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

Alimony. *Frances A. and Teresa A. Bera, and James Konrath. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 14, 2001). The issue in this case is whether payments made by James Konrath to Teresa Bera in 1995 and 1996 should be considered child support and thus neither taxable to Teresa nor deductible by James, or alimony or separate maintenance and thus taxable to Teresa and deductible by James.

Taxpayers Teresa Bera and James Konrath were divorced in July 1984. The judgment of divorce provided that James was to pay family support in the amount of 25% of his gross weekly income. In August 1995, Teresa and James stipulated to a reduction in James' support obligation from 25% to 17%, because one of the children had attained the age of majority and graduated from high school.

On their 1995 and 1996 Wisconsin income tax returns, Frances and Teresa did not report any family support payment that Teresa received from James in those years. On his 1995 and 1996 returns, James claimed a deduction for alimony or separate maintenance on all amounts he paid to Teresa in those years.

The department issued assessments in the alternative against the taxpayers, based on the inconsistent treatment of James' family support payments to Teresa. With respect to Teresa, the department included the payments in her gross income. With respect to James, the department denied the alimony deduction he claimed. The taxpayers filed timely petitions for redetermination with the department, the department denied them, and the taxpayers filed timely petitions for review with the Commission.

The Commission concluded that the payments made by James Konrath to Teresa Bera in 1995 and 1996 should be considered alimony or separate maintenance and thus taxable to Teresa and deductible by James. The Commission affirmed the department's action relating to Frances and Teresa Bera and reversed its action relating to James Konrath.

The 1995 document did not change the family support to child support. Since the divorce judgment was entered before December 31, 1984, it is governed by section 71 of the Internal Revenue Code prior to the Tax Reform Act of 1984. Because the 1995 stipulation and order did not provide that the post-1984 treatment of section 71 should apply, the pre-1985 provisions also apply to the 1995 stipulation and order.

Neither the department nor the taxpayers have appealed this decision.

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

Alimony. *Melvin O. Seamans, Melvin O. Seamans and Tatyana Vedyasheva, and Leah H. Seamans vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 2, 2002). The issue in this case is whether payments that Melvin Seamans made to Leah Seamans constitute alimony or separate maintenance under section 71 of the Internal Revenue Code ("IRC").

Melvin O. Seamans and Leah H Seamans were divorced in March 1994. The judgment of divorce incorporated the terms of a marital settlement agreement entered into by Melvin and Leah. The marital settlement agreement provided that maintenance to both parties was waived and would be denied, and it also provided for a monthly cash settlement payment payable until Leah's death or remarriage, or until Melvin's death, whichever occurs first. Neither the divorce judgment nor the marital settlement agreement contained any provision that the payments would not be includable in Leah's gross income or deductible by Melvin.

During 1995 through 1998, the years at issue, Melvin paid $900 per month to Leah. She did not report any of those payments as income on her Wisconsin income tax returns. Melvin claimed the payments as a deduction on his Wisconsin income tax returns for 1995 and 1996, and on the joint returns filed with Tatyana Vedyasheva for 1997 and 1998.

The department issued assessments in the alternative against all of the taxpayers with respect to the payments made by Melvin during the years at issue. The assessment against Leah is based on the premise that the payments were reportable as income as alimony or separate maintenance. The assessments against Melvin, and Melvin and Tatyana, are based on the premise that the payments are not deductible as alimony or separate maintenance.

All of the taxpayers filed timely petitions for redetermination with the department, all of which the department denied. The taxpayers then filed timely petitions for review with the Commission.

The Commission concluded that the payments at issue constitute alimony or separate maintenance under IRC sec. 71 because (1) they were paid under a divorce or separation instrument, (2) the instrument did not designate the payments as not includable in Leah's income or non-deductible to Melvin, and (3) the payments will terminate upon Leah's death. The Commission affirmed the assessment against Leah Seamans and reversed the assessments against Melvin Seamans and Melvin Seamans and Tatyana Vedyasheva.

Neither the department nor the taxpayers have appealed this decision.

Appeals - frivolous. *Mark Joseph Rell and Marie Anne Rell vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, December 11, 2001). There is no genuine issue of material fact in this case. Both parties have filed motions for summary judgment. In addition, the department has also moved for the imposition of an additional assessment against the taxpayers, on the grounds that their position in this proceeding is frivolous or groundless.

The taxpayers filed a 1998 Wisconsin income tax form, with a copy of their 1998 federal Form 1040, two Form W-2 wage statements, and a two-page document titled "Attachment to 1998 Tax Return." The taxpayers entered zeros on the first 33 lines of the Wisconsin form, and "1018.24" on line 34 (Wisconsin income tax withheld). They requested a refund of that amount on line 43, which the department did refund to them.

The taxpayers filed a 1999 Wisconsin income tax form, with a one-page form titled "Attachment to 1999 Wisconsin Tax Form 1," a copy of their 1999 federal Form 1040 with a two-page document captioned "Attachment to 1999 1040," and a Form W-2 wage statement. The taxpayers entered zeros on the first 31 lines of the Wisconsin form, and "724.06" on line 32 (Wisconsin tax withheld). They requested a refund of that amount on line 41.

In August 2000, the department issued an estimated assessment to the taxpayers for income tax, interest, and a negligence penalty for 1998 and 1999. The taxpayers filed a document that the department deemed a petition for redetermination, and the department denied it. The taxpayers then filed a timely petition for review with the Commission.

The taxpayers assert that wages are not income that is taxable by Wisconsin. They also assert that they did not receive an "assessment" because the communication from the department is captioned "Notice of Amount Due" rather than "Assessment," that they are being denied due process, that they were denied the "right" to cross-examine department employees, that the assessment is invalidated because some department letters to them were not signed, and that the Wisconsin Legislature improperly delegated its authority by adopting portions of the Internal Revenue Code.

The Commission ruled that the taxpayers' arguments are frivolous, irrelevant, and useless ramblings about the department's authority and the Wisconsin income tax statutes. It also ruled that because the taxpayers have offered nothing but groundless and frivolous arguments, an additional assessment is proper, as provided in sec. 73.01(4)(am), Wis. Stats.

The Commission granted the department's motion for a summary judgment and dismissed the petition for review, denied the taxpayers' motion for summary judgment, and assessed the taxpayers an additional $500.

The taxpayers have not appealed this decision.

Estoppel. *Alfred C. Williams III and Ruth E. Williams vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, November 29, 2001). The issue in this case is whether the department is estopped from collecting its assessments from Ruth E. Williams ("Ms. Williams") on the basis of information she received from a department auditor.

In February 2000, the department issued assessments in the alternative to Alfred C. Williams III ("Mr. Williams") and to Ms. Williams, for tax year 1993. Also in February 2000, the department issued a second assessment to Ms. Williams, for tax years 1994 and 1995. Both taxpayers filed petitions for redetermination with the department, relating to all three assessments, and the department denied all of the petitions for redetermination. The taxpayers then filed timely petitions for review with the Commission, relating to all three assessments.

Ms. Williams and Mr. Williams were divorced from each other in 1993. Among other things, the divorce judgment required Mr. Williams to pay Ms. Williams family support payments each month, for the support and maintenance of the minor children and Ms. Williams. This requirement was for a period of three years, at which time the matter was to be reviewed. In addition, the family support payments were to terminate earlier upon the death of either party, the remarriage of Ms. Williams, or as otherwise provided by statute or case law.

Mr. Williams made the required payments and deducted those payments on his federal and Wisconsin income tax returns as alimony for 1993, 1994, and 1995. Ms. Williams did not include the payments as income on her federal and Wisconsin income tax returns for 1994 or 1995 (she did not file a 1993 return because she believed she did not receive the minimum amount of income to require filing for that year).

At the divorce hearing in January 1993, the presiding judge and Ms. Williams' attorney told her that she must pay income tax on the payments. When her tax preparer prepared her 1994 and 1995 returns, they also told her the payments were taxable income to her. They required her to sign a waiver of any liability before they would prepare returns without including the payments as income, and Ms. Williams signed the waivers.

Ms. Williams testified that a Department of Revenue auditor advised her (after inquiring if the divorce decree used the terms "child support" or "alimony") that she did not have to pay income tax on family maintenance or family support. She relied on that advice in not filing an income tax return for 1993 and not including the payments on her 1994 and 1995 income tax returns. She did not rely on the advice of the judge, her attorney, or her tax preparer.

The Commission concluded that the department is not estopped from collecting its assessments from Ruth E. Williams on the basis of information she received from a department auditor. Four factors must be proven to find estoppel against a non-government person, and estoppel against the Department of Revenue applies only if the four elements are present and it would be unconscionable to allow the state to revise an earlier position. The four factors are (1) action or non-action, (2) the action includes reliance, (3) the reliance must be to the person's detriment, and (4) the reliance must be reasonable.

The Commission held that the general estoppel doctrine is not a valid defense in this case. The action relating to the auditor's advice was not clearly proven because Ms. Williams' testimony was not consistent. Her reliance was not to her detriment because the income was taxable regardless of whether it was taxed earlier or as a result of the assessments. Her reliance was not reasonable because she was told by the judge, her attorney, and her tax preparer that the amounts were taxable; based on this, it was unreasonable to not seek clarification from the department auditor.

Based on the Commission's conclusion, the assessments against Ms. Williams were affirmed, and the assessment against Mr. Williams was reversed.

Neither the department nor the taxpayers have appealed this decision.

Interest income, municipal bonds. *Michael and Betty C. Borge vs. Wisconsin Tax Appeals Commission and Wisconsin Department of Revenue* (Court of Appeals, District IV, December 28, 2001). The issue in this case is whether distributions received by the taxpayers, shareholders of a mutual fund that invests solely in state and local bonds, are included as taxable income for Wisconsin income tax purposes under sec. 71.05(6)(a)1, Wis. Stats.

The taxpayers held shares in mutual funds that invest in certain state and local bonds. The mutual funds receive interest payments on the bonds, subtract expenses and management fees, and distribute the remaining interest payments to the fund shareholders. The taxpayers received such distributions each year from 1993 to 1996.

The distributions are undisputedly tax-exempt for federal income tax purpose. However, the taxpayers also excluded the distributions on their state income tax returns for those years. The department adjusted the returns, asserting that the distributions were taxable under sec. 71.05(6)(a)1, Wis. Stats. The taxpayers appealed the department's determination, arguing that the statute does not tax the distributions because they characterized them as "dividends." The Wisconsin Tax Appeals Commission ruled that the department's determination was correct, and the Circuit Court affirmed the Commission's decision.

The Court of Appeals concluded that sec. 71.05(6)(a)1, Wis. Stats., unambiguously requires the taxpayers to include in their Wisconsin adjusted gross income "any interest … which is not included in federal adjusted gross income." And, under 26 U.S.C. secs. 103(a) and (852)(b)(5), the distributions are treated as "an item of interest" that is excluded from federal gross income.

The taxpayers have not appealed this decision.

Retirement funds exempt. *Edward C. and Jean F. Wilkinson vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 2, 2002). The issue in this case is whether retirement benefits paid to Edward C. Wilkinson ("the taxpayer") are exempt from the Wisconsin income tax.

The taxpayer taught in the Milwaukee city public schools from 1955 to 1967. As of September 1959, he was a member of the Milwaukee School Teachers' Annuity and Retirement Fund ("MTRF"). In April 1967, the taxpayer submitted a signed application for a refund of his contributions, and in June 1967 he received a complete refund of his contributions. The application provided, in part: "As a member of the FUND, I further agree that payments of said accumulation(s) made shall constitute a full and complete discharge and release of all right, interest or claim on my part to state deposit accumulations which accrued while a member of said FUND."

The taxpayer took a position with the University of Wisconsin-Milwaukee and the University of Wisconsin Extension. By virtue of his taking this position, he became a member of the Wisconsin State Teachers Retirement System ("STRS") in August 1967. He returned to employment with the Milwaukee public schools in 1974, until his retirement in 1990.

When he retired, the taxpayer received a copy of the department's Publication 108, *How Your Retirement Benefits Are Taxed*, dated June 1989. The publication provided, in part, that some payments received from the Wisconsin Retirement System are exempt for Wisconsin tax purposes, including such payments paid "on the account of a person who was a member of the … Milwaukee Teacher's Retirement System as of December 31, 1963…." He relied on the publication in preparing the taxpayers' Wisconsin income tax returns for 1991, 1992, and 1993 ("the years at issue"). The taxpayers assert that this publication led them to believe the taxpayer's pension was not taxable, and therefore the department is equitably estopped from imposing Wisconsin income tax on the retirement payments.

Following the withdrawal of his MTRF contribution in 1967, the taxpayer had on account with the STRS no deposits from either him or the state attributable to his teaching service prior to 1967. In 1990, he applied to the Wisconsin Retirement System to purchase previously forfeited years of service under the MTRF. For the years at issue, the taxpayer's retirement benefits from the WRS included benefits for the years previously forfeited.

The taxpayer received payments from the WRS in 1991, 1992, and 1993 but did not include the income on the taxpayers' Wisconsin income tax returns for those years. The department issued an assessment against the taxpayers for those years, on which it asserted that the WRS payments were subject to Wisconsin income tax. The taxpayers filed a petition for redetermination with the department, which it denied, and the taxpayers then filed a timely petition for review with the Commission.

The Department of Employee Trust Funds interprets and applies Wisconsin's law to mean that an eligible employee who purchases previously forfeited creditable service obtains the right to use the purchased years of service only to determine the final amount of that person's retirement annuity and insurance eligibility at retirement, not to reinstate or restore any other rights the person may have had in the retirement system or its predecessor before withdrawing from the system.

The Commission concluded that the retirement benefits paid to the taxpayer are not exempt from the Wisconsin income tax because they were not paid on the account of a person who was a member of an eligible retirement system as of December 31, 1963. After the taxpayer withdrew all of the assets that remained in his MTRF account subsequent to December 31, 1963, there was nothing in the account to which he had a right.

The taxpayers' estoppel argument fails in two respects. First, one of the elements of estoppel against the department is that the conduct of the department must be unconscionable. The department accurately paraphrased a statute in its publication, even though parts of the statute had not yet been construed by the courts and the Commission. It would thus be unconscionable to allow the taxpayers to prevail on this point, as the department did not mislead the public about the meaning of the statute. Second, the taxpayers have not shown that they have suffered a detriment. Their reliance on the publication led them to their failure to report the taxpayer's retirement payments, which in turn led to an assessment for the tax that was not paid but was owed in the first place. This does not constitute a detriment.

The taxpayers have appealed this decision to the Circuit Court.

SALES AND USE TAXES

Aircraft - taxable use. *G & G Trucking, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 3, 2001). The issue in this case is whether the taxpayer made taxable use of aircraft purchased for the purpose of lease or rental.

The taxpayer is a Wisconsin corporation engaged in the business of interstate trucking. During the period under review, the taxpayer purchased aircraft, and maintenance service and repair parts for the aircraft, without payment of Wisconsin sales or use tax.

Prior to purchasing the aircraft, the taxpayer entered into oral lease agreements to lease the aircraft to aircraft charter companies. The oral lease agreements provided that:

A. Each charter company must take possession of the aircraft it leases and keep the aircraft in its hangar in Wisconsin.

B. The charter companies are responsible for keeping their leased aircraft in a safe and secure location and for all insurance, registration and licensing, cleaning, and maintenance.

C. The charter companies must make reasonable efforts to charter the aircraft to people needing the service and must pay the taxpayer a negotiated rental fee based on the number of hours each is chartered.

D. The charter companies are solely responsible for scheduling the use of their leased aircraft and for selecting, training, and paying pilots. The charter companies may bill the taxpayer for some items, such as maintenance. The taxpayer pays a special monthly fee to have its lessees house the aircraft indoors year-round.

E. Either party may terminate the agreement by giving a 30 day notice to the other party.

When a third party chartered an aircraft, a flight was scheduled and an initial charter fee was paid. The third party also paid a $350 pilot fee and a per hour fee of $850, which included fuel.

When the taxpayer chartered aircraft, the taxpayer would reserve an aircraft but it did not pay an initial charter fee. If one of the aircraft owned by the taxpayer was not available, the taxpayer would either not go on the flight, or arrange alternate transportation consisting of “trading hours” with the owner of another aircraft leased to the charter company. The taxpayer had a special hourly rate, equal to the hourly rate the owner of the other aircraft paid to the taxpayer. The charter company did not separately bill its charges to the taxpayer, but rather offset them against the rental fee paid to the taxpayer for the lease of the aircraft. The taxpayer also paid for fuel, and other amounts typically charged to third party charter customers, such as the pilot fee.

The Commission concluded that the taxpayer made use of the aircraft as that term is defined in sec. 77.51(22)(a), Wis. Stats. (1999-00), because the taxpayer had the right to use the aircraft, and did use them. The taxpayer’s use of the aircraft was more than "solely for lease or rental" as described in sec. Tax 11.29(2)(a), Wis. Adm. Code (June 1991 Register), and the purchase of the aircraft, parts, and maintenance are subject to the use tax.

The taxpayer has appealed this decision to the Circuit Court.

Officer liability. *Eugene C. Rondon vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, January 29, 2002). This is a judicial review of a Wisconsin Tax Appeals Commission decision dated June 5, 2001. See *Wisconsin Tax Bulletin* 127 (October 2001), page 25, for a summary of the Commission’s decision. The issue in this case is whether the taxpayer is a responsible person who is liable for the unpaid sales taxes of National Vehicle Management, Inc. (“the corporation”), under sec. 77.60(9), Wis. Stats., for the periods of February, May through August, November, and December 1995, and January through July 1996, and for a dealer plate project assessment for January 1992 to December 1995.

The taxpayer was president and sole shareholder of the corporation, was in charge of the corporation's day-to-day operations, and was authorized to sign checks on the corporation's checking account.

In May and December 1995 and January 1996, the taxpayer signed and issued checks to pay creditors other than the department, even though he knew there were unpaid sales taxes due to the department.

The taxpayer signed all of the corporation's monthly Wisconsin sales and use tax returns for the period under review, reporting taxes due to the department. The taxpayer, on behalf of the corporation, also signed an agreement with the department on October 12, 1995, acknowledging sales and use tax delinquencies through August 1995.

The Circuit Court concluded that the Commission properly granted summary judgement to the Department of Revenue in the absence of any disputed issue regarding any material fact.

The taxpayer's claim that the department violated his rights to due process is unfounded because sec. 77.60(9), Wis. Stats., is clear and unambiguous. The department's interpretation of the statute is reasonable, and giving great weight to the Commission's interpretation, the finding of wilfulness is upheld. The taxpayer’ claim that the assessment is an "excessive fine" is not supported because the assessment simply recovers the amount of revenue lost to the state as a result of his conduct.

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

Services subject to tax - emergency response services. *SSM Health Care vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 22, 2002). The issues in this case are:

A. Whether the taxpayer's emergency response services provided in its Lifeline Program telephone or telecommunication services are subject to Wisconsin sales or use tax.

B. Whether the taxpayer's Lifeline Program is a rental of tangible personal property subject to Wisconsin sales or use tax.

C. What is the proper interest rate if the service or rental is subject to tax?

The taxpayer is a tax exempt organization engaged in operating nonprofit hospitals and nursing homes and providing health care services.

The Lifeline Program offered by the taxpayer is a 24-hour emergency response system providing security and support to subscribers so they may live independently in their own homes. A person interested in the program completes an information sheet and a monitoring plan agreement specifying the obligations and responsibilities of the subscriber, and the commitments, duties, and responsibilities of the Lifeline Program, and specifically the third party company which actually provides the emergency response service. Upon receipt of the signed monitoring plan agreement, the taxpayer arranges for installation of the emergency response equipment in the subscriber's home. While the equipment is in the subscriber's home, the taxpayer maintains and services the equipment.

The equipment installed in the subscriber's home consists of two units. The first, a communicator, is connected to the subscriber's existing telephone jack. The subscriber's telephone is then connected to the communicator. The second unit is a portable help button worn by the subscriber on either a pendant hung from the neck or a wrist strap. When assistance is needed, the subscriber presses the help button, which sends a radio signal and activates the communicator. The communicator then automatically dials the telephone number of the third party emergency response service provider located in a state outside Wisconsin. The service provider's staff answers the telephone call from the communicator, and attempts to communicate with the subscriber over a powerful speakerphone built into the communicator. If the subscriber is unable to speak, the staff member will call either neighbors or relatives, if available, or local emergency services. The service provider's staff has access to files containing emergency notification information about each subscriber.

In addition to the voice model communicator, the service provider also offers an alarm model communicator, which only dials the service provider's staff and alerts them the subscriber needs assistance. The staff member must then either place a telephone call to the subscriber to make voice contact, or call neighbors or relatives, if available, or local emergency services. Both communicator models feature a timer allowing the subscriber to set a time period after which, if the timer is not reset, the communicator automatically dials the service provider's staff who them attempts to place a telephone call to the subscriber to make voice contact, or calls neighbors or relatives, if available, or local emergency services.

To use the Lifeline Program, a subscriber must have telephone service through an independent telephone service provider, who bills the subscriber directly. The subscriber is responsible for installation and maintenance of any local and long distance service.

The taxpayer charges a subscriber an initiation fee, part of which goes to the third party service provider, and a monthly Lifeline Program fee for either model of communicator. A portion of the monthly Lifeline Program fee also goes to the service provider.

The Lifeline Program is not regulated by the Federal Communications Commission or the Wisconsin Public Service Commission. The equipment used in the program does need to comply with FCC rules regarding radio communication equipment.

The Commission concluded as follows:

A. The taxpayer's emergency response services provided in it's Lifeline Program are not telephone or telecommunication services subject to Wisconsin sales or use tax. Nothing in the statutes imposes sales tax on the services provided in the Lifeline Program. In *Wisconsin Tax Bulletin* 34 (October 1983), page 13, the department discussed the issue of a "direct connect" burglar and fire alarm protection service in a tax release and concluded that the protection service was not taxable. The Lifeline Program service is similar to the direct connect protection service, and the gross receipts for providing the Lifeline Program service are also not taxable.

B. The taxpayer's Lifeline Program is not a rental of tangible personal property subject to Wisconsin sales or use tax. The Lifeline Program provides subscribers with two pieces of equipment, the rental of which is not the true objective of the service provided by the taxpayer. Subscribers purchase a service by which they may obtain emergency response assistance, and the equipment is incidental to this service.

C. It is not necessary to determine the proper interest rate, because the service or rental is not subject to tax.

The department has not appealed this decision but has filed a notice of nonacquiesence with regard to those parts of the decision that state or imply that the Lifeline Program must be specifically enumerated in a tax imposition statute in order to be taxable. The department considers sec. 77.52(2)(a)5m, Wis. Stats., as created by 1997 Wis. Act 27 effective for transactions that occurred on or after December 1, 1997, to require imposition of tax on Lifeline Program gross receipts after the period involved in this case (1989 through 1992). The effect of this action is that, although the decision is binding on the parties in this case and will be extended to other parties providing or purchasing the Lifeline Program until November 30, 1997, the Commission's conclusion of law, the rationale, and construction of statutes with regard to the Lifeline Program are not binding on or required to be followed by the department in other cases.