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

Bad debts. *DaimlerChrysler Services North America LLC vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, September 7, 2004). The issue in this case is whether the taxpayer may claim a refund for bad debts resulting from installment contracts assigned to the taxpayer by motor vehicle dealers and later found to be worthless.

During the years 1997, 1998, and 1999, Wisconsin motor vehicle dealers entered into retail installment contracts with motor vehicle purchasers. The dealer then paid the sales tax to the Department of Revenue. The amount financed under each contract consisted of the purchase price of the motor vehicle and the sales tax that was charged on the vehicle.

The retail installment contracts were then assigned to the taxpayer. The taxpayer did not pay the sales tax due on each contract to the Department of Revenue. The taxpayer paid the full amount financed, including the sales tax, to the dealer when the contract was assigned to the taxpayer. After the taxpayer purchased the contracts from the dealers, the vehicle purchasers owed the amount financed to the taxpayer.

When a vehicle purchaser went into default on a contract purchased by the taxpayer, the taxpayer repossessed the vehicle and sold it at auction to a third party. The taxpayer then applied the auction proceeds to the amount due from the purchaser, leaving an unpaid balance due. The taxpayer determined the unpaid balances on the default contracts were worthless and bad debts, and charged the unpaid balances off for income tax purposes, including a proportional share of the sales tax paid to the dealer when the contract was assigned to the taxpayer. The taxpayer held a Wisconsin seller's permit because it sold and leased motor vehicles in addition to financing dealer sales of motor vehicles. The taxpayer did not take a bad debt deduction on its sales and use tax return for any of the bad debts resulting from the default contracts.

The Commission concluded that the taxpayer was not entitled to a Wisconsin sales tax bad debt deduction for the default contracts because the taxpayer was not the retailer that previously paid the sales tax to the Department of Revenue as required by secs. 77.51(4)(b)4 and 77.52(6), Wis. Stats. The Commission also held that the taxpayer was not entitled as an assignee under the contracts at issue to claim a deduction that the assignor possessed, had no such assignment occurred.

The taxpayer has appealed this decision to the Circuit Court.

Computer software - taxability (canned vs. custom programs). *Menasha Corporation vs. Wisconsin Department of Revenue* (Circuit Court for Dane County, October 26, 2004). This is a judicial review of a Wisconsin Tax Appeals Commission decision dated December 1, 2003. See *Wisconsin Tax Bulletin* 137 (January 2004), page 29, for a summary of the Commission's decision. The issue in this case is whether computer software purchased by the taxpayer was tangible personal property and subject to sales or use tax.

The taxpayer is a Wisconsin corporation that produces packaging, paperboard, material handling, plastics, promotional materials, and printing in numerous states and in eight countries.

During the period under review, the taxpayer purchased integrated business application computer software as a result of an evaluation of its business and accounting software systems. After approximately two years of evaluation, the taxpayer purchased the software at a cost of $5.2 million.

The software consisted of the taxpayer's selection from more than 70 software modules, each of which were designed to provide a different aspect of the business and accounting computer software system for a segment of the taxpayer's business. The basic modules required customization using a specific programming language in order for the software system to serve the taxpayer's business and accounting needs.

The software was delivered to the taxpayer on multiple CD-ROM disks, which were installed over a two day period onto the taxpayer's computer hardware by a former employee of the software vendor. The customization and testing of the software was done by an implementation team and a programming team consisting of employees of the taxpayer as well as employees of the software vendor and third party consultants. The total cost of customizing and implementing the new software added approximately $17.8 million to the initial cost of the software.

The customization and testing of the software, and training of the taxpayer's employees in its use took approximately nine months. The software vendor continues to provide technical support, upgrades, new releases, and patches to the software.

Using six of the seven factors for determining whether a program is a custom program listed under sec. Tax 11.71(1)(e), Wis. Adm. Code, the Commission concluded the software was custom software, because there had been: (1) significant presale consultation, (2) installation by a former employee of the vendor and extensive testing, (3) substantial training and written documentation, (4) enhancement and maintenance support, (5) a cost greater than $10,000, and (6) the software was not "prewritten" software because of the significant efforts required to bring it on-line for the taxpayer under factors 1-4. The Commission determined that factor seven—pre-existing programs which need to be significantly modified by the vendor to be usable—was not applicable as the Commission already had concluded that the software was custom.

Giving "due weight" to the Commission's decision, the Circuit Court found that the Commission's omission of the seventh factor was in error. The Circuit Court also found that: (a) the installation by a former employee of the vendor did not mean the software was installed *by the vendor* under factor two; (b) the fact the software's cost was in excess of $10,000 did not mean it was custom software under factor five; (c) the software **is** "prewritten" software under factor six as defined in sec. Tax 11.71(1)(k), Wis. Adm. Code; and (d) the vendor's involvement in the customization of the software was minor in relation to that of the consultants and the taxpayer's own employees such that the pre-existing programs were not considered significantly modified *by the vendor* under factor seven. Because the software was not custom, but prewritten, its sale was subject to sales tax.

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

Gross receipts – discounts reimbursed by manufacturer. *Braeger Chrysler Plymouth Jeep Eagle, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, October 12, 2004). The issues in this case are:

1. Were payments received by the taxpayer from the manufacturer of the vehicles under an employee/retiree new vehicle purchase/lease program required to be included in the taxpayer's gross receipts from the sale or lease of the vehicle to the purchaser/lessee?

2. Was the taxpayer deprived of due process by a letter written by the Department of Revenue to a motor vehicle dealership association subsequent to the period under review confirming that the payments received by the taxpayer from the manufacturer were subject to tax?

The taxpayer is a Wisconsin corporation and holds a Wisconsin seller's permit for the purpose of selling motor vehicles as an authorized dealer for a vehicle manufacturer (the "manufacturer"). The taxpayer participates in the manufacturer's program ("program") of selling or leasing vehicles to employees of the manufacturer, retirees, and their family members ("participants").

When selling or leasing a vehicle to a program participant, the taxpayer reduces the price of the vehicle by an amount agreed to in a program agreement the taxpayer has with the manufacturer. Subsequent to a sale or lease transaction with a participant, the manufacturer sent a program payment to the taxpayer of six percent of the employee purchase price plus $75.

In a letter to the motor vehicle dealership association subsequent to the period under review the department confirmed that the program payments received by the taxpayer from the manufacturer were subject to tax.

The Commission concluded that the payments received by the taxpayer from the manufacturer of the vehicles under the program were required to be included in the taxpayer's gross receipts from the sale or lease of the vehicle to the participant. The payments were not reductions of the purchase price, "holdbacks" (amounts a manufacturer includes in dealer invoices but returned to the dealer as a credit), or wholesale incentives (amounts a manufacturer pays to dealers for selling a certain number of vehicles). It did not matter how the payments by the manufacturer were labeled. They were still credits paid to the taxpayer in the same manner as the payments to the dealer in the case of *Schenker vs. Wisconsin Department of Revenue* (Dane County Circuit Court, September 1998). A summary of the Commission decision in *Schenker*, affirmed by the Court, appeared in *Wisconsin Tax Bulletin* 110 (July 1998), page 22. The Commission concluded that the program payments were more analogous to rebates and coupon discounts reimbursed by a manufacturer, which are subject to tax.

The Commission also concluded that the taxpayer was not deprived of due process by a letter written by the Department of Revenue to a motor vehicle dealership association subsequent to the period under review confirming that the payments received by the taxpayer from the manufacturer were subject to tax. The letter written by the department did not convey a new policy, but merely restated the existing taxability of the program payments which were taxable as provided in the Wisconsin Statutes, Wisconsin Administrative Code, *Wisconsin Tax Bulletins*, and the *Schenker* case, all of which existed during the period under review.

The taxpayer has appealed this decision to the Circuit Court.