

STATE OF WISCONSIN
TAX APPEALS COMMISSION

OSB, INC.,

DOCKET NO. 02-I-460

Petitioner,

vs.

DECISION AND ORDER

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

DAVID C. SWANSON, COMMISSIONER:

This matter comes before the Commission on a Stipulation of Facts filed by the parties on April 8, 2008, with exhibits filed on May 1, 2008 (together, the "Stipulation"). Attorneys John R. Austin and Kristina E. Somers of Reinhart Boerner Van Deuren S.C. represent the Petitioner in this matter. Respondent, the Wisconsin Department of Revenue (the "Department"), is represented by Attorney Mark S. Zimmer. Both parties have submitted briefs. In addition the Wisconsin Bankers Association filed an *amicus curiae* brief in support of the Petitioner's position in this matter.

The Commission's findings of fact consist of the facts stipulated by the parties, with certain non-substantive changes made for form, clarity and consistency.

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

FINDINGS OF FACT

1. OSB, Inc. ("OSB") is a Delaware corporation incorporated on October 1, 1981.
2. OSB was formed to hold the stock in several corporations including The Glennon Group, Inc. (a Wisconsin corporation), The Glennon Group of Indiana, Inc. f/k/a Marcraft Industries Corp. (an Indiana corporation) and Stadia Corp. (a Colorado corporation).
3. OSB sold its interest in Stadia Corp. in February 1994 and began investing the sales proceeds.
4. OSB's sole shareholder is Charles Osborne, who holds its stock 49% directly and 51% indirectly, through three trusts.
5. OSB's stock was owned, directly or indirectly, by or for not more than five individuals, as defined in § 542(a)(2) of the Internal Revenue Code ("IRC"), during the entire period October 1, 1994 through September 30, 2000 ("Audit Period" or "period at issue").
6. At least 60% of OSB's adjusted ordinary gross income for the Audit Period is personal holding company income as defined in IRC §§ 542(a)(1) and 543(b)(2).

7. Personal holding company income is defined in IRC § 543(a) to include dividends, interest, royalties and certain rents.

8. OSB did not file a consolidated tax return for Wisconsin income/franchise tax purposes, for any year during the Audit Period, as Wisconsin requires separate filing by each corporation.

9. OSB was not required to file a consolidated tax return pursuant to IRC § 1501 for Wisconsin income/franchise tax purposes for any year during the Audit Period.

10. Beginning with the 1987 taxable year, Wisconsin net income for a corporation means gross income as computed under the IRC as modified by the Wisconsin Statutes, pursuant to § 71.26(2)(a), Wis. Stats. (1993-2000), applicable during the Audit Period.

11. During the Audit Period, the provisions in IRC §§ 542 and 543 were not modified by § 71.26(3), Wis. Stats. (1993-2000), applicable to the Audit Period.

12. During the Audit Period, the provisions in IRC §§ 1501 to 1505, 1551, 1552, 1563 and 1564 (relating to consolidated returns) were excluded in calculating Wisconsin net income, pursuant to § 71.26(3)(x), Wis. Stats. (1993-2000).

13. For Wisconsin tax purposes, all income, gain or loss from intangible property that is earned by a personal holding company, as defined in § 542 of the IRC,

as amended to December 31, 1974, is allocated to the residence of the taxpayer, pursuant to § 71.25(5)(b)2., Wis. Stats. (1993-2000), applicable during the Audit Period.

14. Wisconsin Form 5 is used by corporations (other than tax-option corporations) whose entire business income is attributable to Wisconsin.

15. Wisconsin Form 5 instructions for 2000 state:

Consolidated Returns

Wisconsin law doesn't permit corporations that are members of an affiliated group, as defined in IRC section 1504, to file consolidated returns. Each corporation organized under Wisconsin law, licensed to do business in Wisconsin, or doing business in Wisconsin must file a separate Wisconsin franchise or income tax return. In addition, each corporation must make its own estimated tax payments.

This same language, related to consolidated returns, was contained in the Form 5 instructions for each year of the Audit Period.

16. Wisconsin Form 5 instructions for 2000 state:

PERSONAL HOLDING COMPANIES

The intangible income of a personal holding company is assigned to its state of incorporation. "Personal holding company" has the meaning prescribed in IRC section 542 effective December 31, 1974.

This same language, relating to a personal holding company, was contained in the Form 5 instructions for each year of the Audit Period.

17. Wisconsin Form 5 instructions for 2000 state:

Who Must File:

- Corporations organized under Wisconsin law.
- Foreign corporations licensed to do business in Wisconsin.
- Unlicensed corporations doing business in Wisconsin.
- Foreign corporations having an interest in a partnership that does business in Wisconsin.
- Foreign corporations that are the sole owner of an entity that is disregarded under IRC section 7701 and does business in Wisconsin.

This same language regarding corporation filing requirements was contained in the Form 5 instructions for each year during the Audit Period, except that during years 1994 through 1996, the last bullet point thereof read as follows:

- Publicly traded partnerships treated as corporations in Section 7704 of the Internal Revenue Code (IRC).
- Limited liability companies treated as corporations for federal income tax purposes.

18. Wisconsin Form 5 instructions for all years in the Audit Period state that:

The intangible income of a personal holding company is assigned to its state of incorporation.

19. Wisconsin Form 4 is used by corporations (other than tax-option corporations) reporting under the apportionment or separate accounting methods.

20. Wisconsin Form 4 instructions for 2000 state:

Consolidated Returns

Wisconsin law doesn't permit corporations that are members of an affiliated group, as defined in IRC section 1504, to file consolidated returns. Each corporation organized under Wisconsin law, licensed to do business in

Wisconsin, or doing business in Wisconsin must file a separate Wisconsin franchise or income tax return. In addition, each corporation must make its own estimated tax payments.

This same language, related to consolidated returns, was contained in the Form 4 instructions for each year of the Audit Period.

21. Wisconsin Form 4 instructions for 2000 state:

PERSONAL HOLDING COMPANY

The intangible income of a personal holding company is assigned to its state of incorporation. "Personal holding company" has the meaning prescribed in IRC section 542 in effect on December 31, 1974.

This same language, relating to a personal holding company, was contained in the Form 4 instructions for each year of the Audit Period.

22. Wisconsin Form 4 instructions for 2000 state:

Who Must File:

- Corporations organized under Wisconsin law.
- Foreign corporations licensed to do business in Wisconsin.
- Unlicensed corporations doing business in Wisconsin.
- Foreign corporations having an interest in a partnership that does business in Wisconsin.
- Foreign corporations that are the sole owner of an entity that is disregarded under IRC section 7701 and does business in Wisconsin.

This same language regarding corporation filing requirements was contained in the Form 4 instructions for each year during the Audit Period, except that during years 1994 through 1996, the last bullet point thereof read as follows:

- Publicly traded partnerships treated as corporations in Section 7704 of the Internal Revenue Code (IRC).
- Limited liability companies treated as corporations for federal income tax purposes.

23. Wisconsin Form 4 instructions for all years in the Audit Period

state:

The intangible income of a personal holding company is assigned to its state of incorporation.

24. The Department's Corporate Audit Manual states the following in

Chapter 8-4 entitled "Nonapportionable Income":

Nonapportionable income is that income, which by statute, is allocated directly to a particular state. Total company nonapportionable income (loss) is removed from the total company income of a unitary multistate business and the remaining "business" income (loss) is apportioned. Wisconsin nonapportionable income (loss) is then added to the business income (loss) apportioned to Wisconsin to determine Wisconsin net income (loss).

* * *

8-4.2 Nonapportionable Income of Personal Holding Companies:

Section 71.25(5)(b)2 provides that all income, gain or loss from intangible property that is earned by a personal holding company is nonapportionable income and shall be allocated to the residence of the corporation. The residence of a corporation is the state of incorporation.

For this purpose a personal holding company means a personal holding company as defined in section 542, IRC, as amended to December 31, 1974.

These instructions were contained in the Department's Corporate Audit Manual during the Audit Period. (Emphasis as in original.)

25. The definition of "personal holding company" in IRC § 542, as of December 31, 1974, provides in relevant part as follows:

(a) GENERAL RULE.-- For purposes of this subtitle, the term "personal holding company" means any corporation (other than a corporation described in subsection (c)) if---

(1) ADJUSTED ORDINARY GROSS INCOME REQUIREMENT.--At least 60 percent of its adjusted ordinary gross income (as defined in section 543(b)(2)) for the taxable year is personal holding company income (as defined in section 543(a)), and

(2) STOCK OWNERSHIP REQUIREMENT.--At any time during the last half of the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than 5 individuals. For purposes of this paragraph, an organization described in section 401(a), 501(c)(17), or 509(a) or a portion of a trust permanently set aside or to be used exclusively for the purposes described in section 642(c) or a corresponding provision of a prior income tax law shall be considered an individual.

(b) CORPORATIONS FILING CONSOLIDATED RETURNS. --

(1) GENERAL RULE.--In the case of an affiliated group of corporations filing or required to file a consolidated return under section 1501 for any taxable year, the adjusted ordinary gross income requirement of subsection (a)(1) of this section shall, except as provided in paragraphs (2) and (3), be applied for such year with respect to the consolidated adjusted ordinary gross income and the

consolidated personal holding company income of the affiliated group. No member of such an affiliated group shall be considered to meet such adjusted ordinary gross income requirement unless the affiliated group meets such requirement.

26. Wisconsin Statutes § 71.25(4) during all years of the Audit Period

read as follows:

CORPORATIONS ENGAGED IN BUSINESS WHOLLY WITHIN THIS STATE. For corporations engaged in business wholly within this state, all income is subject to, or included in the measure of, the Wisconsin income or franchise tax.

27. OSB was entitled to the privilege of filing and did file a consolidated federal income tax return together with Glennon Corporation for federal tax purposes pursuant to IRC § 1501 for all of the tax years included in the Audit Period. The consolidated federal tax returns filed by OSB and its affiliated group of corporations were not taxed as a personal holding company for federal tax purposes during the Audit Period.

28. Each such consolidated federal tax return filed by OSB and its affiliated group had on the first page a box to check to indicate whether personal holding company status applied. On none of the federal tax returns filed by OSB and its affiliated group for federal tax purposes during the Audit Period was such personal holding company status box checked. The federal tax returns of OSB and its affiliated group for the Audit Period are now closed. Any state tax adjustments with respect to

OSB would not affect the consolidated federal tax returns filed by OSB and its affiliated group of corporations.

29. The IRS instructions for Schedule PH (1120) for tax years 1999 and 2000 state that:

Corporations use this schedule to figure the personal holding company (PHC) tax.

Who Must File

A corporation that is a PHC must file Schedule PH by attaching it to the corporation's income tax return.

For all other tax years of the Audit Period, the equivalent instructions to Schedule PH (1120) stated:

This schedule is used to figure personal holding company (PHC) tax.

Who Must File

A corporation that is a PHC must attach this schedule to its income tax return.

30. OSB did not file a Schedule PH for personal holding company tax for federal tax purposes with the IRS (whether separately or as a part of a consolidated group) for any tax year of the Audit Period.

31. For the filing of its consolidated federal income tax returns and the imposition of federal income taxes, OSB has not asserted or maintained that for the

consolidated group that each member was a personal holding company or that as a consolidated group they qualified as a personal holding company.

32. OSB and its affiliated group of corporations were an ineligible affiliated group under IRC § 542(b)(2) during the Audit Period.

33. During the entire Audit Period, OSB was not a corporation described in IRC § 542(c).

34. OSB had a single employee during the Audit Period.

35. The sole OSB employee's payroll would be assigned to Wisconsin pursuant to § 71.25(8)(b), Wis. Stats.

36. OSB did not own or rent any real or personal property inside or outside of Wisconsin.

37. OSB did not maintain an office in Pewaukee, Wisconsin.

38. OSB did not make any sales during the Audit Period that would be assigned to the sales factor pursuant Wisconsin Statutes section 71.25(9)(e).

39. OSB managed its own intangible assets during the Audit Period.

40. OSB used several state mailing addresses including Wisconsin and Delaware during the Audit Period.

41. OSB utilized one or more accounting firms and one or more legal firms located in Wisconsin during the Audit Period.

42. OSB maintained certain corporate and financial records in Wisconsin during the Audit Period.

43. OSB filed Wisconsin Corporate Franchise/Income Tax Returns for the years of the Audit Period using a Wisconsin mailing address.

44. On its Wisconsin Corporate Franchise/Income Tax Returns, OSB marked "No Wisconsin Activity."

45. OSB, as a Delaware domestic corporation, was subject to Delaware's jurisdiction.

46. OSB was audited by the Department for the years of the Audit Period.

47. The Department timely issued an assessment to OSB for the Audit Period in the amount of \$106,230.55, inclusive of interest as of January 29, 2002. (Stip. Ex. A.)

48. OSB filed a timely petition for redetermination to the Department. (Stip. Ex. B.)

49. The Department's Resolutions Office timely issued a notice of action on or about December 4, 2002 denying OSB's petition for redetermination. (Stip. Ex. C.)

50. OSB filed a timely petition for review with the Wisconsin Tax Appeals Commission on or about December 30, 2002. (Stip. Ex. D.)

51. OSB claimed a bad debt deduction from the insolvency and subsequent liquidation of Great Lakes Marketing Systems, Inc. ("Great Lakes") on its return for the tax year ending September 30, 1998.

52. The IRS examined the tax return for the year ending September 30, 1998, in which OSB claimed the bad debt deduction related to Great Lakes.

53. The IRS issued a "no change report" (Stip. Ex. E) for the federal tax return for the year ending September 30, 1998 in which OSB claimed the bad debt deduction related to Great Lakes.

54. OSB responded to requests for admissions related to this matter (Docket No. 02-I-460) initiated by the Department.

55. The Department responded to requests for production of documents, a request for admissions and interrogatories initiated by OSB.

56. As part of its Response to OSB's Second Set of Interrogatories, the Department produced a true and correct copy of an Approval Request Form for Large Unagreed Adjustments/New or Controversial Issues, redacted for confidentiality purposes under § 71.78, Wis. Stats. (Stip. Ex. F¹.)

¹ The Department stipulates as to the authenticity of Exhibits F, G and H, but objects to the admission of these exhibits pursuant to § 904.02, Wis. Stats., on grounds of relevance. The Commission overrules the Department's objection and admits Exhibits F, G and H into evidence in this matter. We agree with the Department that these documents have little probative value in this matter, but also find that they provide useful background information regarding the statutes at issue, and that the Department is not prejudiced by their admission, because we have given them no weight in reaching our decision.

57. Dan Davis of the Department prepared a report entitled “Financial Institutions And Their Wholly Owned Investment Subsidiaries: Impact On Wisconsin Corporation Franchise Tax.” (Stip. Ex. G.)

58. The Department prepared a report to the Legislative Reference Bureau regarding “Combined reporting for corporations.” (Stip. Ex. H.)

ISSUES PRESENTED

1. Is OSB’s income properly allocated or apportioned to Delaware or Wisconsin for the period at issue?
2. Did the Department properly disallow the bad debt deduction at issue taken by OSB?

DECISION

A. APPLICABLE STATUTES AND RULES

Relevant portions of Wis. Stat. § 71.25² provide:

71.25 Situs of income; allocation and apportionment. For purposes of determining the situs of income under this section:

* * *

(4) Corporations engaged in business wholly within this state. For corporations engaged in business wholly within this state, all income is subject to, or included in the measure of, the Wisconsin income or franchise tax.

² Cited portions of § 71.25, Wis. Stats., are those currently in effect and include amendments made since the Audit Period; however, these changes did not affect § 71.25(4) or (5)(b)2. as applied in this case.

(5) Corporations engaged in business both within and without the state.

(a) Apportionable income. Except as provided in sub. (6), corporations engaged in business both within and without this state are subject to apportionment. Income gain or loss from the sources listed in this paragraph is presumed apportionable as unitary or operational income or other income that has a taxable presence in this state. Apportionable income includes all income or loss of corporations, other than nonapportionable income as specified in par (b), including, but not limited to, income, gain or loss from the following sources:

* * *

(b) Nonapportionable income.

1. Income, gain or loss from the sale of nonbusiness real property or nonbusiness tangible personal property, rental of nonbusiness real property or nonbusiness tangible personal property and royalties from nonbusiness real property or nonbusiness tangible personal property are nonapportionable and shall be allocated to the situs of the property, except that all income that is realized from the sale of or purchase and subsequent sale or redemption of lottery prizes if the winning tickets were originally bought in this state shall be allocated to this state.

2. All income, gain or loss from intangible property that is earned by a personal holding company, as defined in section 542 of the internal revenue code, as amended to December 31, 1974, shall be allocated to the residence of the taxpayer, except that all income that is realized from the sale of or purchase and subsequent sale or redemption of lottery prizes if the winning tickets were originally bought in this state shall be allocated to this state.

Wis. Admin. Code § Tax 2.39 provides in relevant part:

Tax 2.39 Apportionment method.

(1) GENERAL. Except as provided in sub. (3), any person, except resident individuals, resident estates, and resident trusts, engaged in business both in and outside this state shall apportion its apportionable income using the statutory apportionment method as provided in s. 71.04 (4) or 71.25 (6), Stats., when the person's business in this state is an integral part of a unitary business unless the department, in writing, allows reporting on a different basis. Nonapportionable income shall be allocated as provided in s. 71.25 (5) (b), Stats.

(2) DEFINITIONS. In this section:

(a) "Apportionable income" has the meaning given in s. 71.25 (5) (a), Stats.

(b) "Engaged in business in and outside this state" means having business activity which is sufficient to create nexus in this state and at least one other state or foreign country.

(c) "Gross receipts" means gross sales less returns and allowances, plus service charges, freight, carrying charges or time-price differential charges incidental to the sales. Federal and state excise taxes, including sales and use taxes, shall be included as part of the receipts if the taxes are passed on to the purchaser or included as part of the selling price of the product.

(d) "Nexus" means that a taxpayer's business activity in a state or foreign country is of such a degree that the state or foreign country has jurisdiction to impose an income tax or franchise tax measured by net income on the taxpayer. Nexus may exist even if a state or foreign country does not impose a tax on the taxpayer. Conversely, voluntary filing and paying income or franchise taxes when not required to do so, or paying a fee for qualification, organization or for

the privilege of doing business in that state or foreign country does not, in itself, create nexus.

B. STANDARD OF REVIEW

Assessments made by the Department are presumed to be correct, and the burden is on 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); Wis. Stat. § 77.59(1). Tax exemptions, deductions, and privileges are matters of legislative grace and will be strictly construed against the taxpayer. *Fall River Canning Co. v. Dep't of Taxation*, 3 Wis. 2d 632, 637, 89 N.W.2d 203 (1958). However, a tax cannot be imposed without clear and express language for that purpose, and where ambiguity and doubt exist, it must be resolved in favor of the person upon whom it is sought to impose the tax. *Kearney & Trecker Corp. v. Dep't of Revenue*, 91 Wis.2d 746, 753, 284 N.W.2d 61 (1979); *Dep't of Revenue v. Milwaukee Refining Corp.*, 80 Wis.2d 44, 257 N.W.2d 855 (1977).

When interpreting a statute, we assume that the legislature's intent is expressed in the statutory language. Statutory interpretation "begins with the language of the statute. If the meaning of the statute is plain, we ordinarily stop the inquiry." *State ex rel. Kalal v. Circuit Court*, 271 Wis. 2d 633, 663, 681 N.W.2d 110 (2004). "Statutory language is given its common, ordinary, and accepted meaning, except that technical or specially-defined words or phrases are given their technical or special definitional meaning." *Id.*; see also, Wis. Stat. § 990.01(1). Context and structure are also important

factors, and construction should strive to avoid absurd or unreasonable results. “If this process of analysis yields a plain, clear statutory meaning, then there is no ambiguity, and the statute is applied according to this ascertainment of its meaning.” *Id.*

C. ANALYSIS

1. Burdens of Proof

The Department argues that OSB has the burden of proof because it is challenging an assessment, seeking an exemption from tax via allocation of its income to Delaware, and seeking to deduct the disputed bad debt. OSB reasons that the Department has the burden of proof because this matter requires interpretation of a statute that imposes a tax on OSB and that any ambiguity therefore must be resolved in its favor.

On the issue of apportionment or allocation, we agree with OSB. Section 71.25(5) is a statute of imposition, not exemption. To the extent that the statute apportions or allocates income to other jurisdictions, it does not exempt that income from tax; it simply recognizes that such income is not taxable in Wisconsin. Exemption statutes, in contrast, concern income that is subject to Wisconsin income tax (including income apportioned or allocated to Wisconsin), but is granted exemption from tax, usually for reasons of public policy. For example, Wisconsin does not tax the income of charitable organizations that have been recognized as exempt by the IRS under IRC § 501(c)(3).

With respect to the disputed bad debt deduction, the Department is clearly correct. As the party claiming the deduction, OSB has the burden of proof on this issue, and the terms of the applicable statute are strictly construed against granting the deduction.

2. Wis. Stat. § 71.25(4)

Before addressing the issue of apportionment, the Department first argues that OSB is not eligible for apportionment under § 71.25(5), Wis. Stats., because it is subject to § 71.25(4), which provides: “For corporations engaged in business wholly within this state, all income is subject to, or included in the measure of, the Wisconsin income or franchise tax.” § 71.25(4), Wis. Stats. The Department notes that the stipulated facts show only that OSB is engaged in business in Wisconsin and do not reflect any business activities in Delaware (OSB’s state of incorporation), or any other state.

However, the Department’s argument is inconsistent with applicable administrative rules. Under Wis. Admin Code § Tax 2.39(1), the general rule requires apportionment by a corporation “engaged in business both in and outside this state” Wis. Admin. Code § Tax 2.39(1)(a). Under the applicable definition, “[e]ngaged in business in and outside this state’ means having business activity which is sufficient to create nexus in this state and at least one other state or foreign country.” Wis. Admin Code § Tax 2.39(2)(b). “Nexus’ means that a taxpayer’s business activity in a state or

foreign country is of such a degree that the state or foreign country has jurisdiction to impose an income tax or franchise tax measured by net income on the taxpayer.” Wis. Admin. Code § Tax 2.39(2)(d).

OSB is incorporated in Delaware and the parties stipulated that OSB is subject to Delaware’s jurisdiction. (Stip. ¶ 45.) We are aware of no authority that would prevent Delaware from exercising jurisdiction over a resident corporation, and the Department cites none. Consequently, the applicable definitions indicate that OSB is engaged in business both in and outside Wisconsin, and thus is subject to apportionment under § 71.25(5), not allocation under § 71.25(4).

In support of its argument under § 71.25(4), the Department cites only one case, *General Robotics de Puerto Rico, Inc. v. Dep’t of Revenue*, Wis. Tax Rptr. (CCH) ¶ 202-977 (Dane Co. Cir. Ct. 1988), in which the Circuit Court held that a corporation’s income was not subject to apportionment in Wisconsin where its sole contact with the State was its incorporation in Wisconsin. However, this decision was based primarily on the court’s determination that the Commission had drawn inferences and found facts that were not supported by the record in the case, which consisted of the parties’ stipulation. In addition, this case predates the administrative rules discussed above.³ Under current

³ In reaching its decision, the Dane County Circuit Court reversed the Commission’s holding in the case, which was based in part on the Commission’s determination that the term “engaged in business within the state” was “not defined in any statute or administrative tax regulation.” *General Robotics de Puerto Rico, Inc. v. Dep’t of Revenue*, Wis. Tax Rptr. (CCH) ¶ 202-906 (WTAC 1987). The Circuit Court’s decision was later affirmed by the Court of Appeals in an unpublished decision. *General Robotics*, 148 Wis. 2d 950, 437 N.W.2d 236 (Ct. App. 1988) (unpublished decision).

rules, we find that OSB is engaged in business both in and outside Wisconsin, and thus is required to apportion its income under Wis. Stat. § 71.25(5).

3. Wis. Stat. § 71.25(5)

OSB's argument for allocation of its income to Delaware under § 71.25(5) is straightforward. Certain types of apportionable income are allocated, rather than apportioned. In this case, the relevant statutes provide that the income of a personal holding company, as defined in IRC § 542,⁴ is allocated to its state of incorporation. Wis. Stat. § 71.25(5)(b)2. Applying these rules, OSB argues that it qualified as a personal holding company during the Audit Period, and that all of its income thus was allocated to Delaware, its state of incorporation, during that period.

a. Qualification of OSB as a Personal Holding Company

For purposes of § 71.25(5)(b)2., "personal holding company" (herein, "PHC") is defined by IRC § 542, which imposes requirements on adjusted ordinary gross income and stock ownership. (*See*, Stip. ¶ 25.) According to the Stipulation, OSB satisfied these requirements during the Audit Period. First, personal holding company income is defined in IRC § 543(a) to include dividends, interest, royalties and certain rents. (Stip. ¶ 7.) At least 60% of OSB's adjusted ordinary gross income for the Audit Period was personal holding company income as defined in IRC §§ 542(a)(1) and

⁴ As amended to December 31, 1974 (herein, "Section 542"). Although Section 542 has been amended several times since December 31, 1974 through the Audit Period, both parties cite the December 31, 1974 version of the statute as the version germane to this case. (Pet. Br., p. 4; Dept. Br., p. 6.)

543(b)(2). (Stip. ¶ 6.) Second, OSB's stock was owned, directly or indirectly, by or for not more than five individuals, as defined in IRC § 542(a)(2), during the Audit Period. (Stip. ¶ 5.)

b. The Department's Arguments Against Treatment as a PHC

The Department objects that OSB should not be permitted to claim status as a PHC for several reasons. First, OSB did not file its federal returns as a PHC during the Audit Period. (Stip. ¶¶ 28-31.) By not filing as a PHC, OSB avoided paying the 15% tax imposed on undistributed PHC income under IRC § 541, assuming OSB would have owed any such tax if it had filed federal form PH. The Department asserts that OSB "refuses to accept the burdens" of PHC status, "while seeking to claim" its benefits. (Dept. Br., p. 7.)

Here, the Department argues that OSB has the same "duty of consistency" in reporting its Wisconsin tax positions as it has on its federal returns. *See, Kielmar v. Comm'r*, 884 F.2d 959, 965 (7th Cir. 1989). This duty "prevents the taxpayer from taking a position on one tax return and a contrary position on a subsequent return after the limitations period has run for the prior year." (Dept. Br., p. 8.) The Department argues that this federal tax concept should be extended to cover a taxpayer's "positions for federal purposes and positions taken before a federalized state, where the statute of limitations has expired for one or the other, absent a statutory difference that would abrogate such a duty." *Id.* The years at issue in this case are closed for federal

purposes, which would give rise to the duty of consistency urged by the Department. (Stip. ¶ 28.)

In further support of extending this standard to Wisconsin, the Department cites *Dep't of Revenue v. River City Refuse Removal, Inc.*, 289 Wis. 2d 628, 656, 712 N.W.2d 351 (Ct. App. 2006), quoting *Diagnostic Radiology Assocs. of Wis., S.C. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-087 (WTAC 1994). As stated in that case, “[a] taxpayer cannot, in hindsight, recant its former transactions for ones that it might have made in order to obtain tax advantages.” *Id.* However, this argument does not apply here, because OSB has not recanted any former transactions.

By imposing a duty of consistency, the Department is claiming the right to a type of equitable recoupment, but it is not clear why the Department should be able to claim a state tax benefit arising from a taxpayer’s federal returns. Adoption of this doctrine would grant the Department greater authority to make adjustments to taxpayers’ Wisconsin returns based upon the Department’s opinions of their federal reporting, even in cases where the IRS has not challenged the federal return in question. While Wisconsin’s income tax is largely federalized, there remain significant differences between federal and Wisconsin income tax laws, and further federalization should come through legislation, not a decision by the Commission.

The Department’s proposed duty of consistency also is undercut in this case by the fact that Wisconsin does not permit the filing of consolidated returns. For

federal purposes, OSB filed its returns as part of a consolidated group during the Audit Period. Since OSB could not file such a return in Wisconsin, it was impossible for it to take positions for both federal and Wisconsin tax purposes that were entirely consistent during the Audit Period. In addition, the Department's own inconsistent positions in this case further undercut its argument. With respect to OSB's claimed bad debt deduction, the Department asserts that it is not required to follow federal treatment of the same, while simultaneously arguing that OSB must maintain entirely consistent positions regarding PHC status. We agree with the Department that it is not bound by determinations of the IRS, but its contradictory arguments on these two issues in the same case make its position seem less than reasonable.

Finally, we note that § 71.25(5)(b)2. requires that the taxpayer qualify as a PHC under the IRC § 542 definition of the same, not that it file federal returns as a PHC. Had the Legislature intended to impose that specific filing requirement, it could have done so. For these reasons, we decline to extend the federal duty of consistency to this case as urged by the Department.

c. Allocation of OSB's Income to Delaware

Since we have determined that OSB qualified as a personal holding company under IRC § 542 during the Audit Period, its income is allocated to Delaware during that same period under § 71.25(5)(b)2., Wis. Stats. On this point, there is no dispute, because the terms of the statute unambiguously require this result.

4. The Bad Debt Deduction

The second issue submitted by OSB for review by the Commission is the disputed bad debt deduction. However, as noted by OSB, this issue becomes moot if the Commission finds that its income for the Audit Period is allocated to Delaware. (Pet. Reply, p. 40 n. 13.) Because the Commission has so determined, we do not reach the issue of the bad debt deduction.

CONCLUSION

As noted above, the Department's assessment is presumed to be correct and OSB has the burden of showing that it is incorrect. However, because we are interpreting a statute that imposes a tax, any ambiguity must be resolved in OSB's favor. We conclude that OSB's analysis is correct, and that it has met its burden of proof.

ORDER

The Department's action on the Petitioner's petition for redetermination in this matter is reversed.

Dated at Madison, Wisconsin, this 26th day of January, 2009.

WISCONSIN TAX APPEALS COMMISSION

David C. Swanson, Chairperson

Roger W. Le Grand, Commissioner

Thomas J. McAdams, Commissioner

ATTACHMENT: "NOTICE OF APPEAL INFORMATION"