

Taxation

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Repository Citation

Eugene O. Duffy, *Taxation*, 61 Marq. L. Rev. 350 (1977).

Available at: <http://scholarship.law.marquette.edu/mulr/vol61/iss2/10>

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etry and awarded damages rather than land.³⁰ To award an additional eighteen feet of land would have resulted in interference with future property lines³¹ and with the recreational use of the lots.³² Although not without precedent,³³ the award of damages to the plaintiff in this decision demonstrates the value of presenting evidence as to the type of property, current land values and potential markets for the court's consideration of possible remedies.

NATALIE B. KOEHN

TAXATION*

I. AD VALOREM TAX

In Wisconsin, interstate air carriers who conduct part of their operations within the state are subject to an ad valorem tax exacted under Chapter 76 of the Wisconsin Statutes.¹ The ad valorem tax is assessed in lieu of all other property taxes on an air carrier's property within this state used in the operation of its business.² The tax liability of an air carrier subject to the ad valorem assessment in any year is the product of its Wisconsin assessed value multiplied by the average state property tax rate.³ Included in this assessed value are both the real and personal property of a carrier, and all rights, franchises and

30. *Id.* at 203, 252 N.W.2d at 659.

31. *Id.*

32. *Id.* at 196, 252 N.W.2d at 656.

33. *Rondesvedt v. Running*, 19 Wis. 2d 614, 121 N.W.2d 1 (1963); *Jansky v. Two Rivers*, 227 Wis. 228, 278 N.W. 527 (1938).

* An important tax case finding the negative-aid school financing plan unconstitutional will be the subject of a student comment in a later issue of volume 61. *Buse v. Smith*, 74 Wis. 2d 550, 247 N.W.2d 141 (1976).

1. Wis. STAT. § 76.01 (1975) provides in part: "The department of revenue shall make an annual assessment of the property . . . of all air carriers . . . within this state, for the purpose of levying and collecting taxes thereon, as provided in this chapter."

2. Wis. STAT. § 76.23 (1975). Excepted from this exemption are special assessments for local improvements.

3. Wis. STAT. § 76.12 (1975). The rate is equal to the sum of all general property taxes levied in the prior year divided by the state assessment of all general property within the state for the corresponding year.

privileges.⁴ For purposes of the tax all property is valued and assessed as a unit.⁵

The case of *Northwest Airlines, Inc. v. Department of Revenue*⁶ involved a challenge to the constitutionality of the ad valorem tax imposed on Northwest Airlines in 1973 under Chapter 76 of the Wisconsin Statutes. Northwest argued that Wisconsin's unitary method of valuation which included non-migratory property located outside the state, violated the equal protection and due process clauses of the fourteenth amendment as well as the commerce clause of the United States Constitution.

Prior to 1973, the Department of Revenue determined an air carrier's Wisconsin assessed value by identifying the value of migratory property subject to Wisconsin apportionment and adding to this the value of the carrier's property located in the state.⁷ The value of migratory property subject to apportionment was derived by applying four operating ratios⁸ to the system value of all migratory property. These ratios were deemed to be representative of Wisconsin's contribution to the overall system value of the air carrier.

The valuation of migratory property involved four steps. First, the airline system value was computed utilizing a composite of three financial valuation formulas, *i.e.*, cost less depreciation, stock debt ratio, and capitalization of income. Second, tangible property was classified as migratory and nonmigratory. Third, utilizing net book cost as a basis, the percentage of tangible property representing migratory property was determined. Fourth, the percentage calculated in step 3 was applied to the system value determined in step 1 to arrive at the system value of migratory property.

In 1973 the Department of Revenue substantially changed the method of calculation for Wisconsin assessed value. In determining system value, some of the factors changed included substitution of an industry average for the stock debt ratio

4. WIS. STAT. § 76.03(1) (1975).

5. *Id.*

6. 77 Wis. 2d 152, 252 N.W.2d 337 (1977).

7. *Id.* at 156, 252 N.W.2d at 342.

8. The ratios included: (1) revenues originating in Wisconsin over all originating revenues, (2) tonnage originating and terminating in Wisconsin over all originating and terminating tonnage, (3) flight and ground time in Wisconsin over all flight and ground time, and (4) arrivals and departures in Wisconsin over all arrivals and departures.

instead of the carrier's actual ratio and 40 percent as the effective federal income tax rate rather than 48 percent. Additionally, ground time and arrivals and departures were deleted from the operating ratios used to determine the percentage of the system allocable to Wisconsin. The reasoning supporting the changes was that the revised factors were more realistic and more accurately measured Wisconsin's contribution to the system value. However, the principal change in the formula was the inclusion of an airline's out-of-state nonmigratory property in the base from which Wisconsin assessed valuation was derived. By including out-of-state nonmigratory property in the valuation base, the prior practice of segregating migratory and nonmigratory values was discontinued.⁹

Pursuant to statutory provision, Northwest sought a judicial redetermination of the tax assessment in the circuit court for Dane County.¹⁰ The trial court awarded limited relief to Northwest, holding that the capitalized income value of the airline was too high in view of a steady decline in Northwest's income. However, the trial court found the assessment formula to be constitutional.

Northwest's principal contention on appeal was that the Wisconsin formula resulted in the value of nonmigratory property having a tax situs outside Wisconsin, being imported into Wisconsin for purposes of the tax. Northwest argued that the formula ignored the fact that the states and countries within which this nonmigratory property was located had the power to fully tax this property, and often exercised it. Consequently, a double tax on the same property resulted which, it argued, was violative of the due process and equal protection clauses. In addition, the carrier argued that such a tax imposed an undue burden on interstate commerce.¹¹

The Wisconsin court in meeting this argument recognized that for the tax to comport with the requirements of the commerce and due process clauses, the following requisites must be satisfied:

Initially, the taxpayer's activities within the taxing state must "form a sufficient 'nexus between such a tax and trans-

9. 77 Wis. 2d at 157, 158, 252 N.W.2d at 339.

10. Wis. STAT. § 76.08(1) (1975).

11. Brief for Plaintiff-Appellant at 17-18, *Northwest Airlines, Inc. v. Department of Revenue*, 77 Wis. 2d 152, 252 N.W.2d 337 (1977).

actions within a state for which the tax is the exaction'. In order to satisfy due process, the tax must have a "relation to opportunities, benefits, or protection conferred or afforded by the taxing state." Additionally, to satisfy the commerce clause the tax must not be discriminatory and must be properly apportioned to local activities.¹²

In disposing of Northwest's challenge, the court deemed that the practical effect of the taxing formula did not import extra-territorial value but rather was a legitimate means, sanctioned by statute, of ascertaining the value of the system which could be properly attributed to its property in Wisconsin.¹³ The court reiterated the well settled rule that one challenging such a tax has a heavy burden and must show that the imposition of the tax "has resulted in such gross overreaching, beyond the values represented by the intrastate assets purported to be taxed, as to violate the Due Process and Commerce Clauses of the Constitution."¹⁴

The court reasoned that there was a sufficient nexus with the out-of-state property to satisfy the commerce and due process clauses. Using as an example Northwest's out-of-state hotel properties, the court speculated that these properties may have been the inducement for customers to use Northwest and thus the state had provided a "benefit or opportunity" justifying their inclusion in the base from which Wisconsin value was determined.

The court further noted that a formula may withstand constitutional challenge "even though it could not be demonstrated that the results they yielded were precise evaluations of assets located within the taxing state."¹⁵ The court concluded by finding that Northwest had not met its burden of proof to establish that the formula applied resulted in an inequitable allocation of system value to Wisconsin.

Having found that Northwest had failed to meet its burden of proof on the issue of apportionment, the court readily disposed of Northwest's assertion of "multiple taxation" since

12. 77 Wis. 2d at 160, 252 N.W.2d at 340, quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 464 (1959); *Braniff Airways v. Nebraska Bd.*, 347 U.S. 590, 600 (1954).

13. 77 Wis. 2d at 162, 252 N.W.2d at 34.

14. *Id.*, quoting *Norfolk & W. Ry. v. Missouri State Tax Comm'n*, 390 U.S. 317, 326 (1968).

15. *Id.*

"[i]f one cannot show an unfair apportionment, the argument that there is a multiple tax must fail."¹⁶

The instant case teaches that the one questioning the constitutionality of the ad valorem tax imposed by Chapter 76 of the Wisconsin Statutes has a "heavy" if not insurmountable burden. It is clear from the decision that an interstate carrier cannot successfully challenge such a tax by merely attacking how the formula is denominated. While not expressly so holding, the result reached by the Wisconsin court, in effect, applied the "practical realities" test recently articulated by the United States Supreme Court in the case of *Complete Auto Transit, Inc. v. Brady*.¹⁷ In that case, the Supreme Court announced that it would not look to the formal language of the tax statute in deciding its constitutionality under the commerce clause but rather would look to its practical effect. If a statute's practical effect does not offend constitutional standards, then it will be sustained.

The one major question unresolved by the case is exactly what type and quantum of evidence is sufficient to meet the "heavy" burden placed on the taxpayer. Northwest introduced testimony in the trial court that during the period in question it was engaged in several income-producing ventures, not related to airline operations, involving nonmigratory property located in other states and foreign countries. These ventures included the servicing of foreign and other American airlines in Saigon, Korea and Tokyo, the operation of a hotel in Tokyo and a restaurant, bar and lounge in Alaska, and providing catering service to other airlines in Alaska.¹⁸

When this testimony is considered, it appears the court is flying in the face of the very constitutional principles it purports to embrace. On such a record, it is very difficult to justify, for example, that services performed in a war zone provide the inducement for a Wisconsin traveler to utilize Northwest's airline service.

In deference to the court, however, it appears that Northwest overlooked the means by which the formula could have been successfully attacked. As noted by the court,¹⁹ Northwest

16. *Id.* at 163, 252 N.W.2d at 342.

17. 97 S. Ct. 1076 (1977), *rehg. denied*, 97 S. Ct. 1669 (1977).

18. Brief for Plaintiff-Appellant at 21, *Northwest Airlines, Inc. v. Department of Revenue*, 77 Wis. 2d 152, 252 N.W.2d 337 (1977).

19. 77 Wis. 2d at 162, 252 N.W.2d at 341.

did not challenge the operating ratios by which the system value is apportioned to Wisconsin. To comport with constitutional requirements the tax must be properly apportioned to local activities within the state.²⁰ However, the ratios used by the Department of Revenue relate solely to the activities of a passenger-cargo airline and have no demonstrable correlation to the extraterritorial business activities sought to be reached by Wisconsin.

II. GAIN OR LOSS OF LIQUIDATING CORPORATION

WKBH Television, Inc. v. Department of Revenue,²¹ involved a challenge to the constitutionality of Wisconsin Statutes section 71.337(1).²² This statutory section, as originally enacted, was intended to bring Wisconsin law into conformity with section 337(a) of the Internal Revenue Code of 1954.²³ Section 337(a) had been enacted to provide liquidating corporations with a means of disposing of corporate assets without running the risk of double taxation.²⁴ However, Wisconsin soon discovered that its parallel provision operated to prevent the state, in some instances, from collecting any tax, since the gain in the hands of a nonresident shareholder would not be subject to Wisconsin's jurisdiction. To overcome this undesirable result,²⁵ Chapter 190, Laws of 1961, amended section 71.337(1) to

20. *Id.* at 160, 252 N.W.2d at 340.

21. 75 Wis. 2d 557, 250 N.W.2d 290 (1977).

22. Wis. STAT. § 71.337(1) (1975) provides:

General Rule. If a corporation adopts a plan of complete liquidation, and within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then gain or loss shall not be recognized to such corporation from the sale or exchange by it of property within such 12-month period to the extent that such gain or loss is participated in by Wisconsin resident shareholders.

23. *Simanco, Inc. v. Department of Revenue*, 57 Wis. 2d 47, 51, 203 N.W.2d 648, 650 (1973), *dismissed for want of substantial question*, 414 U.S. 804 (1973) (citing the bill jacket for Wis. Laws 1955, ch. 571, § 4).

24. 57 Wis. 2d at 51, 203 N.W.2d at 650, *citing* BITTKER AND EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 11.64 *et seq.* (3d ed. 1971). Prior to its enactment, a liquidating corporation ran the substantial risk that the gain derived therefrom would result in a double tax. The corporation would be liable for a tax on the gain from the sale of its assets and the shareholder was subject to tax on the gain derived from the liquidation redemption of stock.

25. Wis. STAT. § 71.337(1) (1955) had provided:

General Rule. If a corporation adopts a plan of complete liquidation, and within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less

enable Wisconsin to collect taxes from a corporation on the gain derived from liquidation to the extent that nonresident shareholders participate in the liquidation distribution.²⁶

WKBH, a corporate taxpayer, disposed of its assets pursuant to a plan of liquidation, and reported as taxable Wisconsin income that percentage of the gain derived from sale and distribution which represented the stock ownership held by nonresidents. Upon denial of a refund, the taxpayer challenged the statute on the grounds that: (1) classification of a corporation based upon the residency of its shareholders constituted a denial of equal protection of the laws, (2) the statute constituted a regulation of interstate commerce among several states in violation of the commerce clause, and (3) the statute denied WKBH and its shareholders the privileges and immunities of citizens of the several states and citizens of the United States in violation of the fourteenth amendment to the Constitution.

The Wisconsin court, relying principally on its prior decision in *Simanco, Inc. v. Department of Revenue*,²⁷ held the statute comported with equal protection requirements. The court noted that the impact of the tax levied falls equally on both the resident and nonresident shareholders and that the classification which resulted in the tax was a reasonable implementation of a legislative policy to avoid escaping tax on gain which is within the jurisdiction of the state's taxing authority.²⁸

The court rejected the claim of the taxpayer that the statute imposed an undue burden on interstate commerce.²⁹ WKBH had argued in support of this contention, that a tax measured by nonresident ownership was discriminatory per se, that the tax hindered the flow of capital and that there was a possibility

assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

26. "[T]o the extent that such gain or loss is participated in by Wisconsin resident shareholders." Added by Wis. Laws 1961, ch. 190.

27. 57 Wis. 2d 47, 203 N.W.2d 648 (1973), *dismissed for want of substantial question*, 414 U.S. 804 (1973). Equal protection was the only issue raised in this case. The case is discussed in *1974 Wisconsin Term of Court*, 57 MARQ. L. REV. 335, 338 (1974).

28. 75 Wis. 2d at 564, 250 N.W.2d at 296, *quoting Simanco, Inc. v. Department of Revenue*, 57 Wis. 2d 47, 57-58, 203 N.W.2d 648, 653 (1973).

29. In reaching its result the court was aided by the state's concession in its brief and on oral argument that the tax imposed by the statute sought only to reach the local activity of corporate liquidation prior to distribution. 75 Wis. 2d at 568, 250 N.W.2d at 296.

of multiple state taxation. The court held that the taxpayer had failed to show discrimination and invidious multiple state taxation. Examining the purpose and operation of the statute, the court reasoned that the statute provided a source of revenue having a relation to the event taxed and thereby obviated a tax windfall to nonresident shareholders. The court concluded that the statute's effect at most could be viewed as neutralizing a tax advantage of nonresidents.³⁰

In disposing of WKBH's contention that the statute denied the corporation and its shareholders the privileges and immunities of the citizens of the several states and citizens of the United States, the court noted that the corporation, although a legal entity, was not a citizen for purposes of the privileges and immunities clause. The court, however, avoided the issue of the corporation's standing to raise the issue based solely on the rights of its shareholders and instead decided the issue on its merits.

Recognizing that one of the fundamental privileges and immunities under the United States Constitution was an exemption from higher taxes than those paid by the other citizens of the state, the court analyzed the distribution of the tax burden between resident and nonresident taxpayers. Concluding that the burden of the tax is on the corporation and thus is shared by all shareholders alike, the court held that the statute did not contravene the privileges and immunities clause.³¹

In view of the court's holding in *WKBH Television, Inc. v. Department of Revenue*, it appears further constitutional challenge to the statute has been effectively foreclosed. However, it is still unsettling that the statute does not accomplish the purpose it was intended to achieve. In effect, the impact of the tax falls heavily on the Wisconsin resident. Not only is the resident shareholder's distributive share reduced by the tax on the corporation's gain apportioned to nonresidents but, in addition, the resident is subject to income tax on his personal distribution. While this result, in itself, does not contravene constitutional principles,³² it does suggest that further remedial legislation is required to avoid the current tax windfall to non-

30. *Id.* at 569-71, 250 N.W.2d at 297.

31. *Id.* at 574, 250 N.W.2d at 298.

32. *Simanco, Inc. v. Department of Revenue*, 57 Wis. 2d 47, 59, 203 N.W.2d 648, 654 (1973), *dismissed for want of substantial question*, 414 U.S. 804 (1973).

resident shareholders which is realized at the expense of resident shareholders.

One solution suggested by the trial judge in the *Simanco* case³³ would be to tax the gain in the hands of the corporation while giving a tax credit to the resident taxpayer. This would have the desirable effect of avoiding any unfair benefit to the nonresident while insuring the equal treatment of the resident and nonresident shareholder alike.

-EUGENE O. DUFFY

TORTS

The Wisconsin Supreme Court decided several tort cases which are worthy of special mention and have been subdivided into categories of releases, defamation, *res ipsa loquitur*, and strict liability. Several significant cases on "duty" in negligence actions have been omitted from this discussion in deference to a comprehensive article on duty in a later issue of volume 61. The significant cases on duty which the court decided this term are *Padilla v. Bydalek*,¹ *Coffey v. City of Milwaukee*,² *Clark v. Corby*³ and *Buel v. LaCrosse Transit Co.*⁴

I. RELEASES

*Krezinski v. Hay*⁵ dealt with the effectiveness of a release based on mutual mistake. In that case the trial court granted the defendant's motion for summary judgment and dismissed the plaintiff's complaint. The complaint alleged that the defendant was negligent in causing an automobile accident which resulted in numerous injuries to the plaintiff. The defendant denied negligence and asserted an affirmative defense, based on a release in which the plaintiff released the defendant from all claims and injuries "in any way growing out of, any and all known and unknown personal injuries, developed or undeveloped, including death and property damage resulting or to re-

33. 1974 Wisconsin Term of Court, 57 MARQ. L. REV. 338, at 340 (1973-74).

1. 56 Wis. 2d 772, 203 N.W.2d 15 (1973); 74 Wis. 2d 46, 245 N.W.2d 915 (1976).

2. 74 Wis. 2d 526, 247 N.W.2d 132 (1976).

3. 75 Wis. 2d 292, 249 N.W.2d 567 (1977).

4. 77 Wis. 2d 480, 253 N.W.2d 232 (1977).

5. 77 Wis. 2d 569, 253 N.W.2d 522 (1977).