Report on Litigation

Summarized below are recent significant Wisconsin Tax Appeals Commission (WTAC) and Wisconsin Court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher Court.

The following decisions are included:

INDIVIDUAL INCOME TAXES

Assessments – issuance after a delinquent tax clearance; Assessments – offset of a refund; Assessments – timeliness; Assessments – correctness. *Allen G. Bedynek vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 11, 2003). The issues in this case are:

A. Whether the department properly assessed the taxpayer for the years 1995 and 1996.

B. Whether the department properly offset the taxpayer's refund for the years 1998 and 1999 against the amounts assessed for 1995 and 1996.

C. Whether the department's assessment was made in a timely manner.

D. Whether the issuance of a "clearance letter" by the department precluded the issuance of an assessment to the taxpayer.

In December of 2000, the taxpayer requested a "tax clearance certificate" or other written documentation that he had a zero balance owing to the department. In January, 2001 the department issued an "Occupation License Delinquent Tax Release" that provided, in part:

> This is to certify that an examination of the delinquent tax roll of the Department of Revenue has been made and as of this date, the person named above is not liable for delinquent taxes.

Attached to the document was a "Statement of Delinquent Tax Account" that showed the taxpayer had a zero balance.

In February of 2001, the taxpayer filed homestead credit claims for the years 1998 and 1999. During the processing of these claims, the department discovered, based on documentation received from the Internal Revenue Service, that the taxpayer had received substantially more income than was reported on his 1995 and 1996 Wisconsin income tax returns.

The department determined that the taxpayer owed additional income tax on the unreported income that he received in 1995 and 1996, and that he was not entitled to the homestead credits he had received for those two years. The department also determined that the taxpayer was entitled to the homestead credits claimed for the years 1998 and 1999. In April of 2001, the department issued a notice of assessment to the taxpayer for the years 1995, 1996, 1998 and 1999, in which the refunds for 1998 and 1999 were offset against the amounts due for 1995 and 1996. The taxpayer filed a petition for redetermination with the department, the department denied it, and the taxpayer filed a timely petition for review with the Commission.

The taxpayer raised multiple arguments, most of which the Commission determined lacked any merit. Among the arguments raised that the Commission determined had some merit were:

- The department failed to demonstrate that the documentation received from the Internal Revenue Service justifies the assessment.

- The department improperly withheld the homestead credits for which he was eligible in 1998 and 1999. The taxpayer pointed to Secs. 71.89(1) and (3) Wis. Stats., which stay most of the department's collection efforts once a hearing has been requested or an appeal has been filed with the Commission.

- A Circuit Court action in 1998, which resulted in a refund being issued to the taxpayer that had been withheld by the department against an assessment that was the subject of an appeal, was still binding on the department.

- The assessment was issued more than four years after the returns for 1995 and 1996 were filed, thus it was not timely.

- As the department issued a tax clearance letter and Statement of Delinquent Tax Account in January 2001, they were precluded from subsequently issuing an assessment.

The Commission concluded as follows:

A. The taxpayer failed to offer any credible or substantial evidence showing that the assessment issued by the department was incorrect. All he has done is to assert, without evidence or authority, that the documentation from the Internal Revenue Service is unreliable, erroneous, or incorrect.

B. Prohibitions on collection activity during the pendency of an appeal before the Commission do not apply to offsets withheld by the department as part of an assessment prior to appealing the department's action to the Commission. The Circuit Court action taken in 1998 on collection activity of the department at that time is an entirely different situation and is not binding on the department.

C. The assessment with respect to the taxpayer's 1995 and 1996 income tax returns was timely. Ordinarily, the statute of limitations for income tax assessments is four years following the date the return was filed (Sec. 71.77(2) Wis. Stats.). However, if the taxpayer reported less than 75% of the income properly assessable, then the statute of limitations is six years following the date the return was filed (Sec. 71.77(7)(a) Wis. Stats.). The taxpayer did report less than 75% of the income properly assessable on his 1995 and 1996 income tax returns, and the department's assessment was issued within six years following the dates the returns were filed.

D. The issuance, 95 days prior to the assessment, of a "clearance letter" by the department stating that the balance of the taxpayer's delinquent tax account was zero, did not preclude the department from issuing the assessment against him. The "clearance letter" pertained only to delinquencies on record at that time with the department. It cannot be read to mean that the taxpayer had no potential liability that would not emerge if he were assessed.

The taxpayer has appealed this decision to the Circuit Court.

SALES AND USE TAXES

Exemptions – manufacturing machinery and equipment. *Hammersley Stone Company, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 13, 2003). The issue in this case is whether the furnishing of crushing equipment with operators, for crushing stone used in the taxpayer's construction activities, was a sale of a taxable service or a lease of equipment that qualifies for the exemption for manufacturing machinery and equipment.

The taxpayer was a Wisconsin corporation engaged in the business of real property construction contracting, in which it acted as a general contractor or a subcontractor on construction projects. The taxpayer also operated two quarries on leased property from which it extracted stone which it crushed, and on which it performed additional services (i.e., screening, sorting) before applying most of the resulting crushed stone products in its construction activities. The taxpayer also sold a minor amount of stone to third parties.

The taxpayer separates rock from quarry walls by first removing the dirt from on top of the rock, then drilling holes into and setting off charges to break the rock loose from the quarry wall. The rock is then lifted from the quarry floor by end loader and dumped into a crusher.

During the calendar years 1994 through 1997, the taxpayer had oral lease agreements with several companies, the two at issue having been formalized in writing in 1998 and made retroactive to January, 1994, to use another company's (Company Y's) crushing equipment and operators at one of the taxpayer's quarries for

crushing the stone used in the taxpayer's construction activities.

Company Y's crushing equipment was portable and Company Y paid for its setup and dismantling. Company Y provided the taxpayer with a primary and secondary (and sometimes a third) stone crusher, one or two end loaders or wheeled loaders, a conveyor system, and two or three employees. Company Y's invoices did not itemize the cost of leasing the various pieces of equipment or the employees. The end loaders removed stone from the banks of the quarry and dumped it into the primary crusher, which did the initial crushing to the size of three to four inches. The secondary crusher crushed the stone to the size of one inch, and the third crusher, when used, crushed the stone into sand. The conveyor moved crushed stone from one crusher to another, and from the crushers to stockpiles.

The Commission concluded that the taxpayer was leasing stone crushing equipment with operators from another company (Company Y), for crushing stone used in the taxpayer's construction activities, which qualified for the exemption for manufacturing machinery and equipment provided by sec. 77.54(6)(a), Wis. Stats.

Although the Commission previously ruled in the decision *Hammersley Stone Company, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 17, 1998), as reported in *Wisconsin Tax Bulletin* 112, page 27, that the taxpayer was properly assessed use tax on its purchase of crushing "services" during the years 1990 through 1993, the Commission ruled that the taxpayer's "lease" of the equipment in the present case was different from the purchase of crushing services in the prior case, and that the leased equipment was used in manufacturing.

The department has appealed this decision to the Circuit Court.

Use tax – transfer of tangible personal property from related corporation. *River City Refuse Removal, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, August 19, 2003). The issues in this case are:

A. Whether tangible personal property the taxpayer received by intercompany transfer from separately organized affiliated entities is subject to Wisconsin use tax.

B. Whether the taxpayer's failure to report use tax on its intercompany transfers and other purchases was subject to the negligence penalty under sec. 77.60(3), Wis. Stats.

During the period from October 1, 1993 through September 30, 1997, the taxpayer, a wholly-owned subsidiary of Browning-Ferris Industries, Inc. (BFI), was a Wisconsin corporation with its headquarters and principal place of business in Eau Claire, Wisconsin.

The taxpayer was primarily engaged in the business of hauling refuse and recyclables for Wisconsin residences and businesses.

Other subsidiaries of BFI (BFI subsidiaries) transferred to the taxpayer items of tangible personal property such as trucks, tractors, and tractor trailers. The taxpayer did not provide BFI subsidiaries with exemption certificates claiming any exemption on these transfers. These "intercompany transfers" included all rights to, and ownership of, the transferred assets. The motor vehicles transferred were re-titled in the taxpayer's name with the Wisconsin Department of Transportation. The assets transferred were depreciated on the taxpayer's income or franchise tax returns. The taxpayer paid no sales or use tax on the intercompany transfers.

The BFI subsidiaries that transferred assets to the taxpayer were separate, legal, corporate entities from the taxpayer and were not divisions or units of the taxpayer. The taxpayer's bookkeeping entry for the receipt of the intercompany transfers was to debit the specific asset account and credit an intercompany account. No money was exchanged or expected between the BFI subsidiaries and the taxpayer for the intercompany transfers. The taxpayer received no invoice or other bill in connection with the receipt of intercompany assets.

The Commission concluded:

A. The intercompany transfers of tangible personal property to the taxpayer from BFI subsidiaries had no mercantile intent and were not subject to Wisconsin use tax. There was no transfer for remuneration or consideration, no exchange of money or expectation of payment and the transfers resulted in the taxpayer's receiving no invoice or other bill. The taxpayer's recording of the trans

ferred property on its books as payables or liabilities, depreciation of the property, and reconciliation of the transfers on the records of BFI and its subsidiaries did not result in any promise of payment.

B. The negligence penalty is cancelled because the taxpayer met its burden of showing its failure to report the use tax was because the issue was under appeal in another case at the time of assessment, and thus "due to good cause and not due to neglect."

The department has appealed this decision to the Circuit Court.

DRUG TAX

Drug tax, appeals - jurisdiction. *Forest J. Morkin vs. Wisconsin Department of Revenue* (Circuit Court for Walworth County, January 10, 2003).

In the previous issue of the *Wisconsin Tax Bulletin,* it was reported that the taxpayer had not appealed the Circuit Court's decision to dismiss the petition for review. See *Wisconsin Tax Bulletin* 135 (July 2003), page 19, for a summary of the Circuit Court decision. The taxpayer, however, has appealed the Circuit Court decision to the Court of Appeals.