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

Gambling losses. *Dennis C. and Jacqueline S. Mahoney vs. Wisconsin Department of Revenue* (Court of Appeals, District II, December 23, 2008). See *Wisconsin Tax Bulletin* 153 (October 2007), page 20, for a summary of the Wisconsin Tax Appeals Commission decision. The Circuit Court's prior decision was not summarized in the *Wisconsin Tax Bulletin*. The issue in this case is whether the department properly disallowed the deduction for gambling losses claimed by the taxpayers.

The department issued an income tax assessment against the taxpayers disallowing the deduction for gambling losses claimed on the 2003 Wisconsin income tax return, and the taxpayers sought review before the Commission. The taxpayers argued that although the gambling losses could not be deducted as a miscellaneous itemized deduction for Wisconsin income tax purposes, they could be subtracted from federal adjusted gross income under sec. 71.05(6)(b)5., Wis. Stats. The Commission concluded that the taxpayers failed to demonstrate that sec. 71.05(6)(b)5., Wis. Stats., allows a deduction for gambling losses and failed to show that the department's assessment was in error. The taxpayer petitioned the Circuit Court for review of the Commission's decision, and the Circuit Court affirmed the Commission.

The Court of Appeals affirmed the Commission's decision that the taxpayer was not entitled to a deduction for gambling losses under sec. 71.05(6)(b)5., Wis. Stats. The Court also rejected the taxpayers' argument that the Wisconsin Constitution does not permit the taxation of gambling income of a non-professional gambler because that income does not fall within the common, ordinary meaning of income. Therefore, the Court of Appeals affirmed the Circuit Court's order upholding the Commission.

The taxpayers have not appealed this decision.

Tax-option (S) corporation losses – basis limitation. *Wayne Roden and Suzanne Balistreri vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 26, 2009). The issue in this case is whether the department properly disallowed the taxpayers' deduction for tax-option (S) corporation losses due to basis limitation.

By notice dated December 13, 2004, the department issued an income tax assessment against the taxpayers that, in part, disallowed the losses from Golf Fitness, Inc., a closely-held S corporation of the taxpayers. The taxpayers filed a timely petition for redetermination of the department's assessment, which was denied by the department by notice dated August 8, 2005. The taxpayers filed a timely petition for review with the Commission on September 23, 2005.

In substantiation of their basis in Golf Fitness, Inc., the taxpayers provided bank statements showing checks written on the account of Balistreri & Associates Physical Therapy, Inc., another closely-held S corporation of the taxpayers. The department concluded that the statements provided did not substantiate that the taxpayers either loaned money to or invested money in Golf Fitness, Inc.

The Commission looked to established case law, which has placed a heavy burden on shareholders who seek to rearrange the indebtedness of related closely-held S corporations. Courts have often found that when a related party funds a shareholder loan to an S corporation, the shareholder has made no economic outlay sufficient to generate basis as the necessity of repayment of the funds is uncertain. Case law has also established a narrow "incorporated pocketbook" exception, which generally

holds that an S corporation acts as an agent of the shareholder by making payments on the shareholders behalf, thus allowing the taxpayer to increase his or her basis even though the funds advanced came from a related corporate entity and not from the taxpayer directly.

The Commission concluded that the taxpayers failed to meet their burden of proof that the department erred in its determination, as they 1) did not make an actual economic outlay by transferring funds from one S corporation to another, 2) have not met the "incorporated pocketbook" exception, and 3) have not demonstrated the necessity of repayment of the funds advanced to Golf Fitness, Inc.

It was not known at the time of publication whether the taxpayers would appeal this decision.

SALES AND USE TAXES

Admissions. *Milwaukee Symphony Orchestra, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals, April 16, 2009). See *Wisconsin Tax Bulletin* 150 (January 2007), pages 31 and 32, and *Wisconsin Tax Bulletin* 157 (July 2008), page 23, for summaries of the Wisconsin Tax Appeals Commission and Dane County Circuit Court decisions, respectively.

The main issue in this case is whether revenues received by Milwaukee Symphony Orchestra Inc. (MSO) from admissions to its concerts are subject to Wisconsin sales tax under sec. 77.52(2)(a)2., Wis. Stats., which imposes Wisconsin sales and use tax on the sale of admissions to amusement, athletic, entertainment, or recreational events or places.

The Department of Revenue contends that MSO's performances are *primarily entertainment* in nature. It was the assertion of MSO that its purpose of performing is *primarily educational* in nature. The Wisconsin Tax Appeals Commission previously concluded that the concerts at issue are *not primarily educational* events and the receipts from its concerts are, therefore, subject to Wisconsin sales tax.

The Wisconsin Tax Appeals Commission (the Commission) previously held that (1) MSO's performances were properly characterized as entertainment events for purposes of imposing sales tax under sec. 77.52(2)(a)2., Wis. Stats.; and (2) sales of admissions to MSO's performances are not immune from sales tax under *Kollasch* and its progeny.

In a judicial review of the Commission's decision, the Circuit Court determined that the Commission's interpretation of sec. 77.52(2)(a)2., Wis. Stats., as establishing a test based on a distinction between educational and entertainment events, had no foundation in the statute. The Circuit Court stated that the educational value of an event is not an appropriate test to determine whether an event is "entertainment." The Circuit Court remanded the action back to the Commission to develop a standard for determining whether an event is "entertainment" within the meaning of sec. 77.52(2)(a)2., Wis. Stats., and then apply its standard to the evidence.

MSO appealed the Circuit Court's decision, contending that a remand is unnecessary. The Department of Revenue filed a cross appeal.

The Court of Appeals concluded that the Commission's decision is entitled to due weight deference, and applying that standard, the Commission properly interpreted sec. 77.52(2)(a)2., Wis. Stats., in deciding that MSO's concerts are primarily entertainment events. The Commission reasonably decided that MSO's concerts are not charitable under the definition MSO provided, notwithstanding the importance of the performing arts to communities. The Commission also reasonably decided that neither the charitable purpose of a concert nor the fact that an organization is considered "charitable" for other tax purposes precludes a concert from being considered primarily an entertainment event and therefore taxable under sec. 77.52(2)(a)2., Wis. Stats. The Court of Appeals reversed the Circuit Court's decision ordering a remand to the Commission and directed the Circuit Court to enter an order affirming the Commission's decision.

It was not known at the time of publication whether this decision would be appealed.