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:

SALES AND USE TAXES, AND WITHHOLDING OF TAXES

Closing Agreements - finality. *Michael A. Pharo vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, April 7, 2004). The issue in this case is whether the department's motion to dismiss the taxpayer's petition for review should be granted on the basis that the parties had previously entered into a Closing Agreement.

On October 18, 1999, the department issued an assessment to the taxpayer for $24,646.98 for withholding tax, interest, and a penalty under sec. 71.83(1)(b)2, Wis. Stats. regarding personal liability for the withholding taxes of American Security & Protection for the periods January 1995 through April 1995, October 1995 through July 1996, and October 1996 through May 1997. On December 21, 1999, the taxpayer filed a petition for redetermination of the assessment.

On January 7, 2000, the department sent the taxpayer a letter requesting additional information, to which the taxpayer replied by letter dated February 4, 2000. On March 27, 2000, the department sent the taxpayer a letter notifying him that the case had been assigned to a Resolution Officer and setting forth the facts of the case. On May 15, 2001, the taxpayer sent the department a letter and, among other things, stated that he was "willing to enter into a negotiated settlement…."

On July 30, 2002, the parties entered into a "Closing Agreement" settling the case. In that agreement, the parties stipulated "that this agreement and the payment of…[amounts agreed to as withholding taxes] shall serve as a final disposition of the office audit assessment" in dispute. The settlement amount was $9,350.29, which the taxpayer paid.

On December 1, 2003, the taxpayer appealed to the Commission the same taxes covered in the July 30, 2002 Closing Agreement. In his petition for review the taxpayer argued, as he asserted in his petition for redetermination to the department, that he was not the responsible officer or party for paying the taxes at issue. He also raised three additional objections: (1) he had no knowledge of taxes due in the assessment; (2) he did not fail to pay taxes; and (3) he disagreed with the calculations of the amount of the settlement.

The Commission concluded that the department's motion to dismiss the taxpayer's petition for review should be granted. The taxpayer and the department entered into a Closing Agreement to settle the department's assessment and the taxpayer's disagreement with it. Portions of the settlement agreement read as follows:

> IT IS HEREBY STIPULATED AND AGREED That *for purposes of settlement* of the office audit assessment dated October 18, 1999, the correct adjusted amounts of the above named, Michael A. Pharo…are in the amounts set forth on the attached schedule(s)….[Emphasis supplied.]
>
> IT IS FURTHER STIPULATED that this agreement permits the taxpayer to make monthly payments as set forth on the attached schedule….
>
> IT IS FURTHER STIPULATED that this agreement and the payment of…[the amounts agreed to] *shall serve as a final disposition* of the office audit assessment referred to above. [Emphasis supplied.]

The Commission and the judiciary have long recognized that the parties to a Closing Agreement can rely on the finality of the agreement. The taxpayer can rely on it to preclude future department assessments on the same issues for the same periods specified, and the department can rely on it to resolve any later claims or assertions on the same matters for the same periods. The title of the "Closing Agreement" and its contents (especially the provisions cited above) clearly demonstrate

that the document resolved the dispute between the parties over the October 18, 1999 assessment. The agreement's language and the reason for both parties agreeing to the document are clear and unequivocal.

The taxpayer asserts that "This Closing Agreement…did not determine liability. At no time did the Petitioner wave [sic] his rights to further appeal…." He further argues that he "was not the responsible party for payment [of] the taxes of the Corporation…; he only attempted to resolve the matter at hand as an intermediary." These assertions lack merit. They attempt to negate the agreement that the taxpayer and the department freely entered into. If this argument prevailed, future parties could resolve a matter by settlement, then appeal to the Commission with the hope they might get an even better deal. The tax appeals system would be flooded with matters already resolved, and could not function that way.

The taxpayer also contends that he is entitled to a review by the Commission on any assessments made by the department. That broad statement is not accurate. It ignores that there are statutory time periods for filing appeals; that the Commission only has jurisdiction over specified matters; and the finality of clear, unambiguous agreements that are freely entered into.

The taxpayer 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* (Circuit Court for Dane County, August 2, 2004). This is a judicial review of a Wisconsin Tax Appeals Commission decision dated August 19, 2003. See *Wisconsin Tax Bulletin* 136 (October 2003), page 19, for a summary of the Commission's decision. 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 under sec. 77.53(1), Wis. Stats.

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 was a separately incorporated Wisconsin corporation and wholly-owned subsidiary of Browning-Ferris Industries, Inc. (BFI), with its headquarters and principal place of business in Eau Claire, Wisconsin.

The taxpayer was primarily engaged in the business of collecting refuse and recyclables from Wisconsin residences and businesses and hauling those materials to landfills or recycling centers.

Other subsidiaries of BFI (BFI subsidiaries) transferred to the taxpayer items of tangible personal property such as motor vehicles and related assets. 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 retitled in the taxpayer's name with the Wisconsin Department of Transportation. The assets transferred were valued at net book value (original purchase price less accumulated depreciation), entered into the taxpayer's financial records at that value, and 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 intercompany asset account and credit an intercompany payable 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 decision held that (1) the intercompany transfers of tangible personal property to the taxpayer from BFI subsidiaries were not subject to Wisconsin use tax because there was no transfer for remuneration or consideration, and (2) the negligence penalty did not apply as the taxpayer's failure to report the use tax was "due to good cause and not due to neglect."

The Circuit Court, in a de novo review (giving the Commission decision no weight), reversed the Commission on both issues.

The Circuit Court found that each subsidiary is a separate legal corporation whose own financial records are solely considered for state tax purposes. Although BFI owns all the subsidiaries, each subsidiary is properly viewed as an independent entity and a separate party to the exchange of goods. It is irrelevant that the consolidated books of BFI are not affected by the transactions, which net to zero on BFI's financial records. The subsidiaries are "retailers" as provided in sec. 77.51(13)(b), Wis. Stats., because the transactions are not occasional sales, but rather constitute transfers of assets previously used by the BFI subsidiaries to conduct a trade or business for which the gross receipts are subject to sales tax.

The Circuit Court further found that the accounting entries for the transactions amounted to an expectation of payment and a change in financial records resulting in consideration, indicating the transactions were purchases under sec. 77.51(12)(a), Wis. Stats. Further indicators of the transactions being purchases are the taxpayer's depreciation of the transferred assets, and the subtraction of the net book value of two vehicles in order to report a lower capital gain upon the sale of each vehicle.

Because the asset transfers from the BFI subsidiaries to the taxpayer were purchases from retailers, the Circuit Court concluded they were subject to the Wisconsin use tax under sec. 77.53(1), Wis. Stats.

The Circuit Court also found that the negligence penalty was properly assessed by the department because the taxpayer had previously been audited for use tax, was aware the department considered the transfers to be taxable, and pending litigation upon which the taxpayer was relying did not commence until after the end of the period under review.

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