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STATE OF WISCONSIN

TAX APPEALS COMMISSION

JOHN D. HENNICK 5020 North Elkhart Avenue Milwaukee, Wisconsin 53217	DOCKET NO. 88-I-433
Petitioner,	DECISION AND ORDER
vs.	
WISCONSIN DEPARTMENT OF REVENUE P.O. Box 8933 Madison, Wisconsin 53708	
Respondent,	

Appearances:

For petitioner: Pro se

For respondent: Robert M. Finley, Esq.
Wisconsin Department of Revenue

Bartley, Commissioner, joined by Timken, Chairperson, and Morris, Junceau, and Wagner-Malloy, Commissioners:

I.

ISSUES

1. Whether Section 71.03(2)(d), Wis. Stats., which exempts from state income taxation certain retirement fund payments received by certain Milwaukee City and County retired employees, denies taxpayer, a private pensioner whose pension is not similarly exempted, equal protection of the laws in violation of either the Fourteenth Amendment of the U.S. Constitution or Article VIII, § 1 of the Wisconsin Constitution?

2. Whether taxpayer should be forgiven for a penalty for filing an incorrect return on the grounds that his purpose in filing as he did was to initiate a good faith, legal challenge to the statute?

II.

FINDINGS OF FACT

For the tax year 1985, taxpayer excluded from his income $6,919 of proceeds he received during that year from a private pension he had from his former employment with a private employer. Taxpayer was enrolled in the pension plan before December 31, 1963. On his 1985 state return, taxpayer included the proceeds in his total federal income but later subtracted them on line 33. Next to the subtracting entry, taxpayer wrote in the words, "See Article VIII" -- indicating that provision as the reason for the subtraction. By office audit Department adjusted taxpayer's income to include the excluded pension proceeds and assessed taxpayer an additional $339 in taxes, plus interest and a 25% penalty, for a total assessment of $506.34 as of April 25, 1988.

Taxpayer's exclusion of his pension income was based upon his personal and legal conviction that there should be tax equity among every sort of pension. He purposely excluded the proceeds in order to force litigation on the issue of disparate treatment.

Taxpayer once before brought the same issue to the Commission. In that instance, taxpayer filed a claim for refund for 1983, received the refund, and then received an assessment

for the amount refunded. The Commission sustained department's assessment./1/

Taxpayer argues the assessment here is unconstitutional, because the state and federal constitutions require that all pensions be taxed equally. The state statute, taxpayer says, which exempts the pensions of only certain retired public employees, creates an unlawful disparity. All pensions must be taxed the same or not at all, taxpayer claims.

Department argues the assessment must stand for three reasons. First, the Commission can't set aside the assessment, because it was made pursuant to statute, and the Commission lacks authority to declare a Wisconsin statute unconstitutional. Second, the statute is constitutional anyway, because there is a rational basis for making the distinction between the public employee pensioners involved and all other pensioners, the basis being that the public pensioners were given the exclusion, because they were paid comparatively low salaries./2/ Third, it would be unconstitutional for the Commission to invalidate the statute, because to do so would unconstitutionally impair the state's contractual obligations to the public employee pensioners, in violation of Article I, Section 10 of the federal constitution./3/ To subject these pensions to tax would be, department argues, to deprive the recipients of their vested, contractual rights to receive tax-free pensions.

III.

CONCLUSIONS OF LAW

1.

Validity of Exemption

Section 71.03(2)(d) exempts:

> "All payments received from the employe's retirement system of the City of Milwaukee, Milwaukee county employe's retirement system, sheriff's annuity and benefit fund of Milwaukee county, police officer's annuity and benefit fund of Milwaukee, fire fighter's annuity and benefit fund of Milwaukee, or the public employee trust fund as successor to the Milwaukee public school teachers' annuity and retirement fund and to the Wisconsin state teacher's retirement system, which are paid on the account of any person who was a member of the paying or predecessor system or fund as of December 31, 1963, or retired from any of the systems or funds as of December 31, 1963."

Without reaching the question of our authority to nullify the statute on constitutional grounds, we assume for the sake of this case we have it./4/

In determining whether the statute violates equal protection as an improper legislative classification, we apply the so-called rational basis test which calls for restrained review, as opposed to the "heightened" or "strict scrutiny" tests, under which the government bears at least some burden of justifying the classification./5/ Here because this is a tax case and thus involves economic regulation by the state, and because the classification doesn't fall into the "suspect" classification categories such as those based on race, gender, nationality, or alienage, we must use the traditional or rational basis approach in evaluating the constitutionality of the exemption./6/

We begin our analysis by noting that the mere fact

legislation creates a classification does not itself create an equal protection violation -- "it is only 'invidious discrimination' that offends the Constitution."/7/ To determine whether a classification is invidious, we apply the rules summarized in Lindsley v. Natural Carbonic Gas Co./8/, a 1911 case which states the still prevailing principles:

> "1. The Equal Protection Clause * * * does not take from the state the power to classify in the adoption of police laws, but admits of the exercise of a wide scope of discretion in that regard, and avoids what is done only when it is without any reasonable basis and therefore is purely arbitrary. 2. A classification having some reasonable basis does not offend against that clause merely because it is not made with mathematical precision or because in practice it results in some inequality. 3. When the classification * * * is called in question, if any state of facts reasonably can be conceived that would sustain it, the existence of that state of facts at the time the law was enacted must be assumed. 4. One who assails the classification * * * must carry the burden of showing that it does not rest upon any reasonable basis, but is essentially arbitrary."/9/

Applying these principles to the case at hand, we conclude the tax classification here does not offend equal protection. There are two reasons for our conclusion.

First, taxpayer has introduced no evidence showing the classification to be arbitrary. As the party assailing the classification, taxpayer has the burden of proving the classification arbitrary. Because the evidentiary record contains no evidence, from either side, showing the unreasonableness or reasonableness of the classification, there is a failure of proof, and that failure must be resolved against taxpayer.

Second, on this record we cannot say the classification is essentially arbitrary, because we can conceive of a rational

basis for it -- namely that the exclusion was thought by its framers as desirable to correct or ameliorate pay inequities for Milwaukee municipal employees, perhaps to keep those employees from moving on to other, more lucrative positions. Although there is no evidence in the record to support this proposition, under Lindsley, such evidence is not necessary to sustain the statute. Indeed because we can conceive of such a rationale, we are bound to assume the rationale obtained when the classification was enacted, at least where there is no evidence to the contrary.

Accordingly, because taxpayer has not shown the legislation to be arbitrary, and because the exemption has a conceivable rational basis, we hold that the statute comports with federal equal protection.

We also hold that the classification survives the Article VIII, § 1 challenge. That provision requires that "[t]he rule of taxation shall be uniform . . . and that reasonable exemptions may be provided." In determining whether the exemption here is "reasonable", we conclude that the federal equal protection, rational basis approach applies also to the state constitutional analysis. Thus because the exemption has a conceivable rational basis and has not been shown to be unreasonable, we conclude the exemption is "reasonable" under the state constitution.

One further point on the constitutional question. Taxpayer cites Davis v. Michigan Department of Treasury/10/ as authority for the proposition that the exemption here is unconstitutional and unreasonable. It is true that Davis struck

down a Michigan exemption for pension proceeds paid to state employees on a challenge by a former federal employee receiving a taxable federal pension. However Davis is distinguishable in that it did not turn on equal protection grounds. Rather, the court's holding rested on its conclusion that the Michigan exemption violated a federal statute, as well as on the conclusion that the doctrine of intergovernmental tax immunity prevented the Michigan exemption. In fact the court specifically rejected the relatively restrained equal protection analysis in favor of the more stringent, intergovernmental tax immunity "inquiry whether the inconsistent tax treatment is directly related to and justified by 'significant differences between the two classes.'"/11/

But what's really significant about Davis is that it actually supports a finding of constitutionality here. In analyzing the tax immunity question; the court said that Michigan's reason for giving preferential treatment to state employees -- its interest in hiring and retaining qualified employees -- was "a rational reason for discriminating", though insufficient to overcome the principles of intergovernmental tax immunity./12/ Thus the court in effect approved the notion that the same sort of interest that conceivably motivated Wisconsin here to favor certain public employees would survive rational basis analysis.

Having disposed of the case on equal protection grounds, we need not reach the impairment of contract issue raised by department.

2.

Penalty

Department imposed a 25% penalty on taxpayer under Section 71.11(47) which imposes the penalty when "any person . . . files an . . . incorrect return, unless it is shown that such filing was due to good cause and not due to neglect. . .

Here of course there was no neglect -- the incorrect return was filed deliberately as a means of challenging the exemption. The question becomes one of whether taxpayer's desire to test the exemption constitutes "good cause."

In one sense, it might well be argued that this is a case of good cause. There seem to be the necessary ingredients -- good faith and a colorable claim. For one thing, we are totally convinced taxpayer's purpose for excluding his pension proceeds was his good faith belief in the unconstitutionality of the statute.

Moreover, the virtue of the statute is certainly questionable. It may very well be that in a case with a more developed record, the statute will ultimately fall to an equal protection attack. Even accepting the "conceived wisdom" behind the statute, one could still make a strong argument that the statute is the type of law that ought to be stricken off the books, at least as a matter of good tax policy./13/ And individuals, like taxpayer, who are earnestly seeking legitimate reform, ought not to be chilled in those efforts by the spectre of nettlesome penalties we believe were designed to deter the chronically

careless -- not the public-spirited.

Unfortunately, in our opinion taxpayer chose the wrong means of bringing his challenge. What he should have done was to have included all his income, paid the tax on it, and then filed a claim for refund based on the constitutional challenge. That is the method by which all penalty could have been avoided, and the method taxpayer used in his earlier appeal involving the same issue.

Finally, as a practical matter, we are very hesitant to hold that arguable constitutional infirmity constitutes good cause for not paying a tax. Such a ruling, it seems to us, would open the door to all sorts of analytical difficulties, the foremost being the establishment of standards to define the essentially illusory concept of how strong must a case be for it to qualify as "good cause". Slightly more than "utterly without redeeming social value"? Plausible? Intellectually defensible? Close? Very close? Resulting in a 3-2 decision? As presented here the penalty issue is, we believe, one of those relatively rare issues best left to "mechanical jurisprudence" -- to stand or fall solely on the outcome of the case-in-chief.

IV.

ORDER

Department's denial of taxpayer's petition for redetermination is affirmed.

Dated at Madison, Wisconsin, this 12th day of October, 1989.

WISCONSIN TAX APPEALS COMMISSION

Thomas R. Timken, Chairperson

John P. Morris, Commissioner

Robert C. Juneau, Commissioner

Douglass H. Bartley, Commissioner

Mary Wagner-Malloy, Commissioner

Attachment: "NOTICE OF APPEAL INFORMATION"

FOOTNOTES

/1/ Docket Nos. I-11629-SC, I-11630-SC, I-11677-SC, and I-11678-SC.

/2/ Department made this point in argument. There is no evidence in the record to support the proposition that low salaries were the reason for the exclusion.

/3/ The Article provides, "No state shall . . . pass any . . . law impairing the obligation of contracts. . ."

/4/ We leave for another day the question of our authority to declare a statute unconstitutional. There are two schools of thought on this subject. One view is that we lack the authority, because we are a creation or an arm of the legislature, thus inferior to it, and therefore incapable of nullifying its enactments. The other view is that the legislature gave us such authority by granting us jurisdiction over "all questions of law and fact arising under [various state tax laws]." Section 73.01(4).

/5/ "Heightened" scrutiny requires the government to show that the legislation serves "important governmental objectives". Craig v. Boren, 429 U.S. 190, 197 (1976). In contrast where "strict" scrutiny review is applied, such as where there is a racial classification, the classification "is presumptively invalid and can be upheld only upon an extraordinary justification." Mass. Personnel Administrator v. Feeney, 442 U.S. 256, 272 (1979).

/6/ The rational basis approach is the method employed in tax cases involving classifications. See e.g. F. S. Royster Guano Co. v. Virginia, 253 U.S. 412, 415 (1920).

/7/ Ferguson v. Skrupa, 372 U.S. 726, 732 (1963), citing Lindsley, infra, n. 8.

/8/ 220 U.S. 61, 78-79 (1911), quoted in Morey v. Doud, 354 U.S. 457, 463-464 (1957), overruled on other grounds, New Orleans v. Dukes, 427 U.S. 297 (1976).

/9/ As broad as they seem, the Lindsley principles don't entirely deprive the court of any judgmental role. A few years after Lindsley, in F. S. Royster Guano Co. v. Virginia, 253 U.S. 412, 415 (1920), the court said:

> "[T]he classification must be reasonable, not

> arbitrary, and must rest on some ground of difference, having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced, shall be treated alike."

Thus Royster Guano gave reviewing courts the latitude to evaluate whether the legislative classification meets an articulated goal of the legislative framers.

There is at least a perceived tension between Lindsley and Royster Guano. Lindsley suggests that a court can go outside the evidentiary record to conceive of its own rational basis -- a relaxed standard of review to be sure. On the other hand, the Royster Guano formulation has been considered a stricter standard, because it calls for a judicial evaluation whether the classification has "a fair and substantial relation to the object of the legislation. . . ." Over the years and even into the 70's and 80's, the court has fluctuated on which standard applies.

The relaxed, Lindsley inquiry was employed, for example, in Railroad Retirement Board v. Fritz, 449 U.S. 166, 179 (1980), where the court said it was "constitutionally irrelevant" whether the "goal" there was within Congress' reasoning, because the law doesn't require the legislature to state any reasons for adopting a statute.

In other cases the court has followed the more stringent, Royster Guano standard by evaluating whether the classification reasonably related to a goal articulated by the legislature. See McGinnis v. Royster, 410 U.S. 263, 270 (1973).

In our opinion, there is no "tension" between the two cases -- at least insofar as the case here is concerned. First, Royster Guano did not negate the Lindsley rule that the burden of proof is on the challenger to show the classification to have been irrational. Second, Royster Guano did not really disturb the Lindsley, "any conceivable basis" approach. In fact, both cases actually utilized the conceivable basis approach.

In Lindsley, the court formulated its own rational basis for the legislative classification involved there. The statute at issue was entitled, "An Act for the Protection of the Natural Mineral Springs of the State and to Prevent Waste and Impairment of its Natural Mineral Waters." It provided:

> "Pumping, or otherwise drawing by artificial appliance, from any well made by boring or drilling into the rock, that class of mineral waters holding in solution natural mineral salts and an excess of carbonic acid gas, or pumping, or by any artificial contrivance whatsoever in any manner producing an unnatural flow of carbonic acid gas issuing from or contained in any well made by or boring or drilling into the rock, for the purpose of extracting, collecting, compressing, liquifying or vending such gas as a commodity otherwise then in connection with the mineral water and the other mineral ingredients with which it was associated, is hereby declared to be unlawful."

Appellant, an owner and holder of capital stock and bonds of the Natural Carbonic Gas Company, sought a decree enjoining the company from obeying and the state from enforcing the statute. He argued that the statute was arbitrary in that the statute was directed against pumping from wells bored or drilled into the rock, but not against pumping from wells not penetrating the rock; and in that it was directed against pumping for the purpose of collecting the gas and vending it apart from the waters, but not against pumping for other purposes.

After pointing out that the "allegations of the bill shed but little light upon the classification in question", and invoking against the challenger the rule that one who attacks the classification has the burden of showing it to be arbitrary, the court said, "[I]t may be well to mention other considerations which make for the same result." Lindsley, 220 U.S. at 79.

As to the argument that the statute was arbitrary in the sense that it prohibited pumping from wells that penetrated the rock but allowed pumping from wells not penetrating the rock, the court said:

> "From statements made in the briefs of counsel in oral argument we infer that wells not penetrating the rock reach such waters only as escape naturally therefrom through breaks or fissures, and if this be so, it may well be doubted that pumping from such wells has anything like the same effect -- if, indeed, it has any -- upon the common supply or upon the rights of others, as does pumping from wells which take the waters from within the rock where they exist under great

hydrostatic pressure."

Addressing the second argument as to why the statute was arbitrary, the court said:

> "As respects the discrimination made between pumping for the purpose of collecting and vending the gas apart from the waters and pumping for other purposes, this is to be said: The greater demand for the gas alone and the value which attaches to it in consequence of this demand furnish a greater incentive for exercising the common right excessively and wastefully when the pumping is for the purpose proscribed than when it is for other purposes; and this suggestion becomes stronger when it is reflected that the proportion of gas in the comingled fluids as they exist in the rocks is so small that to obtain a given quantity of gas involves the taking of an enormously greater quantity of water and to satisfy appreciably the demand for the gas alone involves a great waste of water from which it is collected. Thus, it may well be that in actual practice the pumping is not excessive or wasteful save when it is done for the purpose proscribed."

So the court felt quite free to go outside the evidentiary record to conceive of legislative explanations for statutory classification.

In Royster Guano, the court also did some conceiving. In striking down a Virginia tax statute (which subjected domestic corporations which transacted business in the state to a tax on all its income wherever earned and exempted domestic corporations which did no business in Virginia), the court, over the dissent of Justices Brandeis and Holmes, said, "[N]o ground is suggested, nor can we conceive of any, sustaining the exemption. . . ." (Emphasis added).

Unfazed by the majority's inability to conceive, the dissenting Justice Brandesi shot back, "I can conceive of a reason for differentiating. . . . The legislature . . . may have believed that its citizens interested in corporations whose business was wholly in other states or countries, might be tempted to incorporate under more favorable laws of other states but that such temptation could prove ineffective where the companies transacted a part of their business within . . . Virginia and enjoyed compensating advantages." Royster Guano, 253 U.S. at 418.

/10/ 57 U.S.L.W. 4389 (1989).

/11/ Id. at 4392.

/12/ Id.

/13/ The "conceived rationale" for the exemption -- the low salaries -- in the final analysis fails to withstand any sort of rigorous policy analysis. For example, the exemption here works as a discrimination against low-income, privately-pensioned Milwaukee taxpayers in general. Because they can't exclude their pension incomes, such taxpayers pay taxes at a higher effective rate than their publicly-pensioned counterparts.