

STATE OF WISCONSIN
TAX APPEALS COMMISSION

MICHAEL MURPHY,

Petitioner,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

**DOCKET NOS. 09-I-134
AND 09-I-142**

DECISION AND ORDER

DAVID C. SWANSON, COMMISSIONER:

This matter comes before the Commission on a Stipulation of Facts with Exhibits filed by the parties on March 10, 2010 (the "Stipulation"). Attorneys John M. Remmers and Carina R. Garcia of Cramer, Multhauf & Hammes, LLP, Waukesha, Wisconsin, represent the Petitioner in this matter. The Respondent, the Wisconsin Department of Revenue (the "Department"), is represented by Attorney John R. Evans. Both parties have submitted briefs.

The Commission's findings of fact consist of the facts stipulated by the parties, with certain 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. The Petitioner, Mr. Michael Murphy, was a full-year resident of the Commonwealth of Pennsylvania during the tax years at issue in these matters, 2003 and 2004. (Stip. ¶ 3.)

2. The Petitioner was a Class C Member in Northern Capital Management, LLC (“NCM”¹), pursuant to the Northern Capital Management, LLC Third Amended and Restated Limited Liability Company Agreement dated as of January 1, 2003 (the “2003 Agreement”). (Stip. ¶ 4.)

3. The 2003 Agreement was the governing document for the 2003 tax year under review in Docket No. 09-I-142. (Stip. ¶ 5.)

4. The Petitioner was a Class C Member in NCM pursuant to the Northern Capital Management, LLC Fourth Amended and Restated Limited Liability Company Agreement dated as of January 1, 2004 (“2004 Agreement”). (Stip. ¶ 6.)

5. The 2004 Agreement was the governing document for the 2004 tax year under review in Docket No. 09-I-134. (Stip. ¶ 7.)

6. NCM was a regulated investment management firm for the 2003 and 2004 tax years. NCM managed a range of equity and fixed income portfolios for institutional investors and individuals. (Stip. ¶ 8.)

7. NCM was registered with the U.S. Securities and Exchange Commission (“SEC”) as an investment advisor for the 2003 and 2004 tax years. The

¹ Although this fact is not included in the Stipulation, Wisconsin Department of Financial Institutions public records indicate that NCM is a Delaware limited liability company (“LLC”) registered to do business in Wisconsin since September 8, 2000. The Stipulation does not describe NCM’s operations in detail, but they appear to be based in Wisconsin.

employees of NCM were certified in the State of Wisconsin as Investment Advisor Representatives or were certified as Chartered Financial Analysts. (Stip. ¶ 9.)

8. NCM was compensated by investors for these services through a fee that was computed as a percentage of assets under management. These fees were a result of personal and/or professional services rendered by NCM to its clients. (Stip. ¶ 10.)

9. NCM was taxed as a partnership both at the federal level and in the State of Wisconsin during the 2003 and 2004 tax years. NCM reported its income on Federal Form 1065 and Wisconsin Form 3. (Stip. ¶ 11.)

10. During the tax years of 2003 and 2004, the members of NCM were divided into three (3) membership classes: Class A; Class B; and Class C. In 2004, an additional member, the Managing Member, was added. (Stip. ¶ 12.)

11. The Class A Member was MDF Partners, LLC. MDF Partners, LLC was comprised of five (5) individual members and one managing member. (Stip. ¶ 13.)

12. The Class B Member was Norcap Associates, LLC. Norcap Associates, LLC was comprised of eleven (11) individual members and a managing member. (Stip. ¶ 14.)

13. The Class C Membership was composed of three (3) individuals. The Petitioner was one of the Class C members. Each Class C member owned 2.5 units of NCM, which represented a 2.5% ownership interest in NCM. (Stip. ¶ 15.)

14. The Managing Member of NCM was Norcap Murphy, LLC. (Stip. ¶ 16.)

15. The entire and exclusive voting power, including all rights as sole managing member, was vested in the Managing Member. The Managing Member was elected at the sole discretion of the Class A Member. (Stip. ¶ 17.)

16. The Class B and Class C Members were not entitled to vote on any matter. (Stip. ¶ 18.)

17. The Class A Member's interest in NCM could be pledged, encumbered, and/or sold in connection with the operation of NCM. (Stip. ¶ 19.)

18. The Class B and Class C Members could not transfer, assign, pledge or encumber any of their membership interest in NCM. (Stip. ¶ 20.)

19. Each member made capital contributions in the following amounts during the tax year of 2003: the Class A Member contributed property valued at \$4,000,000 and contingent payments which could increase such Member's capital contribution by an additional \$4,000,000; the Class B Member contributed property valued at \$0; and each Class C Member contributed \$250,000 of cash. (Stip. ¶ 21.)

20. For 2004, the capital contributions for the Class A, B, and C Members were unchanged. In 2004, the Managing Member contributed \$175,000 to NCM as a capital contribution for its membership interest. (Stip. ¶ 22.)

21. All expenses and compensation paid to employees were deducted from NCM's revenues during 2003 and 2004. (Stip. ¶ 23.)

22. Four (4) of the five (5) individual members of MDF Partners, LLC and the eleven (11) individual members of Norcap Associates, LLC were active

employees of NCM and therefore were paid compensation by NCM during 2003 and 2004. (Stip. ¶ 24.)

23. NCM's revenue was allocated between the Class A, B, and C Members pursuant to the 2003 and 2004 Agreements. (Stip. ¶ 25.)

24. In general, the revenue amount for the Class A Member (Class A Revenue Amount) was determined as follows for the 2003 and 2004 tax years: (1) if the revenue for the fiscal year was less than the base revenue amount, then the Class A Revenue Share was a base income amount less a percentage amount of the difference between the base revenue amount and the actual revenue amount; (2) if the revenue for the fiscal year was equal to or in excess of the base revenue amount but less than a second base revenue amount, the Class A Revenue Share was a base income amount plus a percentage of the amount by which the actual revenue amount exceeded the base revenue amount; and (3) if the revenue was in excess of the second base revenue income amount, another base and percentage was applicable. (Stip. ¶ 26.)

25. In general, the revenue amount for the Class B Member (Class B Revenue Amount) was determined as follows for the 2003 and 2004 tax years: (1) if the revenue for the fiscal year was less than the base revenue amount, then the Class B Revenue Share was \$0; (2) if the revenue for the fiscal year was equal to or greater than a base revenue amount but less than a second base revenue amount, the Class B Revenue Share was a percentage of the amount above the base revenue amount; (3) if the revenue was between a second base revenue and a third base revenue amount, the Class B Revenue Share was a base income amount plus a percentage of the amount the

revenue exceeded the second base revenue amount; and (4) if the revenue was in excess of the second base revenue income amount, another base and percentage was applicable. (Stip. ¶ 27.)

26. In general, the revenue amount for the Class C Members (Class C Revenue Amount) was determined as follows for the 2003 and 2004 tax years: (1) if the revenue for the fiscal year was less than a base revenue amount, the Class C Revenue Share was a base amount less a percentage of the difference between the base revenue amount and the actual revenue amount; and (2) if the revenue was at or in excess of the base revenue amount, the Class C Revenue Share was a base income amount plus a percentage of the amount the revenue exceeded the base amount. (Stip. ¶ 28.)

27. For 2003 and 2004, Class A Revenue Amounts, Class B Revenue Amounts, and Class C Revenue Amounts were determined as articulated in Paragraphs 25 through 27 with the only difference being in 2004 the Managing Member received a Managing Member Revenue Amount. The Managing Member Revenue Amount was calculated similarly to the Class C Revenue Amount. (Stip. ¶ 29.)

28. The amount distributable to the Class C Members was calculated by multiplying the Class C Revenue Amount by a fraction, the numerator of which was the number of Class C units the individual Class C Member held (2.5 units each) and the denominator of which was the total number of Class C interests outstanding (7.5 units). (Stip. ¶ 30.)

29. The Petitioner was never an employee of NCM, either before, during or after the tax years of 2003 and 2004. The Petitioner's only connection with NCM during the 2003 and 2004 tax years was as an investor. (Stip. ¶ 31.)

30. As a Class C Member, the Petitioner was not entitled to vote on any matters related to NCM. (Stip. ¶ 32.)

31. As a Class C Member, the Petitioner could not transfer, assign, pledge or encumber any portion of his Membership Interest in NCM. (Stip. ¶ 33.)

32. The Petitioner never performed services on behalf of NCM in the State of Wisconsin or in any other state, either before, during or after the tax years of 2003 and 2004. (Stip. ¶ 34.)

33. The income allocated to Petitioner by NCM was solely derived from NCM providing personal and/or professional services. Such personal and/or professional services of NCM included managing a range of equity and income portfolios for individuals and institutional investors. (Stip. ¶ 36.)

34. As a Class C Member of NCM, Petitioner reported the income allocated to him from NCM on his 2003 and 2004 income tax returns for the Commonwealth of Pennsylvania. The Petitioner timely paid taxes on such NCM income allocable to him in Pennsylvania. (Stip. ¶ 37.)

35. On or about October 26, 2007, the Department issued a Notice of Additional Assessment of Income Tax to Petitioner pertaining to the 2003 tax year in the amount of \$4,126.12 (the "2003 Notice"). (Stip. ¶ 38.)

36. On or about October 26, 2007, the Department issued a Notice of Additional Assessment of Income Tax to Petitioner pertaining to the 2004 tax year in the amount of \$7,323.61 (the "2004 Notice"). (Stip. ¶ 39.)

37. On or about December 21, 2007, the Petitioner filed a Petition for Redetermination with the Department objecting to the 2003 Notice (the "2003 Petition"). (Stip. ¶ 40.)

38. On or about December 21, 2007, the Petitioner filed a Petition for Redetermination with the Department objecting to the 2004 Notice (the "2004 Petition"). (Stip. ¶ 41.)

39. On or about May 29, 2009, the Department issued an Action Letter to the Petitioner denying the 2003 Petition (the "2003 Denial"). (Stip. ¶ 42.)

40. On or about May 29, 2009, the Department issued an Action Letter to the Petitioner denying the 2004 Petition (the "2004 Denial"). (Stip. ¶ 43.)

41. At the same time the Petitioner was appealing the Department's decision, two other nonresident members of NCM were appealing an assessment of the similar nature. (Stip. ¶ 44.)

42. All of the individuals involved in the assessment were nonresidents of the State of Wisconsin and did not perform services in the State of Wisconsin. However, the other two nonresident members of NCM did perform services for NCM outside of the State of Wisconsin whereas the Petitioner did not perform any services for NCM. (Stip. ¶ 45.)

43. The Resolution Officer from the Department combined these three matters as they were based on similar facts and pertained to NCM. The Resolution Officer provided the Petitioner and the other two nonresident individuals with a Resolution Unit Action Report (“Report”). (Stip. ¶ 46, Ex. 1.)

44. The Report relied on Wisconsin Tax Bulletin 59, which states “partnership income derived from personal services, including professional services, is taxable to a nonresident partner only if that nonresident partner personally performs services in Wisconsin.” (Stip. ¶ 47, Ex. 2.)

45. The Resolution Officer dismissed the other two nonresident members as she believed that these two individuals met the criteria of Wisconsin Tax Bulletin 59, namely that they were both nonresident partners who did not perform services in Wisconsin. (Stip. ¶ 48.)

46. The Resolution Officer did not dismiss the matter involving the Petitioner, however. The Resolution Officer’s reasoning, according to the Report, was predicated on the fact that the Petitioner, although he was a nonresident partner and did not perform services in Wisconsin, did not perform any services for NCM and therefore fell outside the purview of Wisconsin Tax Bulletin 59. (Stip. ¶ 49.)

47. As a result of this denial, the Petitioner on or about July 27, 2009 filed a timely Petition for Review of the 2004 Denial with the Commission. (Stip. ¶ 50.)

48. On or about August 3, 2009, the Petitioner filed a timely Petition for Review of the 2003 Denial with the Commission. (Stip. ¶ 51 (first).)

49. The Department has issued the following publications that the parties agree may be relevant to the issues herein:

- a. WTB #41 (Ex. 3).
- b. WTB #48 (Ex. 4).
- c. Publication #119 (Ex. 5).

(Stip. ¶ 51 (second), Ex. 3-5.)

50. The following Department interoffice documents were filed as Exhibits 6-16:

- a. Interoffice Memorandum dated February 13, 1963 (Ex. 6).
- b. Correspondence from H.W. Ericksen dated May 16, 1977 (Ex. 7).
- c. Correspondence to Carol Held dated March 7, 1988 (Ex. 8).
- d. Correspondence from J. DeYoung dated October 13, 1988 (Ex. 9).
- e. LRB Draft from James Behrend, Dan Davis, Allan Hubbard, Eng Braun, Margaret Derus, and Ron Rosner dated 1990 (Ex. 10).
- f. Description of Current Law and Problem dated June 14, 1994 (Ex. 11).
- g. Memorandum of July 17, 1963 to all auditors from E. J. Blum (Ex. 12).
- h. Hand Written Memo of March 7, 1988 to Tom Solberg from Carol Held (Ex. 13).
- i. Budget Item Draft of March 10, 1988 by Carol Held (Ex. 14).
- j. Budget Item Draft of September 23, 1988 by Carol Held (Ex. 15).
- k. Letter of December 3, 1992 to Inquirer from Carol Held (Ex. 16).

(Stip. ¶ 52, Ex. 6-16.)

CONCLUSIONS OF LAW

1. The Petitioner has satisfied his burden of proving the assessments at issue in this matter to be incorrect.

2. The Petitioner permissibly treated the income at issue as personal service income that is not subject to Wisconsin income tax.

DECISION

A. RELEVANT STATUTES

Based on their briefs, the parties agree that the relevant applicable statutes in this matter are Wis. Stats. §§ 71.02 and 71.04. Wis. Stat. § 71.02(1) imposes Wisconsin income tax on individuals in relevant part as follows:

71.02 Imposition of tax.

(1) For the purpose of raising revenue for the state and the counties, cities, villages and towns, there shall be assessed, levied, collected and paid a tax on all net incomes of individuals . . . by every nonresident natural person and trust of this state, upon such income as is derived from property located or business transacted within the state including, but not limited by enumeration, . . . income derived from a limited liability company member's distributive share of limited liability company income, . . . and also by every nonresident natural person upon such income as is derived from the performance of personal services within the state, except as exempted under s. 71.05 (1) to (3). . . .

Wis. Stat. § 71.04(1)(a) defines the situs of income subject to tax as follows,

in relevant part:

(a) All income or loss of resident individuals and resident estates and trusts shall follow the residence of the individual, estate or trust. Income or loss of nonresident individuals and nonresident estates and trusts from business, not requiring apportionment under sub. (4), (10) or (11), shall follow the situs of the business from which derived, Income from personal services of nonresident individuals, including income from professions, shall follow the situs of the services. . . . A nonresident limited liability company member's distributive share of limited liability company income shall follow the situs of the business, All other income or loss of nonresident individuals and nonresident estates and trusts, including income or loss derived from land contracts, mortgages, stocks, bonds and

securities or from the sale of similar intangible personal property, shall follow the residence of such persons,

Wis. Stat. § 71.04(3)(b) provides for filing by nonresident members of limited liability companies as follows, in relevant part:

(b) *Part-year residents, nonresidents.* All partners or members who are residents of this state for less than a full taxable year or who are nonresidents shall compute taxes for that year on their share of partnership or limited liability company income or loss under this chapter for the part of the taxable year during which they are nonresidents by recognizing their proportionate share of all items of income, loss or deduction attributable to a business in, services performed in, or rental of property in, this state.

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). The Petitioner therefore bears the burden of proof.

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.*

In seeking a plain meaning, a court seeks a meaning that anyone--a lawyer, a party, an administrator, or any reader--could discern simply by examining the text of the statute, perhaps with the aid of a dictionary, a book generally available to all. *County of Dane v. LIRC*, 315 Wis. 2d 293, 759 N.W. 2d 571 (Abrahamson, J., concurring). If the language in the statute is ambiguous, we may rely on extrinsic aids such as legislative history, scope, purpose, subject matter and context to determine the legislature’s intent. *Id.* A statute is ambiguous only if it is capable of two or more reasonable interpretations. *In re T.P.S.*, 168 Wis. 2d 259, 264, 483 N.W.2d 591 (Ct. App. 1992). A statute, word or phrase is ambiguous, and use of the rules of construction proper, only when it is capable of being interpreted by reasonably well-informed persons in two or more senses. *See, Guertin v. Harbour Assurance Co. of Bermuda, Ltd.*, 135 Wis. 2d 334, 338, 400 N.W.2d 56, 58 (Ct.App. 1986), *aff’d*, 141 Wis. 2d 622, 415 N.W.2d 831 (1987).

A statute that is plain on its face may also be rendered ambiguous by the context in which it is sought to be applied. *See, Roehl v. American Family Mut. Ins. Co.*, 222 Wis. 2d 136, 145, 585 N.W.2d 893 (Ct. App.), *rev. den’d*, 222 Wis. 2d 676, 589 N.W.2d 630; *Brandt v. LIRC*, 160 Wis.2d 353, 368, 466 N.W.2d 673, 679 (Ct. App 1991) (“[D]epending on the facts of a given case, the same statute may be found ambiguous in one setting and unambiguous in another.”). Regarding tax statutes, 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). The ultimate result in this case, therefore, depends upon whether the statute is ambiguous and doubtful. *National Amusement Co. v. Dep't of Taxation*, 41 Wis. 2d 261, 267, 163 N.W.2d 625 (1969); *Manpower, Inc. v. Dep't of Revenue*, Docket No. 05-S-046 (WTAC Aug. 12, 2009).

C. ANALYSIS

The central question in this matter is how to characterize the income that the Petitioner received from NCM during 2003-2004, the years at issue. The Petitioner was a Class C Member of NCM, a Delaware limited liability company doing business in Wisconsin, and received a distributive share of NCM's income in 2003 and 2004. The Petitioner was a full-year resident of Pennsylvania and never performed services on behalf of NCM in Wisconsin or in any other state. At that time, NCM was a regulated investment firm that managed a range of equity and fixed income portfolios for institutional investors and individuals. NCM filed as a partnership for purposes of federal and Wisconsin income tax. The Petitioner reported and paid Pennsylvania income tax on his income from NCM for those years, but did not file or pay income tax in Wisconsin. The Department assessed the Petitioner for Wisconsin income tax for 2003-2004, denied the Petitioner's petition for redetermination, and the Petitioner appealed to the Commission for review.

In brief, the Petitioner argues that NCM, as a regulated investment firm, is engaged in the business of providing personal services, and LLC “income derived from personal services, including professional services, is taxable to a nonresident only if that nonresident personally performs services in Wisconsin.” Pet. Brief at 4, quoting Wis. Tax Bull. 59 (Jan. 1989) (Stip. ¶ 47, Ex. 2). The Department responds that the Petitioner is claiming an exception that does not apply in his case, because he did not perform personal services for NCM or any other party in Wisconsin or any other state during the years at issue.

We find that the meanings of Wis. Stats. §§ 71.02 and 71.04 in this context are not plain, and we therefore look to extrinsic aids to help resolve any ambiguity, beginning with the guidance provided by the Department on this issue. The relevant portion of the Department’s Wisconsin Tax Bulletin 59 (Jan. 1989) is entitled “Change in Taxation of Nonresident Partners” and states as follows:

Prior Position: The department had previously held that a nonresident partner of a personal service or professional partnership was taxable on his or her share of partnership income attributable to personal services performed in Wisconsin, regardless of whether or not the nonresident partner personally performed services in Wisconsin.

New Position: The department has revised its position to provide that partnership income derived from personal services, including professional services, is taxable to a nonresident partner only if that nonresident partner personally performs services in Wisconsin. The amount of personal service income attributable to the nonresident partner’s services performed in Wisconsin is taxable. This new position applies to general partners for all years open under the statute of limitations, as well as prospectively.

(Note: Business income continues to be taxable whether or not the individual partner conducts business in Wisconsin.)

Wis. Tax Bull. 59, p. 4 (Jan. 1989) (Stip. Ex. 2) (emphasis added). Interestingly, the stipulated exhibits further show that Department personnel changed the Department's interpretation of these provisions in response to a request from a law firm with partners residing in and outside Wisconsin, and the intent of this change was

that nonresident partners in partnerships involving personal services, including professions (other than a 'business') will not be taxed unless such partners themselves personally perform personal services in Wisconsin. Only such income attributable to their own personal services in Wisconsin will be subject to Wisconsin tax.

Dept. Memo from J. DeYoung dated Oct. 13, 1988 (Stip. Ex. 9).

The Department subsequently provided additional public guidance in Publication 119 *Limited Liability Companies (LLCs)* in 2009, which states as follows regarding the tax treatment of members of LLC's classified as partnerships:

B. LLC Members Who Are Nonresident Individuals, Estates, and Trusts

A nonresident individual, estate or trust member's portion of the LLC income or loss which is attributable to a business located in Wisconsin, services performed in Wisconsin, or real or tangible personal property located in Wisconsin is includable in the computation of Wisconsin taxable income. Business income is taxable whether or not the individual member conducts business in Wisconsin. **However, LLC income derived from personal services, including professional services, is taxable to a nonresident member only if that nonresident member personally performs services in Wisconsin.** The amount of personal service income attributable to the nonresident member's services performed in Wisconsin is taxable. [§§71.02(1) and 71.04(1)(a), Wis. Stats.]

Example 1: A nonresident of Wisconsin who is an individual has a 30% interest in an LLC that is engaged in business in and outside Wisconsin. The LLC has ordinary income of \$150,000, of which \$60,000 is attributable to its business activities in Wisconsin. The nonresident member is subject to Wisconsin income tax on \$18,000 of LLC income [30% x \$60,000].

Example 2: A nonresident of Wisconsin who is an individual has a 5% interest in an engineering firm that is organized as an LLC and operates in and outside Wisconsin. The LLC receives income solely from the performance of engineering services. The nonresident member does not personally perform any engineering services in Wisconsin. The nonresident member's share of LLC income is not taxable by Wisconsin.

Dept. of Revenue Pub. 119, *Limited Liability Companies (LLCs)*, p. 10 (March 2009) (emphasis added) (Stip. ¶ 51 (second), Ex. 5).

The parties have stipulated that NCM was in the business of providing personal services, that the Petitioner provided no such personal services as a member of NCM, and that the income allocated to the Petitioner by NCM was solely derived from NCM providing personal and/or professional services. (Stip. ¶¶ 10, 34 and 36.) Therefore, the question presented is: what was the character of the income received by the Petitioner from NCM during the years at issue? Did it remain personal service income after being passed through NCM to the Petitioner, or was it business income to the Petitioner?

The Department argues that Wis. Stat. § 71.02 sets up a three-step analysis that requires determining (1) what kind of income is at issue, (2) who performed the

services, and (3) where the services are performed. (Dept. Brief at 2-3.) The income began as personal services income generated by NCM. At the second step of its analysis, the Department asserts that the income passed through NCM to the Petitioner became business income to the Petitioner because he did not personally perform any services. According to the Department, the Petitioner does not reach the third step, because the “taxpayer must be performing personal services before the personal service part of the statute becomes operative.” (Dept. Brief at 3.) The Petitioner argues that the income passed through NCM to him retained its character as personal services income, even though he did not personally provide any personal services.

In support, both parties cite *Shelley v. Dept. of Revenue*, 70 Wis. 2d 551, 235 N.W.2d 515 (1975), and *Whitney v. Dept. of Taxation*, 16 Wis. 2d 274, 114 N.W.2d 445 (1962). However, neither case directly addresses the issue at hand. In both cases, the taxpayer in question actually provided personal services, unlike the Petitioner. The Department interprets this to mean that the Wis. Stat. § 71.02 personal service exception therefore excludes taxpayers who have not provided personal services, but neither court ever addressed that issue in its analysis. This critical fact also distinguishes every other case cited by both parties, all of which involved taxpayers who actually provided personal services.² See, *Shelley* and *Whitney*, *supra*; *Lauritzen II v. Wis. Dep’t of Revenue*, Docket No. I-3079 (WTAC Mar. 2, 1971); *Young v. Wis. Dep’t of Revenue*, Docket No. I-

² The Department later recognizes this problem with the cited case law in its critique of the Petitioner’s case. See, Dept. Brief at 11-12.

2566 (WTAC Sep. 5, 1969); *State ex. rel. Lerner v. Tax Comm.*, 213 Wis. 267, 251 N.W. 456 (1933); and *Bechert v. Comm. of Taxation*, 221 Minn. 65, 21 N.W.2d 101 (1945).

Since the case law is inapposite, we must rely on other sources of law for interpretive guidance. In income tax matters, Wisconsin generally follows federal law. Concerning the “Income and Credits of a Partner,” the Internal Revenue Code generally provides that income passed through a partnership retains its character, as follows: “The character of any item of income, gain, loss, deduction, or credit included in a partner’s distributive share . . . shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.” IRC § 702(b). The Department has issued guidance making this same point with respect to an analogous Wisconsin income tax issue, small business stock held by a partnership under Wis. Stat. § 71.01(10):

Question 14: If a partnership or limited liability company treated as a partnership acquires stock that meets the requirements under sec. 71.01(10), Wis. Stats., may the gain on the sale of the stock qualify for the small business stock capital gains exclusion?

Answer 14: If a partnership or limited liability company treated as a partnership holds the small business stock for at least five years, an individual or fiduciary who is a partner or member of the entity may qualify for the small business stock capital gains exclusion, provided the partner or member owned an interest in the entity at the time the stock was acquired and the partner or member submits the certification with the tax return on which the capital gain is reported. **Since a partnership or limited liability company treated as a partnership is a pass-through entity, items of income, gain, loss, or deduction retain their character when passed through to the partners or members.** Therefore, stock that meets the requirements under sec. 71.01(10), Wis.

Stats., retains its character as small business stock when gain flows through to the partners or members. . . .

Wis. Tax Bull. 94, Q&A 14 (Oct. 1995) (emphasis added). Although this guidance is not directly on point, the general rule followed by both federal and Wisconsin tax law is that partnership income retains its character after being passed through to a partner.

Based on relevant federal and Wisconsin guidance, we find that the Petitioner has the better argument in this case. The Department insists that the previously-quoted portions of Wisconsin Tax Bulletin 59 and Publication 119 apply only to taxpayers who actually performed personal services either in or outside Wisconsin, but that qualification is not present in either the statutes or the Department publications. Instead, the statutes are ambiguous, and the publications are consistent with related federal and Wisconsin law, stating, for example, “LLC income derived from personal services, including professional services, is taxable to a nonresident member only if that nonresident member personally performs services in Wisconsin.” Dept. Pub. 119, *supra*.

As a final point, we note that Wisconsin generally attempts to avoid the double taxation of income of nonresidents, as shown by its adoption of a reciprocity statute providing for the exclusion of personal service income from Wisconsin taxable income for nonresidents. *See*, Wis. Stat. § 71.05(2).³ As stipulated by the parties, the

³ “Nonresident reciprocity. All payments received by natural persons domiciled outside Wisconsin who derive income from the performance of personal services in Wisconsin shall be excluded from Wisconsin gross income to the extent that it is subjected to an income tax imposed by the state of domicile; provided that the law of the state of domicile allows a similar exclusion of income from personal services earned in such state by natural persons domiciled in Wisconsin, or a credit against the tax imposed by such state on such income equal to the Wisconsin tax on such income.” Wis. Stat. § 71.05(2).

Petitioner already has reported and paid Pennsylvania income tax on the income at issue, and the imposition of Wisconsin income tax would result in the double taxation of this income for the period at issue. The Petitioner further argues that because the Department did not issue this assessment until October 26, 2007, he was ineligible to claim a refund in Pennsylvania because he could no longer file amended returns there for the years at issue. (Pet. Brief at 4.) The Department does not dispute that these assessments would result in the double taxation of the income at issue by Pennsylvania and Wisconsin.

The Department argues that the statutory language is clear, at least with respect to §§ 71.02 and 71.04. The Petitioner responds that the language is ambiguous with respect to nonresidents who receive personal service income without performing personal services. Based on the statutes, related federal and Wisconsin law, and the Department's published guidance, we agree with the Petitioner.⁴

The Department's assessments are presumed to be correct and any party challenging an assessment has the burden of showing that it is incorrect. Because we are interpreting a statute that imposes a tax, any ambiguity must be resolved in the Petitioner's favor. We find that, read in conjunction with related federal and Wisconsin

⁴ The Petitioner further offers an analysis of the legislative history of Wis. Stats. §§ 71.02 and 71.04 showing that some Department personnel have regularly disagreed with the income tax treatment described in Wisconsin Tax Bulletin 59 and Publication 119 and have recommended amending §§ 71.02 and 71.04 on multiple occasions to clarify that taxpayers similarly situated to the Petitioner are subject to Wisconsin income tax. (Pet. Brief at 12-15; Stip. Ex. 6-16.) The Petitioner argues that the Legislature's inaction on this issue shows that it has never intended to make such income taxable in Wisconsin. However, the record does not provide a clear indication of legislative intent with respect to the specific issue at hand, which involves the treatment of a nonresident partner who has not personally provided personal or professional services in any state. Consequently, since we find in favor of the Petitioner on other grounds, we do not address this issue further.

law and the Department's published guidance, the statutes at issue, Wis. Stats. §§ 71.02 and 71.04, are ambiguous in this context. We therefore resolve the ambiguity in favor of the Petitioner.⁵ We further conclude that the Petitioner's analysis is correct and that he has met his burden of proof in these matters.

ORDER

The Department's actions on the Petitioner's petitions for redetermination in these matters are reversed.

Dated at Madison, Wisconsin, this 30th day of December, 2010.

WISCONSIN TAX APPEALS COMMISSION

David C. Swanson, Chairperson

Roger W. Le Grand, Commissioner

Thomas J. McAdams, Commissioner

ATTACHMENT: "NOTICE OF APPEAL INFORMATION"

⁵ The Petitioner also argues that the Department should be equitably estopped from pursuing these assessments because the Petitioner reasonably relied on the Department's published guidance to his detriment. (Pet. Brief at 17-20.) Because we find in favor of the Petitioner on other grounds, we do not directly address his assertion of estoppel.