

STATE OF WISCONSIN
TAX APPEALS COMMISSION

NICHOLAS AND CHRISTINA ITSINES,

DOCKET NO. 07-I-065,

1016 KOS, INC.,

DOCKET NOS. 07-I-091,
07-S-092 AND 07-X-093,

519 KOS, INC.,

DOCKET NOS. 07-I-094,
07-S-095 AND 07-X-096,

ITSINES CORP.,

DOCKET NOS. 07-I-097
AND 07-S-098,

and

NICHOLAS ITSINES,

DOCKET NOS. 08-S-149
AND 08-W-150,

Petitioners,

vs.

DECISION AND ORDER

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

ROGER W. LEGRAND, COMMISSIONER:

These matters come before the Commission following a hearing held on December 14, 2009 before Commissioner Roger W. LeGrand. These cases involve eleven separate appeals filed by Petitioners Nicholas and Christina Itsines, 1016 KOS, Inc., 519 KOS, Inc., and Itsines Corporation. Nicholas and Christina Itsines are a married couple and Mr. Itsines is the sole shareholder of the three petitioner corporations. Mr. and Mrs. Itsines appeared at the hearing *pro se*. Respondent, the Wisconsin Department of Revenue (the "Department"), is represented by Attorney Mark S. Zimmer. At the hearing, Mr. Itsines and Mitchell Fikaris provided sworn

testimony for the Petitioners. The witnesses called by the Department were Department Resolution Officer Mary Ann Vitek, Revenue Agent John Mickelson, and George Pappas.

At the close of the hearing, both parties agreed to file proposed findings of facts by January 14, 2010. The Department's proposed jurisdictional and material facts were filed on January 13, 2010. The Petitioners did not file proposed findings of fact, but Petitioner Nicholas Itsines did file a response with attachments to the Department's proposed findings on February 16, 2010. Based on the record in this matter as further discussed herein, the Commission largely adopts the Department's proposed findings of fact.

Having considered the entire record, including the sworn testimony, the parties' exhibits and briefs, the Commission finds, concludes, decides and orders as follows:

FINDINGS OF FACT

I. JURISDICTIONAL FACTS

A. 1016 KOS, INC.

1. 1016 KOS, Inc. was timely assessed for franchise tax for the period January 1, 1999 through December 31, 2003 on June 20, 2005. (Ex. 1.)

2. 1016 KOS, Inc. was timely assessed for sales/use tax for the period January 1, 1999 through December 31, 2003 on June 21, 2005. (Ex. 2.)

3. 1016 KOS, Inc. was timely assessed for local exposition tax for the period January. 1, 1999 through December 31, 2003 on June 20, 2005. (Ex. 3.)

4. 1016 KOS, Inc. timely petitioned for redetermination of these assessments through documents dated August 10, 2005, and received by the Department on August 19, 2005. (Exs. 12, 13 and 14.)

5. The petitions of 1016 KOS, Inc. were timely denied in three Notices of Action dated February 12, 2007. (Exs. 23, 24 and 25.)

6. Petitioner 1016 KOS, Inc. timely filed a Petition for Review with the Wisconsin Tax Appeals Commission of these Notices of Action dated April 5, 2007, and filed with the Commission on April 9, 2007. (Ex. 34.)

B. 519 KOS, INC.

7. 519 KOS, Inc. was timely assessed for franchise tax for the period January 1, 1999 through December 31, 2003 on June 20, 2005. (Ex. 4.)

8. 519 KOS, Inc. was timely assessed for sales/use tax for the period January 1, 1999 through December 31, 2003 on June 21, 2005. (Ex. 5.)

9. 519 KOS, Inc. was timely assessed for local exposition tax for the period January 1, 1999 through December 31, 2003 on June 20, 2005. (Ex. 6.)

10. 519 KOS, Inc. timely petitioned for redetermination of these assessments through documents dated August 10, 2005, and received by the Department on August 19, 2005. (Exs. 15, 16 and 17.)

11. These petitions of 519 KOS, Inc. were timely denied in Notices of Action dated February 12, 2007. (Exs. 26, 27 and 28.)

12. Petitioner, 519 KOS, Inc. timely filed a Petition for Review with the Wisconsin Tax Appeals Commission of these Notices of Action dated April 5, 2007, and filed with the Commission on April 9, 2007. (Ex. 34.)

C. Itsines Corporation

13. Itsines Corporation was timely assessed for franchise tax for the period January 1, 1999 through December 31, 2003 on June 20, 2005. (Ex. 7.)

14. Itsines Corporation was timely assessed for sales/use tax for the period January 1, 2000 through December 31, 2003 on June 21, 2005. (Ex. 8.)

15. Itsines Corporation timely petitioned for redetermination of these assessments through documents dated August 10, 2005, and received by the Department on August 19, 2005. (Exs. 18 and 19.)

16. These petitions of Itsines Corporation were timely denied in Notices of Action dated February 12, 2007. (Exs. 29 and 30.)

17. Petitioner timely filed a Petition for Review with the Wisconsin Tax Appeals Commission of these Notices of Action dated April 5, 2007, and filed with the Commission on April 9, 2007. (Ex. 34.)

D. Nicholas and Christina Itsines

18. Nicholas and Christina Itsines were timely assessed on June 20, 2005, for income tax for the period January 1, 1999 through December 31, 2003. (Ex. 9.)

19. Nicholas and Christina Itsines timely petitioned for redetermination of this assessment through a document dated August 10, 2005, and received by the Department on August 19, 2005. (Ex. 20.)

20. This petition of Nicholas and Christina Itsines was timely denied in a Notice of Action dated February 12, 2007. (Ex. 31.)

21. Petitioner timely filed a Petition for Review with the Wisconsin Tax Appeals Commission of these Notices of Action dated April 5, 2007 and filed with the Commission on April 9, 2007. (Ex. 34.)

E. Nicholas Itsines - Sales Taxes

22. Nicholas Itsines was timely assessed on February 3, 2007, for personal liability for sales tax owed by 1016 KOS, Inc. for the period beginning December 1, 2003 through December 31, 2004. (Ex. 10.)

23. Nicholas Itsines timely petitioned for redetermination of this assessment through a document dated February 1, 2007.¹ (Ex. 21.)

24. This petition of Nicholas Itsines was timely denied in a Notice of Action dated August 4, 2008. (Ex. 32.)

25. Petitioner Nicholas Itsines timely filed a Petition for Review with the Wisconsin Tax Appeals Commission of this Notice of Action dated October 2, 2008 and filed with the Commission on October 3, 2008. (Ex. 35.)

F. Nicholas Itsines - Withholding Taxes

26. Nicholas Itsines was timely assessed on February 5, 2007, for personal liability for withholding taxes owed by 1016 KOS, Inc. for 2003, March through May 2004, and July through December 2004. (Ex. 11.)

27. Nicholas Itsines timely petitioned for redetermination of this assessment through a document dated February 10, 2007. (Ex. 22.)

28. This petition of Nicholas Itsines was timely denied in a Notice of Action dated August 4, 2008. (Ex. 33.)

29. Petitioner Nicholas Itsines timely filed a Petition for Review with the Wisconsin Tax Appeals Commission of this Notice of Action dated October 2, 2008, and filed with the Commission on October 3, 2008. (Ex. 36.)

30. The foregoing eleven assessments and related petitions for review were consolidated by the Commission and heard together in a trial held in the Commission's offices in Madison, Wisconsin, on December 14, 2009.

II. MATERIAL FACTS

1. Nicholas Itsines was the sole shareholder in the corporations 519 KOS, Inc., 1016 KOS, Inc., and Itsines Corporation. (Nicholas Itsines Testimony.)

2. Nicholas Itsines was Vice President of 1016 KOS, Inc. and President of 519 KOS, Inc., and Itsines Corporation. (Nicholas Itsines Testimony.)

3. 519 KOS, Inc. operated a motel as a Days Inn franchisee in Milwaukee County during the audit period. (Ex. 53.)

4. 1016 KOS, Inc. operated a restaurant known as the Pallas Restaurant adjacent to the Days Inn motel operated by 519 KOS, Inc. in Milwaukee County during the audit period. (Ex. 53.)

5. The Pallas Restaurant was in the business of selling food and beverages for onsite and offsite consumption. (Exs. 49, 53.)

6. 1016 KOS, Inc. is now defunct, and until recently the Pallas Restaurant continued to be operated by other entities controlled by Nicholas Itsines. (Nicholas Itsines Testimony.)

¹ The correct date most likely was February 10, 2007, which was the date of the letter petitioning for redetermination of the assessment for withholding taxes described below.

7. At all relevant times, Itsines Corporation owned the fixed assets of the motel and the restaurant, including the equipment, furniture and fixtures, and leased this equipment, furniture and fixtures to 519 KOS, Inc. and 1016 KOS, Inc., in exchange for rental payments. (Exs. 53, 65.)

8. During the Department's audit, the auditor discovered that the records of the Petitioners were inadequate to substantiate the sales and expenses claimed by 1016 KOS, Inc. and 519 KOS, Inc. In particular, the auditor stated as follows:

The taxpayer had all of the inventory records for the restaurant, but no invoices were initially provided for the repairs, supplies and maintenance accounts for either the motel or the restaurant. No records were provided for the room rentals on the motel or supporting the deductions claimed for sales tax purposes on motel sales tax returns filed. No records were ever provided to support how gross receipts were arrived at for the corporate returns for both entities.

(Ex. 37, par. 2.)

In addition, the auditor stated:

The taxpayer failed to provide records for any of the franchise and sales tax audits except for inventory invoices for the markup audit. The taxpayer did not provide much information during the audit and his accountant provided very few records to support how he completed the sales and franchise tax returns.

(Ex. 37, par. 9.)

9. The auditor determined that franchise, sales/use, and local exposition taxes were due from 519 KOS, Inc. and 1016 KOS, Inc. (Exs. 1-6.)

10. In particular, the auditor made the following adjustments to 1016 KOS, Inc. for franchise tax purposes:

A. Determined that not all of the receipts for the restaurant business had been reported for franchise tax purposes for the years 1999 through 2003, inclusive, and that the records of the business were inadequate (Exs. 1, 46-50, 58);

B. Conducted a markup audit based upon the pounds of various types of meat purchased, and estimated the adjusted gross receipts and the franchise tax due on those underreported receipts for that period (Exs. 1, 46-50, 58);

C. Disallowed \$33,127.00 of unsubstantial gifts for tax year 2002 (Exs. 1, 58); and

D. Disallowed \$27,730.55 of unsubstantiated miscellaneous expenses for the tax year 2003 (Exs. 1, 58).

11. The auditor assessed sales taxes due from 1016 KOS, Inc. for the underreported receipts for the period 1999-2003 as determined in the markup audit for franchise tax purposes. (Exs. 2, 53, 59.)

12. The auditor assessed local exposition taxes against 1016 KOS, Inc. for the period 1999-2003 on the food and beverage sales reported on its sales tax returns, and also for the underreported receipts as determined in the markup audit for franchise tax purposes. (Exs. 3, 38, 60.)

13. In particular, the auditor made the following adjustments to 519 KOS, Inc. for franchise tax purposes:

A. Disallowed \$10,000 in unsubstantiated purchases in excess of \$78,198 in allowed purchases during the year 2002 (Exs. 4, 61);

B. Disallowed auto and truck expenses of \$41,685.12 for 2003, which were not substantiated and which were substantially in excess of the approximately \$2,000 auto and truck expenses claimed in 2001 and 2002 (Exs. 4, 61); and

C. Disallowed Miscellaneous Expenses for 2003 in the amount of \$18,862.76, which were not substantiated and which were substantially in excess of the approximately \$2,000 of miscellaneous expenses claimed in other years (Exs. 4, 61).

14. In particular, the auditor made the following adjustments to 519 KOS, Inc. for sales and use tax purposes:

A. Disallowed claimed sales tax exemptions for the years 2000 through 2003, which had not been substantiated (Exs. 5, 53, 62); and

B. Assessed use taxes for the years 2000 through 2003 for purchases made through credit cards, miscellaneous linen supplies from an Illinois vendor, and computer hardware and software maintenance purchased from Days Inn of America, and upon which no Wisconsin sales taxes had been paid (Ex. 5, 54, 55, 62).

15. The auditor assessed local exposition taxes against 519 KOS, Inc. for the years 1999-2003 for the lodging sales reported on its sales tax returns, and also for the lodging sales as to which the unsubstantiated exemptions were disallowed in the sales tax audit. (Exs. 6, 63.)

16. 519 KOS, Inc. and 1016 KOS, Inc. had never registered for local exposition taxes, and had paid none, although their businesses were located in the Milwaukee County local exposition tax district. (Exs. 60, 63.)

17. In particular, the auditor made the following adjustments to Itsines Corporation for franchise tax purposes:

A. Disallowed a portion of the depreciation expenses claimed for the year 2002, on grounds that the accumulated depreciation shown on the balance sheet for Itsines Corporation did not match the depreciation claimed for tax purposes (Exs. 7, 64);

B. Disallowed miscellaneous expenses of \$14,300 for tax year 2003 due to lack of substantiation and the fact that Itsines Corporation had not deducted miscellaneous expenses in other years (Exs. 7, 64); and

C. Disallowed utility expenses of \$7,044 for tax year 2003 due to lack of substantiation and the fact that Itsines Corporation had not deducted utility expenses in other years (Exs. 7, 64).

18. The auditor assessed sales taxes against Itsines Corporation for the years 2000 through 2003 for the leasing of certain tangible personal property, namely furniture, fixtures and equipment, to the motel and the restaurant. (Exs. 8, 38 p. 3, 53.)

19. The auditor determined that Nicholas and Christina Itsines had received constructive dividends from 1016 KOS, Inc., during the years 1999 through 2003 to the extent of the unreported receipts determined in the 1016 KOS, Inc. franchise tax audit, and assessed Nicholas and Christina Itsines income taxes thereon. (Exs. 9, 38 p. 4.)

20. According to the balance sheets of Itsines Corporation, Nicholas and Christina Itsines made loans to that company over the period 1999 through 2003 inclusive, and as of each respective year end, the loan balances were as follows:

1999.....	\$227,000.00
2000.....	\$262,000.00
2001.....	\$262,000.00
2002.....	\$262,000.00
2003.....	\$639,534.00

(Ex. 44.)

21. Although Nicholas and Christina Itsines had loaned money to Itsines Corporation, no interest was charged by them to Itsines Corporation during the years 1999 through 2003. (Ex. 66 at p. 2.)

22. The auditor imputed interest income to Nicholas and Christina Itsines on these loans for the years 1999 through 2003 pursuant to § 7872 of the Internal Revenue Code. (Exs. 9, 51 and 52.)

23. At the hearing, Petitioners testified that the Pallas Restaurant business could not have been generating the income estimated by the Department in the franchise tax audit. (Nicholas Itsines Testimony.)

24. At the hearing, Petitioners introduced no exhibits and submitted no documentation or substantiation or other independent evidence indicating that the Department's assessments were incorrect, or that the Department erred in its estimation of the income of 1016 KOS, Inc., or in making any of the other assessments and adjustments in these consolidated cases.

25. At the hearing, Petitioners introduced no records substantiating the actual receipts of 1016 KOS, Inc.

26. Nicholas Itsines signed the business tax registration forms for 519 KOS, Inc., 1016 KOS, Inc. and Itsines Corporation. (Exs. 40, 41 and 42.)

27. On the business tax registration form for 1016 KOS, Inc. Nicholas Itsines was listed as the sole owner and officer for 1016 KOS, Inc. (Ex. 41.)

28. Nicholas Itsines signed the Powers of Attorney relating to sales, franchise, and withholding taxes on behalf of all three corporations as President. (Ex. 43.)

29. On the form P-650, Nicholas Itsines listed himself as Vice President and sole shareholder of 1016 KOS, Inc. (Ex. 57.)

30. At all relevant times, Nicholas Itsines had check signing authority on behalf of 1016 KOS, Inc. (Ex. 73.)

31. Nicholas Itsines signed sales tax returns dated July 30, 2003, and November 30, 2003, on behalf of 1016 KOS, Inc. (Ex. 70.)

32. Nicholas Itsines signed the Wisconsin Franchise Tax Return for 1016 KOS, Inc. for 2004. (Ex. 81.)

33. On the Wisconsin Franchise Tax Return for 1016 KOS, Inc. for 2004, the corporation was stated to be engaged in the restaurant business, held inventory, paid salaries and wages of \$210,450, and paid \$216,578 in rent to Itsines Corporation. (Ex. 81.)

34. Nicholas Itsines had authority to sign checks on behalf of 1016 KOS, Inc. on its account at Mitchell Bank. (Ex. 73.)

35. 1016 KOS, Inc. employed George Pappas ("Pappas") as manager of the Pallas Restaurant as of November 3, 2003 through a Management Agreement. (Ex. 68.)

36. This Management Agreement did not provide that Pappas obtained any interest in 1016 KOS, Inc., or any other ownership interest, although it did provide Pappas with an opportunity to purchase ownership. (Ex. 68.)

37. Pappas never acquired any stock in 1016 KOS, Inc., nor did Pappas receive any bill of sale or other documentation evidencing a purchase of any interest, direct or indirect, in the Pallas Restaurant business. (Nicholas Itsines and George Pappas Testimony.)

38. Pappas notified Nicholas Itsines in at least May and June of 2004 that the Wisconsin Department of Revenue was contacting the restaurant about sales and withholding taxes that were due and unpaid, and Pappas provided Nicholas Itsines with copies of correspondence from the Department regarding the unpaid taxes. (Exs. 85, 86; George Pappas Testimony.)

39. Pappas provided other similar memoranda to Nicholas Itsines concerning unpaid Wisconsin taxes, but he only had copies of two of them in his possession. (George Pappas Testimony.)

40. Nicholas Itsines assured Pappas on multiple occasions that Nicholas Itsines would handle the unpaid sales and withholding taxes. (George Pappas Testimony.)

41. Pappas told Nicholas Itsines about the tax delinquencies many times, but that Nicholas Itsines told him, "Don't worry about it, it is not your restaurant." (Ex. 69; George Pappas Testimony.)

42. Pappas subsequently became concerned about the unpaid taxes and requested a change to the Management Agreement to protect himself, which was drafted by Nicholas Itsines' attorneys. (George Pappas Testimony.)

43. In the Amendment to the Management Agreement dated January 4, 2005, Nicholas Itsines as owner of 1016 KOS, Inc. agreed, effective November 3, 2003, that he would "in the case of taxes make and file all such returns as are necessary in connection therewith with all appropriate governmental agencies and remit such taxes as and when due." (Ex. 84.)

44. Nicholas Itsines testified at hearing that it was his signature on the Amendment to the Management Agreement. (Nicholas Itsines Testimony.)

45. Pappas was terminated as manager of the Pallas Restaurant by Nicholas Itsines Jr. on February 25, 2005.

46. After Pappas was terminated on February 25, 2005, only Nicholas Itsines had check signing authority on the 1016 KOS, Inc. bank account with Mitchell Bank. (Ex. 78.)

47. After Pappas' termination, Pappas signed no more checks and made no more payments out of the 1016 KOS, Inc. bank account with Mitchell Bank. (George Pappas Testimony.)

48. After Nicholas Itsines was notified of the unpaid sales and withholding taxes of 1016 KOS, Inc. in May and June, 2004, numerous payments were

made out of 1016 Kos, Inc's bank account with Mitchell Bank checks and to creditors other than the Wisconsin Department of Revenue, including Northern Leasing, United Leasing, Cingular Wireless, Ford Credit, American Express, Capital One, as well as the recipients of several hundred other checks. (Exs. 74-77.)

49. Several payments to creditors other than the Wisconsin Department of Revenue were made out of the 1016 KOS, Inc. bank account with Mitchell Bank after February 25, 2005, including payments to Discover, Northern Leasing and United Leasing. (Ex. 74.)

50. 1016 KOS, Inc. and Itsines Corporation both had accounts at Mitchell Bank. (Exs. 73, 76.)

51. On February 26, 2005, Nicholas Itsines signed an order to transfer all of the funds in the bank account of 1016 KOS, Inc. at Mitchell Bank to the account of Itsines Corporation. (Ex. 72.)

52. Itsines Corporation, as lessor of the buildings, fixtures, furniture, and equipment of the Pallas Restaurant to 1016 KOS, Inc., was a creditor of 1016 KOS, Inc. (John Mickelson Testimony.)

53. Nicholas Itsines was President and sole shareholder of Itsines Corporation, and he had check signing authority over the bank account for Itsines Corporation at Mitchell Bank. (Ex. 78; Nicholas Itsines Testimony.)

54. Funds in bank accounts of Itsines Corporation and 519 KOS, Inc. were commingled with funds and expenses of 1016 KOS, Inc. (Exs. 71, 83; John Mickelson Testimony.)

55. During the pendency of these matters, Nicholas and Christina

Itsines held title to a home valued at \$630,000, and owned or leased several cars, including a BMW and a Mercedes. (Ex. 66; Mary Ann Vitek Testimony.)

CONCLUSIONS OF LAW

1. 1016 KOS, Inc. - Docket No. 07-I-091

(a) Petitioner did not meet its burden of proof necessary to overcome the presumption that the franchise tax assessment made by the Department at issue is correct.

(b) Petitioner failed to substantiate its miscellaneous expense deduction for the 2003 tax year and its gift deduction for the 2002 tax year, which were disallowed by the Department.

2. 1016 KOS, Inc. - Docket No. 07-S-092

Petitioner did not meet its burden of proof to overcome the presumption that the Department's sales tax assessment of \$310,137.17 is correct.

3. 1016 KOS, Inc. - Docket No. 07-X-093

Petitioner did not meet its burden of proof to overcome the presumption that the Department's local exposition tax assessment of \$44,923.06 is correct.

4. 519 KOS, Inc. - Docket No. 07-I-094

(a) Petitioner did not meet its burden of proof necessary to overcome the presumption that the franchise tax assessment made by the Department is correct.

(b) Petitioner failed to substantiate the \$10,000 disallowed by the Department of the \$88,198 deduction the corporation reported for purchases on its 2002 income tax return.

(c) Petitioner failed to substantiate the auto and travel expense deduction of \$41,685.12 it reported on its 2003 income tax return, which was disallowed by the Department.

(d) Petitioner failed to substantiate the \$18,862.76 deduction it reported for miscellaneous expenses in 2003, which was disallowed by the Department.

5. 519 KOS, Inc. - Docket No. 07-S-095

(a) Petitioner did not meet its burden of proof to overcome the presumption that the Department's sales tax assessment is correct.

(b) Petitioner failed to substantiate claimed sales tax exemptions for the years 2000 through 2003, which were disallowed by the Department.

6. 519 KOS, Inc. - Docket No. 07-X-096

Petitioner failed to meet its burden of proof to overcome the presumption that the assessment of \$108,591.82 for unpaid local exposition tax is correct.

7. Itsines Corporation - Docket No. 07-I-097

Petitioner failed to meet its burden of proof to overcome the presumption that the Department's franchise tax assessment of \$2,285.85 based on disallowed deductions for depreciation, miscellaneous expenses and utility expenses on its 2002 and 2003 income tax returns is correct.

8. Itsines Corporation - Docket No. 07-S-098

Petitioner failed to meet its burden of proof to overcome the presumption that the Department's assessment of sales tax on leases of personal property by the Petitioner to other entities is correct.

9. Nicholas and Christina Itsines - Docket No. 07-I-065

Petitioners failed to overcome the presumption that the Department's assessments of income tax based on imputed interest and constructive dividends not reported on their individual income tax returns from 1999 to 2003 are correct.

10. Nicholas Itsines - Docket No. 08-S-149

Nicholas Itsines is personally liable under Wis. Stat. § 77.60(9) for the unpaid and delinquent sales taxes, interest, and penalties of 1016 KOS, Inc. for the periods at issue in the assessment.

11. Nicholas Itsines - Docket No. 08-W-150

Nicholas Itsines is personally liable under Wis. Stat. § 71.83(1)(b)2 for the unpaid and delinquent withholding taxes of 1016 KOS, Inc. for the periods at issue in the assessment.

DISCUSSION

These cases involve appeals of eleven separate assessments made by the Department against Nicholas and Christina Itsines and three corporations of which Nicholas Itsines was the sole shareholder, 1016 KOS, Inc., 519 KOS, Inc., and Itsines Corporation. Because these assessments concern the same parties, transactions and years at issue, the Commission consolidated them for hearing and proceedings before the Commission.

As a general rule, assessments made by the Department are presumed to be correct, and the burden is on the petitioners to prove by clear and satisfactory evidence in what respects the Department erred in its determination. *Edwin J. Puissant, Jr. v. Wis. 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). The Commission concludes that the Petitioners have failed to satisfy their burden of proof with respect to the nine franchise/income, sales/use and exposition tax assessments discussed in paragraphs 1-9, below, and that the Department has satisfied its burden of proof with respect to the personal liability assessments discussed in paragraphs 10-11, below.

1. 1016 KOS, Inc. - Docket No. 07-I-091

A. Underreported Receipts

1016 KOS, Inc., owned by Nicholas Itsines, operated a restaurant known as the Pallas Restaurant in Milwaukee County, Wisconsin. (Ex. 53.) The Department audited the franchise tax returns of 1016 KOS, Inc. for the years 1999 through 2003. (Ex. 1.) The audit found that the records of 1016 KOS, Inc. were inadequate and that not all receipts of the restaurant business had been reported for franchise tax purposes. (Ex. 1.) The auditor did a markup audit to compute unreported receipts based upon the pounds of various types of meat the restaurant purchased. (Ex. 47.) It determined a markup ratio (Ex. 48) and applied it to the cost of goods sold in every tax year of the audit. Using this method, the auditor calculated an understatement of gross receipts in each tax year. The audit assessed a franchise tax on the difference between the adjusted gross sales and the reported receipts.

In its appeal, the Petitioner asserts that the auditor overestimated income with the use of the markup ratio. At trial, however, the Petitioner produced no evidence other than the opinion of Mr. Itsines to rebut the assessment.

In corporate franchise tax cases, assessments of the Department are presumed to be correct. The Petitioner bears the burden of proof by clear and convincing evidence that the Department's assessment is in error. *Riegal Distributors, Inc. v. Wis. Dep't of Revenue*, Wis. Tax. Rptr. (CCH) ¶ 201-789 (WTAC Dec. 23, 1980).

The markup ratio method of reconstruction used by the Department in this case to determine gross sales resulted in a number that was admittedly an estimate. However, the Petitioner's records were so inadequate that the Department had no other option but to proceed with an estimate. (Ex. 1.) The Petitioner promised on several occasions to provide data to support its position, but no data was received by the Department, nor was any evidence presented at the trial to contradict the assessment. In cases where the petitioner completely fails to produce any documentary evidence in support of its position, "the Commission will not attempt to second-guess the Department's estimates and determinations regarding the amounts at issue." *Longrie v. Wis. Dep't of Revenue*, Wis. Tax. Rptr. (CCH) ¶ 401-258 (WTAC Oct 27, 2009), *aff'd*, Case No. 10CV0107 (Dane Co. Cir. Ct. June 24, 2010). Consequently, we conclude that the taxpayer did not meet its burden and the assessment is presumed to be correct with respect to this issue.

B. Unsubstantiated Expenses

The audit for 2003 also disallowed \$27,730.55 of unsubstantiated miscellaneous expenses for tax year 2003 and \$33,127 in gifts for tax year 2003. The law is clear that deductions are matters of legislative grace and tax statutes are to be strictly construed against the granting of the same. *NCR Corp. v. Wis. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 202-340 (WTAC Feb. 15, 1984), *aff'd*, 128 Wis. 2d 442, 384 N.W.2d 355 (Ct.

App. 1986). The burden is on the taxpayer to establish these deductions by clear and convincing evidence. Self-serving testimony without substantiation is insufficient to meet the burden. *Longrie, supra; Dvorak v. Wis. Dep't of Revenue*, Wis. Tax. Rptr. (CCH) ¶ 400-600 (WTAC Apr. 30, 2002), *aff'd*, Case No. 02-CV-5292 (Wis. Cir. Ct. November 25, 2002).

At trial, Mr. Itsines testified that he provided free glasses of wine to customers. It is unclear whether the testimony was an attempt to justify the gift deduction, or to support his contention that the audit overstated the restaurant's sales. Regardless, he presented no documentary evidence to support his testimony, which thus constituted self-serving testimony without substantiation. Since there was no substantiation of the deductions presented, the Petitioner has not met its burden with regard to any portion of the assessment, which therefore stands in its entirety.

2. 1016 KOS, Inc. – Docket No. 07-S-092

The Department also assessed this Petitioner the sum of \$310,137.17 in unpaid sales taxes on unreported receipts for tax years 1999-2003. (Ex. 2.) The amount was calculated using the retail markup method. (Ex. 2 and 59.)

All sales and purchases of tangible personal property in Wisconsin are presumed to be subject to sales or use tax until proved otherwise. Wis. Stats. §§ 77.52(13) and 77.53(10); *H. Samuels v. Wis. Dep't of Revenue*, 70 Wis. 2d 1076, 1077-78, 236 N.W.2d 250 (1975). Based on the law and our preceding conclusions, this assessment made by the Department therefore also is presumed to be correct.

In its petition for redetermination, Petitioner promised to provide data to support its original sales tax filings (Ex. 3), but no data was provided prior to trial and

no evidence was presented at trial to support Petitioner's position. Petitioner failed to overcome the presumption that the assessment is correct.

3. 1016 KOS, Inc. - Docket No. 07-X-093

1016 KOS, Inc. operated the Pallas Restaurant, which is located in Milwaukee County, Wisconsin. Milwaukee County is a local exposition district that taxes non-exempt retail sales of local food and beverages pursuant to § 77.98, Wis. Stats. (1999-2003). Food and beverages subject to the tax include meals and beverages sold for direct consumption on the premises and sales for off premises consumption of meals and sandwiches and beverages. Wis. Stat. § 77.54(20)(c). Since the Pallas Restaurant served food and beverages to be consumed on-premises, 1016 KOS, Inc. was subject to the tax. Any items prepared for take-out were also subject to the tax.

1016 KOS, Inc., did not register for the local exposition tax until 2003 (Ex. 4), but had been subject to the tax for the years 1999-2003. (Ex. 60.) The Department issued an assessment of \$44,923.06 for unpaid local exposition tax, interest, and penalties for the years 1999-2003. (Ex. 3.) The assessment was made for tax due on sales reported from the restaurant business and on unreported receipts determined by the auditor using the ratio markup method.

Under the law, the assessment is presumed to be correct. The Petitioner admitted it was subject to the tax and did not deny that it had not paid such tax, but disagreed with the amount assessed. However, the Petitioner presented no evidence either before trial or at trial to contradict the assessment. The assessment is upheld.

4. 519 KOS, Inc. - Docket No. 07-I-094

This case involves three deductions taken by 519 KOS, Inc., a Wisconsin corporation solely owned by Nicholas Itsines. 519 KOS, Inc. operates a motel as a Days Inn franchisee in Milwaukee County. In 2005, the Department assessed 519 KOS, Inc. the sum of \$8,069.76 in franchise tax pursuant to an audit. (Ex. 4.) The audit related to three deductions that were unsubstantiated. On the Petitioner's 2002 franchise tax return, Schedule A, line 2, purchases of \$88,198 were listed. The auditor accepted \$78,198, but the \$10,000 balance was not substantiated. On the Petitioner's 2003 return, auto and truck expenses of \$41,685.12 and miscellaneous expenses of \$18,862.76 were not substantiated.

As noted above, deductions are matters of legislative grace and tax statutes are to be strictly construed against the granting of the same. *Fall River Canning and NCR Corp., supra*. The burden is on the taxpayer to establish these deductions by clear and convincing evidence. *Id.* A petitioner's uncorroborated testimony as to undocumented expenses is insufficient to satisfy that petitioner's burden of proof and overcome the presumption of correctness attached to an assessment. *Longrie and Dvorak, supra*.

Although the Petitioner promised to provide documents to support the appeal (Ex. 15), no evidence was presented prior to trial or at trial to substantiate these deductions. The assessment therefore stands.

5. 519 KOS, Inc. - Docket No. 07-S-095

The Department issued a sales/use tax assessment of \$64,118.01 against 519 KOS, Inc., relating to a undocumented exemptions claimed from sales from 2000

through 2003 and a use tax due on certain purchases made with credit cards for linen supplies and computer hardware and software. The assessment was made following an audit. The Petitioner appealed the adjustment claiming it had records to substantiate the exemptions and to show that use tax had been paid on the purchases.

Again, Petitioner had the burden to provide substantiation. Wis. Stats. §§ 77.52(13) and 77.53(10); *H. Samuels, supra*. But there was no documentary evidence provided to the Department prior to trial, nor any evidence presented at trial to substantiate the claimed exempt sales, or to prove that use tax had been paid on the purchases at issue. The assessment therefore stands.

6. 519 KOS, Inc. - Docket No. 07-X-096

519 KOS, Inc., (the “519 Days Inn”) operates a motel located in the City of West Allis in Milwaukee County, which is a local exposition-tax district under Wis. Stat. § 229.41(4m). Under this statute, Milwaukee County imposes a tax on furnishing rooms or lodging for transients by hotelkeepers or motel operators.

On June 20, 2005, the Department issued an assessment of \$108,591.82 against 519 KOS, Inc. for unpaid local exposition taxes. (Ex. 6.) Petitioner appealed and stated that it would provide documents to support the appeal. (Ex. 17.) Petitioner never provided any substantiation either to the Department (Ex. 13) or at trial to support its appeal. There is no dispute that, as a motel operator, 519 KOS, Inc. was subject to the tax. The law is clear that assessments by the Department are presumed to be correct. By failing to provide any substantiation, Petitioner has not met its burden. The assessment stands.

7. Itsines Corporation - Docket No. 07-I-097

On June 20, 2005, the Department issued an assessment against the Itsines Corporation for \$2,640.85 based on disallowed unsubstantiated depreciation, utilities and miscellaneous expense deductions reported on its 2002 and 2003 franchise tax returns. (Ex. 7.) With respect to depreciation, the auditor adjusted depreciation on the Petitioner's 2002 corporate income tax return in the amount of the net operating loss claimed on the return. (Ex. 64.) In 2003, Petitioner claimed miscellaneous expenses of \$14,300 and \$7,044 in utility expenses. (Ex. 64.) As in the other cases discussed herein, the Petitioner had the burden of proof to substantiate the miscellaneous expenses and to account for the depreciation at issue. The Petitioner provided no evidence to the Department to substantiate the depreciation expense nor the deductions taken for miscellaneous and utilities expenses at issue. The Petitioner failed to meet its burden of proof. The assessment stands.

8. Itsines Corporation - Docket No. 07-S-098

This case involves the nonpayment of sales tax for leases of fixed assets by the Itsines Corporation to 1016 KOS, Inc. and 519 KOS, Inc., which claimed deductions for lease payments to Itsines Corporation on their franchise tax returns. (Ex. 53.) Itsines Corporation never reported or paid any sales tax on these leases.

Leases of tangible personal property are subject to sales tax. Wis. Stat. § 77.52(1). The Petitioner's defense in this case was that the assets in question were owned by a disinterested third party. (Ex. 19.) However, the Petitioner presented no evidence either before or at trial to support its contention. The assessment of the

Department is presumed to be correct. Since there was no evidence to contradict it, the assessment stands.

9. Nicholas and Christina Itsines - Docket No. 07-I-065

A. Imputed Interest

According to the balance sheets of Itsines Corporation, Nicholas and Christina Itsines made certain loans to the corporation, of which Mr. Itsines is the sole shareholder, during the years 1999 to 2003. Mr. and Mrs. Itsines reported no interest on their individual tax returns from these loans during this period. The Department auditor imputed interest to the Itsines on these loans, resulting in additional unreported income to them and the individual income tax assessment at issue.

Wisconsin generally follows federal law with respect to individual income tax. Section 7872 of the Internal Revenue Code generally provides interest may be imputed to the lender on any “below-market loan” between a corporation and shareholder of such corporation. Applying this section of the Code, the Department auditor imputed interest to Mr. and Mrs. Itsines at the applicable federal rates for each period at issue. (Ex. 51-52.)

In their appeal, Mr. and Mrs. Itsines blamed their accountant and said they had hired another accountant to respond to the audit. (Ex. 34.) The Petitioners provided no evidence either before or at trial to show that the Department’s determination or calculation of the imputed interest was incorrect. As in the other cases at issue here, Petitioners have the burden of proof to prove that the Department’s assessment is incorrect, which they failed to do with respect to this issue.

B. Constructive Dividends

The audit of 1016 KOS, Inc. reconstructed the income of that corporation and showed additional income that was not reported. Pursuant to the audit, this additional income was treated as a constructive dividend to the shareholder of the corporation, Mr. Itsines, during the period at issue.

In treating these amounts of unreported corporate income as constructive dividends to the sole shareholder, the Department applied the rule of *Pittman v. Comm'r*, 100 F.3d 1308, 96-2 USTC ¶ 50,658 (7th Cir. 1996), which held that the IRS determination of a constructive dividend was entitled to a presumption of correctness in a case where receipts of a solely-owned corporation were not reflected in its tax returns. In their appeal, the Petitioners stated that the audit overestimated their income. However, no evidence was presented either before or at trial by the Itsines to overcome the presumption of correctness. Thus, the determination of a constructive dividend to Mr. Itsines is presumed correct, as is the overall assessment in this case.

10. Nicholas Itsines - Docket No. 08-S-149

This case involves an assessment against Mr. Itsines of personal liability for the unpaid and delinquent sales taxes of 1016 KOS, Inc. for the period December 1, 2003 through December 31, 2004. Mr. Itsines is the sole shareholder and an officer of 1016 KOS, Inc., and the question is whether personal liability for these unpaid taxes may be imposed upon him.

Any person who is responsible for collecting, accounting for, or paying sales and use tax and who willfully fails to do so is personally liable for the amount due, including interest and penalties, if the corporation primarily liable is unable to pay.

Wis. Stat. § 77.60(9). This personal liability survives the dissolution of the corporation. A “person” for purposes of this provision includes “an officer, employee, or other responsible person of a corporation . . . who, as such officer, employee, member or other responsible person, is under a duty to perform the act in respect to which the violation occurs.” Wis. Stat. § 77.60(9).

In an assessment of personal liability under § 77.60(9), the Department initially bears the burden of proof and must show the presence of the following three elements:

(1) The individual had the authority to pay, or to direct the payment of, the taxes; (2) The individual had the duty to pay, or to direct the payment of, the taxes; and (3) The individual intentionally breached that duty. *See, Bice v. Wis. Dep’t of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-496 (WTAC 2000); *Senf v. Wis. Dep’t of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-441 (WTAC 1999); *Balestrieri v. Wis. Dep’t of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-373 (WTAC 1998).

Field v. Wis. Dep’t of Revenue, Wis. Tax Rptr. (CCH) ¶ 401-102, (WTAC Mar. 19, 2008), *aff’d*, Case No. 08-CV-1766 (Dane Co. Cir. Ct. June 25, 2009), *aff’d*, Appeal No. 2009AP1746 (Ct. App. June 24, 2010). If the Department presents clear and satisfactory evidence establishing the three required elements, then the petitioner bears the burden of proving otherwise by clear and satisfactory evidence. *Drilias v. Wis. Dep’t of Revenue*, Wis. Tax Rptr. (CCH) ¶400-222 (WTAC 1996).

The Commission finds that the Department has established all three elements required for personal liability to attach to Mr. Itsines under Wis. Stat. § 77.60(9), and he has failed to prove the contrary. As an officer and the sole shareholder of 1016 KOS, Inc. (Ex. 57, 67, and 43), Mr. Itsines had the authority to sign checks (Ex. 73), and did in fact sign some of the sales tax returns for 1016 KOS, Inc. (Ex. 70.) Thus,

he had the authority to pay, or direct the payment of the taxes, satisfying the first element. As an officer, Mr. Itsines had the duty to see that the corporation's taxes were paid. *Higgs v. Wis. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-356 (WTAC Mar. 11, 1998.) This meets the second element of duty to pay. The third element is the intentional breach of the duty to pay the sales tax. To satisfy this element, the Department must show that Mr. Itsines paid other creditors when the taxes at issue were due and unpaid. *Field, supra*. The evidence at trial proved that Mr. Itsines paid other creditors and himself (Ex. 72, 74, 78, and 79), while the sales taxes at issue remained unpaid, thereby satisfying the third element.

The Department having established the three elements of personal liability, the burden shifts to the petitioner to provide otherwise. Mr. Itsines argued two points: (1) that he did not own the business at the time the sales taxes were due; and (2) that he had delegated all responsibility for payment of taxes to George Pappas. The evidence presented at trial did not support either point. Mr. Itsines offered a Management Agreement (Ex. 68) between himself and George Pappas, pursuant to which Mr. Pappas was employed as manager of the restaurant and which gave Mr. Pappas an opportunity to buy the restaurant. However, no sale between the parties was concluded, no stock was transferred to Mr. Pappas, and in 2005, he was terminated as manager of the restaurant. Obviously, Mr. Itsines could not have terminated Mr. Pappas if Mr. Pappas had been the owner.

Petitioner further argued that he assigned to Mr. Pappas the responsibility to have all returns, reports, and forms required by law to be prepaid and filed on a timely basis (Ex. 35). However, the facts show that Mr. Itsines remained in control of

the corporation's financial matters at all times at issue, including signing sales tax returns during 2003. (Ex. 70.) Moreover, in 2005, Mr. Itsines and Mr. Pappas signed an Amendment to the Management Agreement, effective November 3, 2003, providing that Mr. Itsines, as owner, would "in the case of taxes make and file all such returns as are necessary in connection therewith with all appropriate governmental agencies and remit such taxes as and when due." (Ex. 84.) Finally, whether Mr. Pappas or anyone else might be a "responsible person" under the statute is irrelevant. The only issue before the Commission is the personal liability of Mr. Itsines. The Department proved the three required elements establishing Mr. Itsines' personal liability for the unpaid sales taxes, he provided no evidence to the contrary, and the Commission therefore upholds the assessment.

11. Nicholas Itsines - Docket No. 08-W-150

This case involves an assessment against Mr. Itsines of personal liability for certain unpaid and delinquent withholding taxes owed by 1016 KOS, Inc. for 2003 and portions of 2004. The applicable statute in this case is Sec. 71.83(1)(b)2, Wis. Stats., which provides in relevant part:

. . . Any person required to withhold, account for or pay over any tax imposed by this chapter, . . . who intentionally fails to withhold such tax, or account for or pay over such tax, shall be liable to a penalty equal to the total amount of the tax, plus interest and penalties on that tax, that is not withheld, collected, accounted for or paid over. The personal liability of such person as provided in this subdivision shall survive the dissolution of the corporation or other form of business association. "Person", in this subdivision, includes an officer, employee or other responsible person of a corporation or other form of business association or a member, employee or other responsible person of a partnership, limited liability company or sole proprietorship who, as such officer, employee, member or

other responsible person, is under a duty to perform the act in respect to which the violation occurs.

Wis. Stat. § 71.83(1)(b)2.

The requirements for determining “responsible person” status under § 71.83(1)(b)2 are the same as those under § 77.60(9), as discussed above in paragraph 10. Thus, the Department must prove the three elements of authority to pay, duty to pay, and intentional breach of that duty to pay the withholding taxes that remain due and unpaid. *See, Berrettini v. Wis. Dep’t of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-802 (WTAC 2005); *Bice v. Wis. Dep’t of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-496 (WTAC 2000).

As discussed above, the Department established that, with respect to 1016 Kos Inc. during the periods at issue, Mr. Itsines had the authority and duty to pay the corporation’s taxes. The evidence shows that Mr. Itsines breached that duty by using corporate funds to pay other creditors (including Itsines Corp., which he owned) during and after the periods at issue rather than pay over the withholding taxes due. (Exs. 72-79.) As further discussed above, Mr. Itsines’ attempts to shift responsibility for the unpaid taxes of 1016 KOS, Inc. to Mr. Pappas are unavailing. Based on the evidence and applicable law, the Commission concludes that Mr. Itsines is liable as a responsible person for the unpaid withholding taxes of 1016 KOS, Inc. for the periods at issue in this assessment.

CONCLUSION

For the first nine cases discussed above, the assessments of the Department were presumed to be correct. The Petitioners had the burden of proving the assessments to be incorrect by providing clear and convincing evidence to the contrary. The Petitioners presented only self-serving testimony and no documentary

evidence to contradict the assessments and thus failed to meet their burden. With respect to the two personal liability cases, Docket Numbers 08-S-149 and 08-W-150, the Department proved that Nicholas Itsines was a responsible person with respect to 1016 KOS, Inc. under the applicable statutes and thus personally liable for the unpaid and delinquent sales taxes and the unpaid withholding taxes of the corporation.

ORDER

The Department's actions on the petitions for redetermination at issue in these matters are affirmed.

Dated at Madison, Wisconsin, this 13th day of August, 2010.

WISCONSIN TAX APPEALS COMMISSION

David C. Swanson, Chairperson

Roger W. Le Grand, Commissioner

Thomas J. McAdams, Commissioner

ATTACHMENT: "NOTICE OF APPEAL INFORMATION"