STATE OF WISCONSIN

TAX APPEALS COMMISSION

TONY AND JOYCE WOODWORTH 4215 Benton Road Sparta, WI 54656	**DOCKET NO. 01-I-22** [1]
THOMAS AND ELLEN WOODWORTH	**DOCKET NO. 01-I-23**
WOODWORTH BROTHERS FARMS, INC.	**DOCKET NO. 01-I-24**
WOODWORTH BROTHERS FARM PARTNERSHIP 2742 Cty. S Sparta, WI 54656	**DOCKET NO. 01-I-25**
TIMOTHY WOODWORTH 2718 Cty. S Sparta, WI 54656-6540,	**DOCKET NO. 01-I-26**

Petitioners,

vs. **DECISION AND ORDER**

WISCONSIN DEPARTMENT OF REVENUE
P.O. Box 8907
Madison, WI 53708-8907,

Respondent.

JENNIFER E. NASHOLD, CHAIRPERSON:

These matters come before the Commission on briefs. Petitioners are represented by Attorney Charles E. Pellino, Jr., of Pellino, Rosen, Mowris & Kirkhuff, S.C. Respondent, Wisconsin Department of Revenue ("Department"), was represented on briefs by Attorney Lili Best Crane and is now represented by Chief Counsel Dana J.

[1] Although the parties have not filed a formal consolidation document, these dockets are consolidated by the Commission for purposes of this decision. In addition, on June 13, 2005, the Commission issued a Notice holding in abeyance the case of *Sally A. Spangler* [formerly, Sally A. Woodworth] *vs. Wisconsin Department of Revenue*, Docket No. 01-I-18, pending the final resolution of these matters. Finally, the Commission notes that these appeals initially involved tax years 1992 through 1996. However, pursuant to two Stipulations and Orders signed by the Commission on June 16, 2005 and March 30, 2006, respectively, the parties settled all claims for tax years 1993 through 1996. Therefore, the period under review only involves tax year 1992.

Erlandsen. The parties have submitted proposed findings of facts, affidavits, exhibits, and briefs.

Having considered the entire record before it, the Commission finds, decides, concludes, and orders as follows:

FACTS

Jurisdictional Facts

1. By notices dated April 1, 1999, petitioners received Wisconsin income tax assessments for the year 1992 ("period under review").

2. On June 1, 1999, the Department received petitioners' petitions for redetermination, dated May 25, 1999.

3. On November 30, 2000, petitioners' petitions for redetermination were denied by the Department.

4. On December 12, 2000, petitioners received the Department's notices of action denying each petition for redetermination for the period under review.

5. Petitioners filed timely petitions for review with the Commission on February 2, 2001.

Other Material Facts

6. On January 1, 1981, petitioners Tony, Thomas, and Timothy Woodworth ("Brothers," "shareholders," or "partners") established the Woodworth Brothers Farm Partnership ("Partnership").

7. The Partnership leased land, buildings, and livestock from the Brothers' father, William Woodworth ("William"), from its inception until June 30, 1992.

The Partnership also purchased equipment to carry on agricultural activities. The equipment was purchased with advances from a revolving credit account the Partnership established with Production Credit Association ("PCA"), now known as Farm Credit Services ("FCS").

8. By January 3, 1992, the Partnership owed $104,277 to PCA.

9. On April 6, 1992, the State of Wisconsin registered and recognized the incorporation of Woodworth Brothers Farms, Inc. ("Corporation"). The Corporation elected subchapter S status for the 1992 calendar year and beyond.

10. The Corporation reported each of the three Brothers as one-third shareholders on its 1992 tax return. The Corporation received a $1,000 capital contribution from its shareholders: $333 from Tony Woodworth, $334 from Thomas Woodworth, and $333 from Timothy Woodworth.

11. Between January 3 and June 29, 1992, PCA advanced additional loan proceeds to the Partnership totaling $64,555. On June 28, 1992, the Partnership owed $157,923 on its revolving credit account with PCA ("the PCA loan"). PCA's Loan Application, signed on March 18, 1992, lists the Partnership as the primary debtor, lists each of the Brothers as a "co-maker," and contains the signature of each of the Brothers, with the word "Partner" next to the typewritten name underneath each signature.

12. On July 1, 1992, the Partnership purchased the land and buildings previously leased from William for $300,000 and then leased them to the Corporation in return for rent. The Corporation purchased for $200,000 the cattle owned by William that were previously leased to the Partnership and began a milk production business,

receiving sole proceeds from Golden Guernsey Dairy.

13. At some point during 1992, the Corporation began making payments in the amount of $3,500 per month on the PCA loan by having $1,750 deducted bi-monthly from the Corporation's milk check from Golden Guernsey Dairy. This amount went to reduce the debt owed to PCA.

14. In a letter dated April 27, 2000, Assistant Vice President of FCS, William J. Hyde, states:

> **The Farm Credit Services (PCA) loan to the Woodworth Brothers Partnership was never forgiven at any time in 1992 when the Brothers incorporated.** The loan was also signed by the corporation for purposes of providing a milk check deduction since the milk checks would be now made in the corporation's name rather than the partnership. The Partnership and Brothers were still liable for the repayment of all loans owed as of July 1, 1992 and thereafter. [Emphasis in original.]

15. On Schedule M-2 of its 1992 Wisconsin tax return, the Partnership reported a "Takeover of Loans" as an increase to the "Partners' Capital Accounts" in the amount of $159,499. Of this amount, $157,923 was loan principal remaining on the Partnership's loan proceeds from PCA as of June 28, 1992.

16. In 1993-95, the Corporation made principal and interest payments to PCA totaling $42,000 per year. These payments were classified on the Corporation's yearly Transaction Reports as payments of "int pca-interest" and "np pca-farm loan." This was the total amount PCA recognized as due on the loan per year according to the original loan agreement.

17. The Corporation made all of the payments and claimed all of the

interest as deductions on its corporate tax returns from July 1992 onward. Neither the Partnership nor the individual partners made any PCA loan payments or deducted any loan interest after that date.

18. As of December 31, 1992, the Corporation's liabilities totaled $351,277.65. This amount consisted of $206,516.65 owed to PCA and $144,761 ($200,000 less $55,239) owed to William. The Corporation's 1992 tax return reported liabilities totaling $312,555, which did not accurately reflect the Corporation's total liabilities.

19. The only liability shown on the Partnership's 1992 Schedule L balance sheet as of December 31, 1992 is the remaining balance on the note payable to William for the purchase of land and buildings of $298,478 ($300,000 less $1,522).

20. PCA received $13,306.51 in interest on loans in 1992. On their 1992 tax returns, the Partnership claimed $4,078 of this interest expense and the Corporation claimed the remaining $9,228.51 as an interest expense. William reported $5,239 in interest income from the Corporation on his 1992 tax returns, which would be an interest expense to the Corporation. The Corporation reported a total interest expense for 1992 of $14,946 on its 1992 tax returns. This amount was comprised of $5,239 to William, $9,228.51 to PCA, and an adjustment of $478.49.

21. Petitioners did not provide the Department with any corporate books or business records summarizing the Corporation's financial transactions for 1992 until filing their Reply Brief with the Commission.

22. Exhibit 1 of petitioners' Reply Brief purports to be an entry from a "corporate book," and is dated July 1, 1992. It is handwritten, signed by Tony

Woodworth, and states, in part:

> Meeting called to Order by Pres. Tom Woodworth at 10' oclock Am.
>
> Motion by Tony Woodworth to leave financing with PCA by Partnership as is. Any new money [b]orrowed will be by Corp. The previous loan to the Partnership will be payed by the partnership, the corp. will pay the Partnership the sum of $3000.00 per month for [l]and [r]ent.
>
> Motion Approved.[2]

23. The record does not contain any documentation showing that the Partnership, the three individual Brothers, or any other party made any of the principal or interest payments to PCA on the loan originated by the Partnership after June 30, 1992. All of the evidence before the Commission shows that the Corporation was the only entity making interest and principal payments to PCA after June 30, 1992.

24. The PCA loan was refinanced in 1995. The Loan Application for the refinancing lists the customer as "WOODWORTH BROS FARMS INC". The name of the applicant is listed as "Woodworth Bros Farms Inc" and individually lists each of the three Woodworth Brothers. The Loan Application is signed by each of the three Brothers. The Promissory Note/Loan Agreement, as well as the Addendum, lists

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[2] The Department requests that this document be stricken from the record because it was not previously provided, despite the Department's written requests on at least five occasions in 1997 through 1998 for "'all of the records on which your franchise tax returns were based for the period January 1, 1992 to December 31, 1996'" and "'documentation of the corporation's assets and liabilites at the time it was formed in 1992.'" (Department's December 7, 2005 letter to the Commission, p. 1.) The Department also questions the authenticity of the document. While the Commission declines to strike the document, its weight is extremely limited because (1) it was not provided until petitioners filed their Reply Brief; (2) it contradicts several statements in petitioners' Reply Brief that they intended to transfer the debt to the Corporation but were not successful (Petitioners' Reply Brief at 2, 3, 7, and 8); and (3) the Commission's decision does not turn on what petitioners intended, but on what actually occurred.

"Woodworth Bros Farms Inc." as a signatory and is signed by each of the three Brothers. Under Thomas Woodworth's signature appears his typewritten name and the notation "PRES./INDIVIDUAL." Under Timothy Woodworth's signature appears his typewritten name and the notation "TREAS./INDIVIDUAL." Under Tony C. Woodworth's signature is his typewritten name and the notation "SEC./INDIVIDUAL." The Partnership is not mentioned.

25. On Schedule L of its 1992 and 1993 federal tax returns, the Corporation reported $104,948 as an asset on its balance sheet under the category "Loans to shareholders." This asset was not reported on its corporate tax returns beyond 1993.

26. No loan agreement, note, loan receivable, or any other documents were executed by the Corporation's three shareholders with the Corporation between July 1, 1992 and December 31, 1996 to establish that the shareholders owed the Corporation any funds.

27. The Corporation made no reference in any of its books or records and made no statements to third-party creditors that an amount was owed to the Corporation by any of its shareholders.

28. During his 1995 divorce from Sally Woodworth (now Spangler), Timothy Woodworth made no mention of any loan liability to the Corporation or to PCA under the section entitled "STATEMENT OF DEBTS AND OBLIGATIONS" on his court-ordered financial disclosure statement.

29. No documentation has been provided to show that the

shareholders made any actual economic outlays to the Corporation other than their initial capital contribution and the purported "Loan to shareholders" in the amount of $104,948, which petitioners claim is an asset transferred from the shareholders to the Corporation.

30. No documentation has been provided to show that the Corporation's three shareholders ever made any loan payments to the Corporation.

CONCLUSIONS OF LAW

1. For Wisconsin income tax purposes, the partners realized taxable gain during 1992 under I.R.C.[3] § 357(c)(1) because the amount of the liabilities transferred from the Partnership to the Corporation exceeded the amount of any assets transferred from the Partnership to the Corporation.

2. For Wisconsin income tax purposes, the transferred debt was not excludable from the partners' gross income in 1992 under I.R.C. § 108.

OPINION

Assessments made by the Department are presumed to be correct, and the burden is upon the petitioner to prove by clear and satisfactory evidence in what respects the Department erred in its determination. *Edwin J. Puissant, Jr. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶ 202-401 (WTAC 1984). Tax exemptions, deductions, and privileges are matters of legislative grace and will be strictly construed against the taxpayer. *Hall Chevrolet Co., Inc. v. Dep't of Revenue*, 81 Wis. 2d 477, 484, 260 N.W.2d 706

[3] Internal Revenue Code of 1986, as amended.

(1978). Petitioners have failed to meet their burden of establishing that the Department's assessments were in error.

I. THE PARTNERS REALIZED TAXABLE GAIN UNDER I.R.C. § 357(c)(1).

For income tax purposes, Wisconsin generally follows federal law, and the parties agree that these cases are governed by I.R.C. §§ 351(a) and 357(c)(1). As a general rule, "[n]o gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation[4] and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation." I.R.C. § 351(a). However, § 357(c)(1) provides the following exception to § 351(a):

> [I]f the sum of the amount of the liabilities assumed exceeds the total of the adjusted basis of the property transferred pursuant to [a §351] exchange, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

The principal issue for our determination is whether the partners realized taxable gain under § 357(c)(1) in tax year 1992 on the transfer of liabilities of the Partnership to the Corporation, to the extent that the liabilities assumed exceeded the adjusted basis of any assets transferred. In deciding this issue, the Commission must

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[4] The record in these cases does not suggest that any transfers of liabilities or assets were made "solely in exchange for stock or securities," as provided in I.R.C. § 351(a). However, as neither petitioners nor the Department raise this issue and the parties assume §§ 351 and 357(c)(1) govern these cases, the Commission need not address this issue. We note, however, that courts have held that "the exchange requirements of section 351 are met where a sole stockholder transfers property to a wholly-owned corporation even though no stock or securities are issued therefor." *Lessinger v. Commissioner*, 872 F.2d 519, 522 (2nd Cir. Ct. App. 1989), *and cases cited therein.*

decide whether the PCA debt was transferred from the Partnership to the Corporation, and, if so, whether any assets were also transferred from the Partnership or partners to the Corporation which offset the liabilities transferred. Petitioners argue that the PCA loan was not transferred to the Corporation, and that, even if it had been, it was offset by a $104,948 loan owed to the Corporation by the shareholders.

A. The Partnership's PCA debt was assumed by the Corporation.

In determining whether the Partnership realized a taxable gain, the first issue to be decided is whether the Corporation assumed liability for the Partnership's PCA debt. The facts demonstrate that the PCA loan, totaling $157,923 on June 28, 1992, was assumed by the Corporation. After its inception, the Corporation made all the payments to PCA with corporate proceeds, *i.e.*, the Golden Guernsey Dairy milk checks, whereas the Partnership did not make payments on the loan. The Partnership reported this takeover of loans on its 1992 tax return. On Schedule M-2 of its 1992 federal return, the Partnership reported a "Takeover of Loans" as an increase to the partners' Capital Accounts of $159,499. Of this amount, $157,923 was loan principal remaining on the Partnership's loan proceeds from PCA as of June 28, 1992. Also, the Partnership's balance sheet reported on Schedule L of its federal return showed that the Partnership's total liability of $298,478 at the end of the 1992 tax year was comprised only of the remaining balance on the note to William for the purchase of land and buildings. The Partnership's loan liability to PCA was not included in that reported figure.

In addition, the Corporation's own yearly transaction reports indicate that the Corporation made the total $42,000 annual payment due on the PCA loan in 1993-

1995, further evidence that the debt had been assumed by the Corporation. Moreover, of the $13,306.51 in interest received by PCA in 1992 on this account, the Partnership only claimed $4,078 of it, while the Corporation claimed the remaining $9,228.51 in interest, demonstrating that for a majority of 1992 the Corporation had assumed the loan. Also, when the loan was refinanced in 1995, the Corporation is listed as the loan applicant, whereas the Partnership is not mentioned.

Petitioners do not dispute these facts. Rather, they assert that there was no assumption of liability by the Corporation because the three Brothers as partners and as shareholders were never released from liability on the PCA loan, and PCA continued to look to them for payment.

However, "there is no requirement in section 357(c)(1) that the transferor be relieved of liability." *Rosen v. Commissioner*, 62 T.C. 11, 19 (1974). *See also Seggerman Farms, Inc. v. Commissioner*, 308 F.3d 803 (7th Cir. 2002); *Estate of Leavitt v. Commissioner*, 875 F.2d 420 (4th Cir. 1989). Liabilities may be assumed even where the transferor remains personally liable for the payment of such liabilities and the creditors do not look to the transferee for payment. *Rosen*, 62 T.C. at 19.

Petitioners do not provide any countervailing authority. Instead, they seek to distinguish the above-referenced cases on grounds that the taxpayers therein were not makers on the loan, but guarantors; whereas in the instant cases, petitioners argue — notwithstanding the Department's assertions to the contrary — the partners were makers, not guarantors, on the PCA loan. However, the holdings in the above-referenced cases were not dependent on such a distinction.

In *Rosen*, Mr. Rosen transferred all the assets and liabilities of his sole proprietorship to a newly formed corporation. 62 T.C. at 11, 13. Mr. Rosen remained personally liable for all the transferred liabilities, having obtained funds either in his own name or on his personal guaranty. *Id.* at 14. The liabilities exceeded the assets transferred to the Corporation. *Id.* at 18. Mr. Rosen argued that "there was no assumption of liabilities by [the Corporation] since he was never released from liability thereon and the creditors continued to look to him for payment." *Id.* at 17. The Tax Court rejected this argument, stating:

> When the [taxpayer] transferred the cinebox business to [the corporation], the sum of the liabilities assumed, or to which the property might be subject, exceeded the basis of the assets transferred to the extent of $147,315.25. While the petitioner nevertheless remained personally liable for the payment of such liabilities, and the creditors never looked to [the Corporation] for payment, there is no requirement in section 357(c)(1) that the transferor be relieved of liability.

Id. at 19. As a result, the Tax Court held that Mr. Rosen had realized gain under § 357(c). *Id.*

In *Leavitt*, the shareholders personally guaranteed a loan from a bank to their corporation, agreeing to be jointly and severally liable for the debt, but the corporation made all of the loan payments to the bank while the shareholders made no such payments. 875 F.2d at 422. The shareholders argued that despite its form as a loan from the bank, the loan was really a capital contribution from the shareholders to their corporation and that they were entitled to add a *pro rata* share of the loan to their adjusted basis. *Id.* The Court held that a guarantee does not constitute an economic

outlay, that it is "merely a promise to pay in the future if certain unfortunate events should occur," and that the shareholders "have experienced no such call as guarantors, have engaged in no economic outlay, and have suffered no cost." (Footnote omitted.) *Id.* The situation would be different, the Court stated, if the corporation had defaulted on the loan payments and the shareholders-guarantors had made actual disbursements on the corporation indebtedness. *Id.* In that instance, "[t]hose payments would represent corporate indebtedness to the shareholders which would increase their bases. . . ." *Id.*

In *Seggerman*, the Seggerman family formed Seggerman Farms, Inc., and each shareholder transferred assets to the corporation, subject to liabilities, in exchange for stock. 308 F.3d at 804. The corporation also assumed various farm-related liabilities of the shareholders, the total of which exceeded the adjusted basis in the transferred assets. *Id.* at 804-05. The Seggermans remained secondarily liable as guarantors on all of the transferred debt. *Id.*

On appeal, the Seggermans argued that they were not relieved personally from any debt that the corporation assumed and therefore should not have to recognize any gain. *Id.* at 806. They based their argument on the premise that the personal liabilities they retained were analogous to loan receivables or promissory notes owed by shareholders to their corporations. *Id.* at 807. The Court of Appeals for the Seventh Circuit disagreed, stating, "'[P]ersonal guaranties of corporate debt are not the same as incurring indebtedness to the corporation because a guaranty is merely a promise to pay in the future if certain events should occur. [Their] guaranties do not constitute economic outlays.'" *Id.* Accordingly, the Court held that where a taxpayer retains

liability as a guarantor on debts transferred pursuant to § 351, the plain language of § 357(c)(1) requires that the amount by which the transferred liabilities exceed the taxpayer's basis in the transferred assets be recognized as taxable gain. *Id.* at 808.

In holding that the transferor of a debt may realize taxable gain under § 357(c)(1) even where the transferor is subject to liability on that debt, *Rosen*, *Leavitt,* and *Seggerman* cut against petitioners' position in these cases. Thus, even assuming that the partners remained personally liable on the debt to PCA after the Corporation began making payments on the loan, this does not foreclose an assumption of the loan by the Corporation. As set forth above, the facts of these cases demonstrate that the PCA loan was assumed by the Corporation, resulting in taxable gain to the partners to the extent the liability exceeded the partners' basis in any transferred assets. *See also Lessinger*, 872 F.2d at 523 ("We find it sufficient that the debts were paid, because their payment by the corporation represents the type of relief from liability that section 357(c) was intended to tax.")

B. The "Loans to shareholders" reported on Schedule L of the Corporation's 1992 tax return did not constitute a genuine shareholder debt and therefore did not offset the liability assumed by the Corporation.

Petitioners next assert that even if the Corporation assumed the liabilities of the Partnership, the liabilities were offset by a loan owed to the Corporation by the shareholders in the amount of $104,948, which increased the partners' basis in the Corporation. At the same time that the Corporation's 1992 return indicated that the Partnership debt was now carried on the books of the Corporation's balance sheet, the return also indicated that the Corporation carried on its balance sheet "Loans to

shareholders" of $104,948. Petitioners state that this amount consists of $104,277, which was the same amount owed by the Partnership to PCA in January 1992, plus interest. Thus, petitioners argue, "the Corporation offset the PCA liability of $104,277 which it (the Corporation) would pay with the 'single milk check' and then be reimbursed by the receivable of like value from the three brothers/Partnership." (Petitioners' Brief, p. 7.)[5] Petitioners assert that the Brothers were indebted to PCA both as a result of the execution of promissory notes which they had given to PCA individually and also by virtue of the "Loans to shareholders."

The Commission has already rejected the argument that the partners would be immune from taxable gain if they remained liable on the PCA debt. We are similarly unpersuaded that the "Loans to shareholders" entry contained on the Corporation's 1992 return relieved the partners from taxable gain. Petitioners rely on several federal cases holding that a taxpayer who transfers his or her own enforceable note to a corporation in a § 351 transaction has a basis in the note equal to its face value for purposes of determining if liabilities exceed the basis of transferred property under § 357(c). The authority petitioners rely upon is distinguishable or not applicable.

In *Lessinger*, the taxpayer, Sol Lessinger, operated a sole proprietorship, running the same business for over 25 years. 872 F.2d at 520. The entire proprietorship was closed out and consolidated into a C corporation. *Id* at 521. Mr. Lessinger's corporation expressly assumed the liabilities of the proprietorship (except accounts

[5] The Commission notes that the appearance of the "Loans to shareholders" as an asset on the Corporation's 1992 tax return is further indication that the PCA debt was indeed transferred to the Corporation, in that the purported asset (the loan) is an attempt to offset the transferred liability (the PCA debt).

payable), which it paid on because the proprietorship's bank account had been closed. *Id.* Total liabilities exceeded total assets by $255,499.37, and that exact amount was added to the corporate assets in the corporation's journal entry as a loan receivable from Mr. Lessinger. *Id.* at 521, 523. Shortly after incorporation, Mr. Lessinger paid $62,209.35 to the corporation toward the satisfaction of the loan receivable debt. *Id.* at 521. Four years after incorporation, the principal creditor of the corporation requested that Mr. Lessinger execute a promissory note for the debt, and he did so. *Id.* Mr. Lessinger also owned the realty company that leased the corporation's premises, and Mr. Lessinger only demanded enough rent from the corporation to cover the building's costs, substantially under the fair market rental value, resulting in savings to the corporation. *Id.* at 522. The Court surmised that Mr. Lessinger may have also paid off his loan receivable debt to the corporation by subsidizing the corporation's rent, although no amounts were actually credited. *Id.* at 522.

The *Lessinger* Court held that Mr. Lessinger's debt to the corporation was real, not artificial. *Id.* at 524. In so holding, the Court found it "significant" that a promissory note was eventually executed. *Id.* In the instant cases, no promissory note was executed by the shareholders, and no corporate book or journal entries were made showing any loan to shareholders. The only indication that the loan was made are entries on the Corporation's 1992 and 1993 tax returns.

Moreover, Mr. Lessinger actually made payments to reduce his loan receivable debt to the corporation, further indicating that it was a real and actual binding obligation. Aside from the payment of $62,209.35 to reduce the debt he owed

the corporation, he also subsidized the corporation's rent payments. In the instant cases, there is no evidence in the record that the shareholders ever made payments on the Corporation's "Loans to shareholders" in any form.

Petitioners' reliance on *Peracchi v. Commissioner*, 143 F.3d 487 (9th Cir. 1998), is similarly misplaced. Mr. Peracchi contributed real estate to his closely-held corporation that was encumbered with liabilities which exceeded his basis in the property. *Id.* at 488. To avoid recognition of the gain, Mr. Peracchi executed a promissory note, promising to pay his corporation $1,060,000 over a term of ten years at 11% interest. *Id.* at 489.

The Court of Appeals for the Ninth Circuit held that the note was a genuine debt. *Id.* at 493. Therefore, it was an asset of his corporation with a value equal to its face, which increased Mr. Peracchi's basis and offset any recognizable gain. Unlike Mr. Peracchi, the shareholders here executed no formal promissory note, let alone one with a certain term and interest rate. Furthermore, whereas in *Peracchi* the taxpayers may have paid "imperfect attention" to their payments on the note, in the instant case the shareholders never many any payments to the Corporation on the claimed debt at all. *Id.* at 494-95.

Moreover, the *Peracchi* Court specifically noted that because his corporation was a C corporation, Mr. Peracchi purposely risked his personal exposure to corporate creditors by executing the note. The Court stated:

> [T]he tax treatment of nonrecourse debt primarily creates problems in the partnership context, where the entity's loss deductions . . . can be passed through to the taxpayer. It is the pass-through of

> losses that makes artificial increases in equity interests of particular concern. . . . We don't have to tread quite so lightly in the C Corp context, since a C Corp doesn't funnel losses to the shareholder. (Footnote 16.)

Id. at 494. So significant was the difference between C and S corporations that the Court specifically stated that its "holding therefore does not extend to the partnership or S Corp context." *Id.* at n. 16. Because the Corporation here is an S corporation, the *Peracchi* holding does not extend to these cases, and the case is also easily distinguishable on its facts.

We conclude that the "Loans to shareholders" reported on the Corporation's 1992 and 1993 tax returns was not a genuine debt. There was no loan agreement executed between the Corporation and the shareholders; the loan was not mentioned in any corporate books or records; there were no statements to third-party creditors or in Timothy Woodworth's financial disclosure documents during his divorce[6] that an amount was owed to the Corporation by the shareholders; and there is no indication that the Corporation's shareholders ever made any loan payments to the Corporation. Based on all of the above, we conclude that the reported loan receivable

[6] Petitioners move to strike Timothy Woodworth's financial disclosure statement under Wis. Stat. § 767.27(3)(a), which provides: "Except as provided in par. (b) [inapplicable here], information disclosed under this section shall be confidential and may not be made available to any person for any purpose other than the adjudication, appeal, modification or enforcement of judgment of an action affecting the family of the disclosing parties." Because this is an adjudication or appeal affecting the family of the disclosing parties, there is no confidentiality requirement under § 767.27(3)(a).

asset was not a genuine loan and did not increase the shareholders'[7] basis in the Corporation such that it would offset the assumption of the partners' loan liability.

II. THE TRANSFERRED DEBT IS NOT EXCLUDABLE FROM GROSS INCOME UNDER I.R.C. § 108.

In the Conclusion portion of their Brief, petitioners raise, but do not develop, the argument that pursuant to I.R.C. § 108, they would recognize no gain even if the Corporation had assumed the Partnership's loan liability.[8] They appear to claim the debt amount would not be includable in gross income either because it would qualify as a discharge of qualified farm indebtedness under § 108(a)(1)(C) or because the parties are "related" under § 108(e)(4), as that phrase is defined in § 267(b)(2). Petitioners have failed to show that these exclusions are applicable.

Internal Revenue Code § 108(a)(1)(C) states:

> IN GENERAL. — Gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if —
>
> . . .
>
> (C) the indebtedness discharged is qualified farm indebtedness, . . .

Under the subsection delineating special rules for discharge of qualified farm indebtedness, the discharge must be by a "qualified person." I.R.C. § 108(g)(1). A "qualified person" is either "a Federal, State or local government or agency or

[7] In discussing the issue of whether there was an offset of liabilities, the Commission has used the terms "partners" and "shareholders" interchangeably because they are the same persons. We note that *Lessinger* and *Peracchi* did not identify the debts as owing from "shareholders," as here, but from the transferors of the liabilities.

[8] Indeed, petitioners may be viewed as abandoning any arguments based on I.R.C. § 108, since their Reply Brief does not respond in any way to the Department's arguments as to the inapplicability of those provisions.

instrumentality thereof" or "any person which is actively and regularly engaged in the business of lending money and which is not" (1) related to the taxpayer, (2) "a person from which the taxpayer acquired the property (or a related person to such a person)", or (3) "a person who receives a fee with respect to the taxpayer's investment in the property (or a related person to such a person)." I.R.C. §§ 108(g)(1)(B) and 49(a)(1)(D)(iv). While PCA, the lender, may fit the definition of "qualified person" under these provisions, PCA did not "discharge" the debt. The debt was still owed and being paid by the Corporation. Therefore, the "discharge of qualified farm indebtedness" exclusion is inapplicable.

Nor have petitioners demonstrated they are entitled to an exclusion in these cases based on the related parties provisions of § 108(e)(4). This section provides, in relevant part:

> (e) GENERAL RULES FOR DISCHARGE OF INDEBTEDNESS (INCLUDING DISCHARGES NOT IN TITLE 11 CASES OR INSOLVENCY). — For purposes of this title—
>
> * * *
>
> (4) ACQUISITION OF INDEBTEDNESS BY PERSON RELATED TO DEBTOR. —
>
> (A) TREATED AS ACQUISITION BY DEBTOR. — For purposes of determining income of the debtor from discharge of indebtedness . . . , the acquisition of outstanding indebtedness by a person bearing a relationship to the debtor specified in section 267(b)[9] . . . from a person who does not bear such a relationship to the debtor shall be treated as the acquisition of such indebtedness by the debtor. . . .

[9] Petitioners rely on I.R.C. § 267(b)(2), in which the relationship is between "[a]n individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual."

Petitioners fail to explain, and it is not readily apparent, how this provision relieves the partners from recognition of taxable gain. Because petitioners have not developed this argument and appear to have abandoned it in their Reply Brief, the Commission does not address it.

III. CONCLUSION

Petitioners have failed to demonstrate that the Department erred in assessing the partners for taxable gain resulting from the Corporation's assumption of the Partnership's debt.

IT IS ORDERED

That the Department's actions on petitioners' petitions for redetermination for tax year 1992 are affirmed.

Dated at Madison, Wisconsin, this 3rd day of April, 2006.

WISCONSIN TAX APPEALS COMMISSION

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Jennifer E. Nashold, Chairperson

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Diane E. Norman, Commissioner

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David C. Swanson, Commissioner

ATTACHMENT: **"NOTICE OF APPEAL INFORMATION"**