claimant relied on the instruction for line 5 in the 1996 homestead credit booklet rather than the instruction for line 11e when she filed her homestead credit claim. Instruction 5 specifies that nondeductible **contributions** to IRAs should not be included in the computation, but the claimant did not make a nondeductible contribution to an IRA in 1996. Instead, she received a nontaxable **distribution** from such an IRA, which is specifically covered by instruction 11e.

The Commission concluded that the department properly determined that the nontaxable distribution received in 1996 by the claimant from a nondeductible Individual Retirement Account was includible in her household income for purposes of computing the Wisconsin homestead credit.

The claimant has 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. □

Property taxes accrued — co-ownership; Credit offset against state agency debts. *Harvard P. Watkins vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 29, 1998). The issues in this case are:

A. Whether the department properly calculated the claimant's homestead credit for 1996.

B. Whatever the size of the claimant's credit, whether it was properly intercepted and sent to the Wisconsin Department of Workforce Development instead of the claimant.

The claimant filed a 1996 homestead credit claim, which listed income of $7,650 and property taxes of $1,071.39; the claimant asserted that he had personally paid the property taxes. He claimed a homestead credit of $860.

The department adjusted the claim to $428, based on one-half of the property taxes, explaining that since his homestead was co-owned for 1996, he was allowed only his one-half share of the property tax. Moreover, the department applied the $428 to the claimant's "delinquent account" with the Wisconsin Department of Workforce Development.

The claimant sent the department a timely petition for redetermination. This was denied in a Notice of Action which asserted that the claimant had failed to supply certain requested information. Thereafter, the claimant filed a timely appeal with the Commission.

In 1996 the claimant was married to Glennda M. Watkins, who was listed on official documents, including the property tax bill, as co-owner of the property. Glennda M. Watkins left the homestead and was not present there in 1996. Hence, the department was correct in asserting that because of his joint ownership, the claimant was entitled to claim only half of the property tax paid, even though he actually paid it all.

Wisconsin tax rules (sec. Tax 14.04(8)(b), Wis. Adm. Code) also permit the claimant to list as a "rent" payment 25% of the remaining half of the property tax paid. The department's calculation omitting this additional amount may have reflected a failure by the claimant to supply required information, but he has now provided evidence.

The department sent the $428 credit to the Department of Workforce Development pursuant to a Tax Refund and Lottery Intercept. Hence, the claimant received none of the homestead credit personally. At the hearing, the claimant testified that he was not the father of children who precipitated the Tax Intercept order.

Although examining the legitimacy of Tax Intercept orders appears to be beyond the jurisdiction of the Tax Appeals Commission, the Commission did inquire about the basis of the Tax Intercept order. The Commission was informed by a case worker in Milwaukee County that in February 1998 a determination was made to lift the intercept because the claimant's liability was zero. The caseworker suggested that the claimant go to the Courthouse at 901 North 9th Street, Milwaukee, to make arrangements for getting a refund of the previously issued $428 homestead credit.

The Commission concluded as follows:

A. Unless the Commission has miscalculated the 1996 homestead credit, the claimant is entitled to an additional $104 of homestead credit, based on allowable tax/rent of $669.62, consisting of one-half of the property taxes, $535.70, plus 25% of the balance as rent, or $133.92.

B. If, in fact, the tax intercept has been lifted, as noted, the additional credit should be forwarded directly to the claimant.

Neither the department nor the claimant has 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. □

CORPORATION FRANCHISE AND INCOME TAXES

Loss deductions (prior law); Interest on assessments and refunds. *Madison Gas and Electric Company vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, June 17, 1998). This is an appeal of the Wisconsin Tax Appeals Commission's December 15, 1997, decision. The first issue in this case is whether the department properly disallowed the taxpayer's deductions claimed in 1975, 1976, and 1977 concerning the line collapse in 1975. The second issue is whether the department erred when it failed to credit or offset the taxpayer's overpayment of 1978 taxes against amounts owed to the department as of the date of the overpayment. See *Wisconsin Tax Bulletin* 107 (April 1998), page 14, for a summary of the Commission's decision.

In an oral ruling, the Circuit Court held against the department and reversed the Commission's decision.

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

Transitional rules — federalization. *Lincoln Savings Bank, S.A., f/k/a Lincoln Savings and Loan Association vs. Wisconsin Department of Revenue* (Wisconsin Supreme Court, January 27, 1998). The taxpayer appealed a decision of the Court of Appeals, which reversed an order of the Circuit Court. The Circuit Court reversed a decision by the Wisconsin Tax Appeals Commission, which interpreted 1987 Wisconsin Act 27, sec. 3047(1)(a), to permit adjustment of bad debt reserves maintained by the taxpayer from 1962 until 1986, but not earlier, as a means of transitioning to the federalization of Wisconsin's income tax law. The Commission's interpretation upheld an assessment by the department of additional franchise taxes and interest against the taxpayer for the years 1987 to 1990, because the taxpayer had adjusted for bad debt reserves maintained before 1962. For summaries of the prior decisions, see *Wisconsin Tax Bulletins* 91 (April 1995), page 13, 95 (January 1996), page 27, and 101 (April 1997), page 15.

The material facts are not in dispute. Lincoln Savings Bank, S.A., formerly Lincoln Savings and Loan Association ("Lincoln"), is a state chartered savings bank and has been subject to an annual state franchise tax since 1962. Under this provision, every domestic or foreign corporation is required to pay an annual franchise tax based on its entire Wisconsin net income from the preceding taxable year. Lincoln became liable to pay the franchise tax after sec. 71.01(3)(a), Wis. Stats., was amended in 1961 to no longer exempt savings and loan associations from taxation.

Thrift institutions like Lincoln maintain accounts known as bad debt reserves or allowances. Maintenance of a bad debt reserve is a system of income deferral and does not constitute a permanent income reduction. A thrift institution makes yearly additions or subtractions to its bad debt reserves utilizing a formula that accounts for prior writeoffs and reserve additions, and its current level of lending activity. Bad debt reserves form the basis for the bad debt deduction, the primary way in which thrift institutions have reduced their tax burden since 1951, when they lost their federal tax-exempt status.

Both Wisconsin and federal tax laws permit thrift institutions to take bad debt deductions. The deduction amount is based on the amount of debt the thrifts can reasonably expect to become worthless during the tax year, and consequently lower their income tax liability. Prior to 1987, Wisconsin tax law established a specific mechanism for this deduction. Section 593 of the Internal Revenue Code contains the federal bad debt reserve deduction provision.

The federal bad debt reserve provisions for the years pertinent here allowed for the deduction of reasonable additions to the reserve at the discretion of the Internal Revenue Service.

Wisconsin's efforts to "federalize" its method of corporate income taxation affected the calculation of the bad debt deduction. The specific Wisconsin provision for deducting additions to bad debt reserves was repealed effective for the taxable year 1987 as part of the legislature's federalization of Wisconsin tax law. As part of the move to federalization, the legislature defined corporate "net income" for Wisconsin income tax purposes as "gross income, as computed under the internal revenue code."

Prior to federalization, the method of applying bad debt reserves authorized by Wisconsin tax law was less favorable to the taxpayer than the method under the Internal Revenue Code.

Federalization of the corporate tax liability in Wisconsin resulted in changes in the tax treatment of items of income, loss, or deduction for all corporations, including Lincoln. The legislature enacted a transition mechanism to equalize those differences, but to avoid doing so abruptly. This nonstatutory transition rule, 1987 Wisconsin Act 27, sec. 3047, provides for adjustments over a 5-year period, beginning with 1987, unless the adjustment involved is $25,000 or less.

The parties agree that Lincoln is a "corporation" as that word is used in sec. 3047(1)(a), and that the transitional rule required Lincoln to subtract the excess of its federal bad debt reserve over its Wisconsin bad debt reserve from Lincoln's Wisconsin tax liability. The parties only disagree as to whether Lincoln may subtract its pre-1962 balance of bad debt reserves for federal tax purposes, which accumulated before Lincoln was subject to the Wisconsin franchise tax.

The Wisconsin Supreme Court concluded that the plain language of the rule gives effect to the intent of the legislature. That intent was to create a mechanism whereby all corporations subject to income tax in Wisconsin at the time of enactment could equalize their items of income, loss, or deduction as maintained for federal tax purposes, with those items as maintained for Wisconsin income tax purposes. The Commission's interpretation of the transitional mechanism, which effectively read in a limitation on which deductions could be equalized, contravenes the intent of the legislature as evidenced by the plain wording of the rule. Therefore, the decision of the Court of Appeals is reversed.

The department has not appealed this decision. □

Transitional rules — stock purchase treated as asset purchase — 1987 and thereafter; Amortization deductions. *GFG Corporation vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 29, 1998). The issues in this case are as follows:

A. Did Wisconsin's corporate franchise or income tax law entitle the taxpayer to amortization deductions resulting from the stepped-up basis of its assets pursuant to an Internal Revenue Code section 338 election?

B. Was the taxpayer entitled to amortization deductions for the cost of the Non-Competition Agreement even though Derlan Industries, Inc., not the taxpayer, made the payment under the Agreement?

GFG Corporation is a Wisconsin corporation with its principal place of business in Milwaukee. The taxpayer manufactures machines that coat certain steel products primarily for use in steel mills. The taxpayer controls 85% of the world market for coil coating and laminating machines and 50% of the world market for electrostatic spraying.

Derlan Industries, Inc. ("Derlan"), is a U.S.-based holding company. Derlan is a wholly owned subsidiary of Derlan Manufacturing, Inc., which is, in turn, a wholly owned subsidiary of Derlan Industries, Ltd., a Canadian public company ("Derlan Canada").

On September 28, 1988, Derlan purchased 85% of the common stock of the taxpayer from Richard F. Groseclose ("Groseclose"). Subsequent to the period at issue, Derlan acquired the remaining 15% of the taxpayer's stock.

At the time of acquisition, Derlan Canada was a holding company with 22 companies in Canada and the United States operating in 3 general areas: aerospace, specialty manufacturing, and construction products. None of these companies is in the taxpayer's line of business.

At no time has the taxpayer been liquidated or merged into Derlan. The taxpayer remains a separate and distinct corporate entity.

Under the terms of the purchase, Derlan paid Groseclose $4 million for 1,275 shares of the taxpayer's common stock. Derlan also paid Groseclose $1.5 million in consideration for delivering an executed Non-Competition Agreement at closing.

The Non-Competition Agreement executed by Groseclose had the following characteristics:

1. While the Agreement recites that it is a "Memorandum of Agreement made … between [Derlan] and [Groseclose]" it is addressed to both Derlan and the taxpayer;
2. The Agreement was in effect during Groseclose's employment with GFG and for three years thereafter;
3. In the Agreement, Groseclose agreed to refrain from (1) ac-

tivities that would compete with the taxpayer's business, (2) efforts to direct any of the taxpayer's suppliers or customers away from the taxpayer, (3) soliciting any of the taxpayer's employes away from the taxpayer, or (4) activities that would be detrimental to the taxpayer's business;

4. Both the taxpayer and Derlan have the right to enforce the Agreement and seek any remedy.

Execution and delivery of the Non-Competition Agreement was a precondition to Derlan's acquisition of the taxpayer's common stock. Groseclose's involvement in the taxpayer's business following the acquisition by Derlan was necessary for the continued success of the taxpayer. In fact, Groseclose's strong managerial skill was one reason why Derlan purchased the taxpayer. Groseclose possessed significant engineering expertise in the products sold by the taxpayer. Groseclose also had strong and valuable relationships with the taxpayer's customers, suppliers, and employes.

It appears Derlan considered the $1.5 million paid for the Non-Competition Agreement as a contribution of capital to the taxpayer. There is, however, no evidence that Derlan took any steps to transfer or assign the Non-Competition Agreement to the taxpayer or memorialize any such contribution of capital. The taxpayer did not list the Non-Competition Agreement as an asset on any balance sheet filed with the department.

The taxpayer's consolidated financial statements for the years 1988 through 1990 were prepared on an historic cost basis, and thus balances were not adjusted to incorporate the $4 million paid for 85% of the taxpayer's stock and the $1.5 million paid for the Non-Competition Agreement. For example, these reports failed to report the increase in the basis of the taxpayer's assets as a result of the section 338 election. Nonetheless, these financial reports disclosed these transactions.

Due to an oversight by the taxpayer's accounting firm, the taxpayer failed to claim any amortization deductions for the Non-Competition Agreement on its Wisconsin corporate franchise or income tax returns for any year.

It appears that Derlan never claimed any amortization deductions for the Non-Competition Agreement on any state corporate franchise or income tax returns for any year.

At the time the taxpayer was acquired by Derlan, the taxpayer lacked the resources to pay Groseclose $1.5 million for the Non-Competition Agreement.

The taxpayer was the primary beneficiary of the Non-Competition Agreement. While Derlan benefited from the Non-Competition Agreement, its benefit was solely as a shareholder of the taxpayer and based upon reaping the benefits of the taxpayer's continued profitability.

On June 15, 1989, Derlan filed with the Internal Revenue Service its election under section 338(g) of the Internal Revenue Code to treat the purchase of the taxpayer's common stock as an asset purchase. In accordance with Derlan's section 338 election, the taxpayer did not recognize any gain or loss on the sale of common stock to Derlan, and the taxpayer also reported a step-up in the basis of its assets to the allocated cost of the basis of the common stock purchase.

For its taxable years ending December 31, 1988, through December 31, 1991, inclusive, the taxpayer claimed amortization deductions on its Wisconsin corporate franchise or income tax returns resulting from the stepped-up basis of its assets.

During the department's audit of the taxpayer, the taxpayer's accounting firm discovered that the taxpayer had not claimed amortization deductions for the $1.5 million paid to Groseclose for the Non-Competition Agreement. The taxpayer then filed a claim for refund prior to the final audit report, claiming amortization deductions over the life of the Non-Competition Agreement.

The department assessed the taxpayer additional corporate franchise or income taxes for the taxpayer's taxable years ending May 31, 1988, September 27, 1988, December 31, 1988, December 31, 1989, December 31, 1990, and December 31, 1991. Among other things, the assessment (1) reduced the taxpayer's amortization deductions to reflect disallowance of the section 338 election and (2) denied the taxpayer's claim for refund for the amortization deductions associated with the Non-Competition Agreement.

The taxpayer filed a timely petition for redetermination that was granted in part and denied in part. The taxpayer then filed a timely petition for review with the Commission.

The Commission reached the following conclusions:

A. The taxpayer is not entitled to amortization deductions resulting from the stepped-up basis of its assets pursuant to a section 338 election because section 3047(1)(c) of 1987 Wisconsin Act 27 did not authorize the taxpayer to use such treatment for purposes of Wisconsin's corporate franchise or income tax law.

B. The taxpayer is entitled to amortization deductions under section 162 of the Internal Revenue Code for the cost of the Non-Competition Agreement, even though this cost was borne by Derlan, because the taxpayer was the primary beneficiary of the Agreement.

The taxpayer has not appealed this decision. The department has not appealed the decision, but has adopted a position of nonacquiescence regarding that portion of the decision permitting an amortization deduction for the cost of the Non-Competition Agreement. The effect of this action is that the Commission's conclusions of law, the rationale, and construction of statutes regarding that issue are not binding upon or required to be followed by the department in other cases. □

SALES AND USE TAXES

Boats, vessels and barges — nonresident purchases. *Raymond and Patricia Wehrs vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, January 22, 1998). The Wisconsin Tax Appeals Commission issued a decision on June 2, 1997. See *Wisconsin Tax Bulletin* 103 (October 1997), page 18, for a summary of the Commission decision. The issue in this case is whether the taxpayer's boat is subject to Wisconsin sales or use tax.

The taxpayers are residents of Illinois. In July 1992, the taxpayers purchased a boat. On the day of the sale, the taxpayers were in Illinois, while the boat and its seller were in Florida. The boat was not titled or registered in Florida, nor was a Florida sales tax paid. The boat left Florida almost immediately after the sale and, after a brief stop in Illinois, was brought to Wisconsin, where it was later registered.

The taxpayers contend that the Commission erred in determining that their boat was ineligible for the use tax exemptions provided in sec. 77.53(17m), Wis. Stats., and sec. Tax 11.85(2)(d), Wis. Adm. Code. The Commission previously held as follows:

A. The department properly imposed use tax on the purchase of the boat. The boat at issue was not purchased in the state of Illinois, thus, taxpayers do not qualify for the exemption from use tax under sec. 77.53(17m), Wis. Stats.

B. The boat at issue is not exempt from use tax under sec. Tax 11.85(2)(d), Wis. Adm. Code, because this exemption applies only to temporary use within Wisconsin, not to storage over a period of at least two months.

The Circuit Court vacated the decision of the Commission and remanded the case for further evidentiary proceedings. The application of the exemption requires that a record be made as to the history of the boat from the time it arrived in Wisconsin to the time it left for good. □

Common or contract carriers. *Superior Hazardous Waste Group, Inc., f/k/a/ Alliance Transportation Services, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 17, 1998). The issues in this case are:

A. Whether the taxpayer's purchases of trucks and accessories qualify for exemption from sales and use tax under sec. 77.54(5)(b), Wis. Stats.

B. Whether sec. 77.54(5)(b), Wis. Stats., as applied to the facts of this case, violates the equal protection guarantees of the state and federal constitutions.

The taxpayer was licensed by the Wisconsin Department of Transportation as a contract carrier and held a Wisconsin contract motor carrier license number to haul goods of others for hire. In the normal course of its business, the taxpayer purchased trucks and accessories, attachments, parts, supplies, and materials. The taxpayer also paid for the repair, alteration, and maintenance of these trucks and accessories.

Virtually all of the materials transported by the taxpayer were classified as hazardous waste by the Environmental Protection Agency and/or the Wisconsin Department of Natural Resources. Approximately 65-75% of the wastes transported by the taxpayer had value to the generator and/or recipient of the waste and 25-35% of the waste transported had no value.

The Commission concluded as follows:

A. The taxpayer's purchases of trucks, etc. *do not* qualify for exemption from sales and use tax under sec. 77.54(5)(b), Wis. Stats.

B. The sales and use tax exemption found in sec. 77.54(5)(b), Wis. Stats., as applied to the facts in this case, *does not* violate the equal protection guarantees of the state and federal constitutions.

Section 77.54(5)(b), Wis. Stats., exempts from sales and use tax certain items "sold to . . . contract carriers who use such (items) exclusively as . . . contract carriers . . . ” This section does not define “contract carriers.” In *Gensler v. Department of Revenue*, 70 Wis. 2d 1108 (1975), the Supreme Court held that in construing this exemption it was appropriate to rely upon the definitions set forth in sec. 194.01, Wis. Stats. This section defines contract carrier as:

“any person engaged in the transportation by motor vehicle over a regular or irregular route upon the public highways of property for hire.”

Waste that has no value is not “property” within the meaning of sec. 194.01(2), Wis. Stats. Using 25-35% of the capacity of each truck for a use that is neither contract nor common carriage is not an incidental, non-exempt use; therefore, the trucks at issue were not used exclusively as contract carriers.

The taxpayer has not appealed this decision. □

Exemptions — telephone company central office equipment. *Ameritech Mobile Communications, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, October 2, 1997).

This decision was summarized in *Wisconsin Tax Bulletin* 106 (January 1998), page 21. That summary stated that the taxpayer had appealed the decision to the Wisconsin Supreme Court.

The Wisconsin Supreme Court denied the taxpayer’s petition for review in February 1998. The case is closed. □

Officer liability. *Joseph A. Balestrieri vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 2, 1998). The issue in this case is whether the taxpayer is a responsible person under sec. 77.60(9), Wis. Stats., during December 1990 and January, February, March, May, June, and August 1991 (“the period under review”).

The taxpayer was president and a director of Riverside Theatre, Inc. (“the corporation”). He managed the day-to-day operations of the corporation and had check signing authority on three corporation checking accounts. The taxpayer reviewed payment requests and directed payments to creditors. He signed checks to pay the corporation’s creditors during the period under review.

In March 1994, the department assessed the taxpayer as an officer or other responsible person of the corporation, who wilfully failed to pay the corporation’s sales taxes due during the period under review.

The Commission concluded that the taxpayer was a responsible person under sec. 77.60(9), Wis. Stats., and was personally liable for the unpaid sales and use taxes.

For personal liability to be established for sales and use taxes, the taxpayer must have had **authority** to pay the corporation’s taxes, a **duty** to pay the taxes, and an **intentional breach of that duty**. The taxpayer was president of the corporation with signature **authority** on its checking accounts. He managed the operations of the corporation, directed payments to creditors, and signed checks; therefore, the taxpayer had the **authority** to pay the taxes. As an officer and director of the corporation, the taxpayer was **duty-bound** to see that the taxes were paid. The taxpayer **intentionally breached that duty** by signing checks and paying other creditors than the department.

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

Retailer — defined. *American Heart Association/ Wisconsin Affiliate, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 24, 1998). The issue in this case is whether the gross receipts from the taxpayer’s sales of literature are subject to Wisconsin sales tax.

The facts in the case are as follows:

1. The taxpayer is a non-stock, non-profit corporation which qualifies for tax exempt status under Internal Revenue Code sec. 501(c)(3).
2. Since its inception, the taxpayer has worked to reduce disability and death from cardiovascular disease and stroke by supporting medical research and providing education and community programs for health professionals and the general public. The taxpayer’s home office, which is located in Milwaukee, is staffed by volunteers and paid employes.
3. During the audit period, the taxpayer’s gross revenue was derived from the following sources:

   a. contributions and bequests from individuals, businesses, and exempt organizations (48.9%);

   b. admissions to fund-raising events, auction sales of donated merchandise at the fund-raising events, and sales of centerpieces at the fund-raising events (24.4%);

c. contributions from federated campaigns (e.g., United Way)(12.8%);

d. investment income (6.5%);

e. sales of literature (3.8%);

f. program service fees (e.g., seminar fees) (2.8%);

g. governmental grants (0.5%);

h. sales of memberships to members of the general public, nurses and allied health professionals, and physicians and health scientists (0.4%); and

i. sales of coffee and soda to employes and others who visited the taxpayer's offices, and other miscellaneous revenue sources (0.1%).

The department imposed Wisconsin sales tax on the taxpayer's:

1. sales of coffee and canned soda to employes and visitors,
2. admissions to fund-raising events,
3. auction sales of donated merchandise and sales of table centerpieces used at an event, and
4. sales of literature.

The taxpayer consented (acquiesced) to pay sales tax on the 1) sales of coffee and canned soda; 2) admissions to fund-raising events; and 3) auction sales of donated merchandise and sales of the centerpieces.

The taxpayer sold a variety of educational literature on a daily basis regarding methods of reducing one's risk of incurring cardiovascular diseases and stroke. The literature included pamphlets, cookbooks, brochures, and technical papers for doctors. During the period under review, the taxpayer did not hold a Wisconsin seller's permit.

The Commission concluded that the taxpayer was not a "retailer" of literature; therefore, its sales of such literature are not subject to Wisconsin sales tax. The Commission stated that the taxpayer's acquiescence to other issues involving sales tax was not an admission that the assessment was correct nor that the taxpayer was required to hold a seller's permit.

In *Kollasch v. Adamany,* 104 Wis. 2d 552, 562 (1981), the Wisconsin Supreme Court ruled that "the type of transactions which make one a sec. 77.51(7)(a) retailer are mercantile ones." The Court made it clear in *Kollasch* that a nonprofit organization engaging in fundamentally nonmercantile transactions is not a "retailer."

The Commission determined that the taxpayer's sales of literature was a fundamentally nonmercantile activity. The taxpayer's mission was to reduce disability and death from cardiovascular disease and stroke. The nature and content of the literature established that the taxpayer's sales and distributions of such literature were an integral part of its mission.

The department has not appealed this decision. □

Time-share property. *Telemark Development, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, April 30, 1998). The Wisconsin Tax Appeals Commission decision of October 28, 1996, was appealed to the Circuit Court, which issued a decision on July 22, 1997. See *Wisconsin Tax Bulletins* 101, (April 1997), page 17, and 106 (January 1998), page 22, for summaries of the Commission and Circuit Court decisions.

The issue in this case is whether the taxpayer's sales of time-share units for flexible use are subject to sales tax. Additional issues of the constitutionality of sec. 77.52(2)(a)1, Wis. Stats., under the Equal Protection and Uniformity of Taxation Clauses, were presented to the Circuit Court.

The taxpayer does not hold a seller's permit and did not collect sales tax on any of its sales of flexible time-share units. The department assessed delinquent sales tax against the taxpayer after an audit. The taxpayer appealed to the Commission, and the Commission confirmed the assessment, concluding that the sale of flexible time-share units is taxable under sec. 77.52(2)(a)1, Wis. Stats.

The Court of Appeals concluded that the Commission's decision was a reasonable interpretation and application of the law. The Court also rejected the taxpayer's constitutional claims.

The taxpayer filed a petition for review, which was denied by the Wisconsin Supreme Court on July 24, 1998. □

SALES AND USE TAXES, AND WITHHOLDING OF TAXES

Officer liability. *Lisa S. Green vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 3, 1998). The issue in this case is whether the taxpayer is a responsible person who is liable for the delinquent withholding and sales taxes of Midtowne Auto Body Repair, Inc. ("the corporation") under sec. 71.83(1)(b)2, Wis. Stats. and sec. 77.60(9), Wis. Stats.

The taxpayer was employed by the corporation since 1992. The taxpayer prepared checks for signature by others, handled the mail, and kept a ledger of receipts and invoices.

The taxpayer's position with the corporation was described as "corporate secretary" and "office manager." The corporation's 1993 and 1994 tax returns were filed and signed by the taxpayer, and the taxpayer signed installment agreements with the department in 1993 on behalf of the corporation for delinquent taxes. The taxpayer was given check writing authority in July of 1994, at which time her title was stated as vice-president.

The Commission concluded that the taxpayer was a responsible person under sec. 71.83(1)(b)2, Wis. Stats. and sec. 77.60(9), Wis. Stats., and was personally liable for the corporation's unpaid withholding and sales taxes. The taxpayer had the **authority** and the **duty** to pay the corporation's withholding and sales and use taxes, and the taxpayer **intentionally breached that duty**.

The taxpayer served as the vice-president and had **authority** to make financial decisions for the corporation. The taxpayer was a signatory on three of the corporation's checking accounts and signed installment agreements with the department. The taxpayer was aware of the corporation's tax problems and was **duty-bound** to address them. The taxpayer was directly involved in the payment of creditors and payroll (including the taxpayer and another officer); therefore, the taxpayer **intentionally breached her duty** to pay the corporation's delinquent taxes.

The taxpayer has not appealed this 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 releases are included:

INDIVIDUAL INCOME TAXES

1 Gain on the Sale of Assets Used in Farming or Business Assets to Related Person

Statutes: Section 71.05(6)(b)9, Wis. Stats. (1995-96), sec. 71.05(6)(b)25, Wis. Stats., as created by 1997 Wisconsin Act 27, and sec. 71.83(1)(d), Wis. Stats., as created by 1997 Wisconsin Act 27 and as amended by 1997 Wisconsin Act 237

Note: This tax release applies only with respect to taxable years beginning on or after January 1, 1998.

Background: Section 71.05(6)(b)9, Wis. Stats. (1995-96), provides an exclusion for 60% of the capital gain on the sale or disposition of assets held more than one year. Capital gains and capital losses are netted before applying the percentage. Section 71.05(6)(b)25, Wis. Stats., as created by 1997 Wisconsin Act 27, provides a subtraction modification to individuals for gains not excluded from taxation under sec. 71.05(6)(b)9, Wis. Stats. (1995-96), on certain assets.

Conditions to Qualify for Subtraction Modification Provided by Sec. 71.05(6)(b)25

The subtraction for gain on the sale or disposition of assets by individuals applies if the following conditions are met:

1. The assets must have been sold or otherwise disposed of to persons who are related to the seller or transferor by blood, marriage, or adoption within the 3rd degree of kinship.