

STATE OF WISCONSIN
TAX APPEALS COMMISSION

STEPHEN R. MARIUCCI,

DOCKET NO. 11-I-295

Petitioner,

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

DECISION AND ORDER

ROGER W. LEGRAND, COMMISSIONER:

This matter is before the Commission following a trial held on October 14, 2013, before Commissioner Roger W. LeGrand. After testimony was heard, both parties filed briefs in lieu of closing arguments. Petitioner appears *pro se*. Respondent, Wisconsin Department of Revenue ("the Department"), appears by Attorney Peter D. Kafkas.

The trial was held pursuant to a Ruling and Order dated June 7, 2013, in which the Respondent's Motion for Summary Judgment was denied on the ground that a factual dispute existed regarding the nature and amount of a business loan purportedly made by Petitioner to his employer, First American Engineered Solutions, LLC.

Testimony at the trial was taken from Gerald Morris, the sole owner of

First American Engineered Solutions, LLC, Petitioner Stephen Mariucci, and Carrie Kloss of the Wisconsin Department of Revenue. The exhibits of the Department and Petitioner were admitted without objection. An audio transcript of the trial was taken.

Based upon the file, the exhibits, and the testimony elicited at trial, the Commission makes the following:

FINDINGS OF FACT

1. Petitioner is an adult resident of the State of Wisconsin and is subject to the income tax laws of the State of Wisconsin for the year 2010 and any other year that may be relevant to said year.

2. The Department is an agency of the State of Wisconsin created pursuant to Chapter 13 of the Wisconsin Statutes and engaged in governmental duties including but not limited to the administration of income tax pursuant to Chapters 71 and 73 of the Wisconsin statutes.

3. On or about April 2, 2011, Petitioner filed with Respondent an original 2010 Form 1 Wisconsin income tax return with attached 2010 Schedule H Wisconsin Homestead credit and 2010 Form 1040 U.S. Individual Income Tax Return (together "2010 return")

4. In the 2010 return, Petitioner listed federal adjusted gross income of negative \$106,674, Wisconsin income of negative \$107,174, and a homestead credit in the amount of \$1,168.

5. This result came because Petitioner claimed a loss of \$161,474 on line 21 of the 2010 Form 1040 due to an alleged "Business Bad Debt of an Employee."

6. Petitioner failed to file a Schedule C on which he would have had to report business income and losses.

7. No record of a Form W-2 for the year 2010 was submitted by Petitioner.

8. Petitioner failed to report the alleged loss as a federal miscellaneous itemized deduction on his federal return for 2010.

9. The claimed "Business Bad Debt of an Employee" related to First American Engineered Solutions, LLC ("FAES"), a Minnesota corporation.

10. FAES was solely owned by Gerald Morris. Petitioner, Stephen Mariucci, had no ownership interest in the corporation and was an employee at will.

11. Petitioner was never given a written contract but his Form W-2 for 2007 showed that he was paid \$90,000 and his Form W-2 for 2006 showed he was paid \$78,750 as an employee of FAES.

12. Petitioner claimed that the "Business Bad Debt of an Employee" consisted of his use of personal credit cards to pay some business expenses of FAES.

13. Gerald Morris, President of FAES, claimed that a Memorandum of Understanding existed concerning the loan. However, neither he nor Petitioner could produce this memorandum. Gerald Morris claimed that he did not have access to the

memorandum because it was seized during an involuntary bankruptcy proceeding by the US Trustee and the trustee would not provide him copies of any company documents.

14. The testimony of Gerald Morris and his affidavit introduced as Exhibit 4 indicate that the bankruptcy proceedings of FAES were very contentious. However, neither Gerald Morris nor Petitioner provided any reason why copies of the corporate and financial records of FAES including the purported Memorandum of Understanding could not have been obtained from the US Trustee.

15. The bankruptcy proceeding of FAES was filed on March 11, 2008, and terminated on November 19, 2010, without any claims being discharged. Stephen Mariucci was listed as a creditor of the corporation but no details on the nature of his claim were given.

16. Neither Petitioner nor the President of FAES could produce any documentation relating to the existence of the purported loan, the nature of the loan, the terms of the loan, whether any funds were actually transferred to the debtor, whether there was any interest, whether there was collateral, when the loan was incurred, and what the transaction history was.

17. Petitioner failed to provide a credible explanation or documentation for his offset against income for the "Business Bad Debt of an Employee."

18. Since business bad debts of an employee losses are not allowed in Wisconsin as part of the Wisconsin itemized deduction credit, the Petitioner attempted to deduct the alleged loss directly from federal income, without any listing on a federal Schedule A, the Itemized Deduction form.

19. The testimony of Gerald Morris regarding the existence and terms of a "purported loan" was not credible.

CONCLUSIONS OF LAW

1. Petitioner failed to establish by clear and convincing evidence that he had experienced a "bad business debt of an employee."

2. Petitioner failed to establish the nature, amount, and terms of the alleged "bad business debt."

3. Petitioner's alleged "Business Bad Debt" would not be deductible nor includable in the calculation of the Wisconsin itemized deduction credit.

OPINION

Petitioner was an employee of First American Engineered Services, LLC (hereafter "FAES"). He was paid a salary for 2006 and 2007, but it is unclear whether he was paid after that. In 2008, an involuntary bankruptcy proceeding was begun against FAES by certain creditors of the company. The case was closed on November 19, 2010, after the trustee in bankruptcy reported that there were insufficient assets in the corporation to administer. (Ex. AA). In his 2010 Federal Income Tax return, Petitioner

reported an income of negative \$106,674. For state purposes, he reported an income of negative \$107,174, and a Homestead Credit in the amount of \$1,168. This was due to reporting on line 21 of his federal return as other income a "Business Bad Debt of an Employee" of \$161,474. (Exh. 6).

The Department of Revenue adjusted the 2010 return to disallow the claimed reduction for "Business Bad Debt of an Employee" and disallowed the Homestead Credit claimed because the adjusted total income exceeded the maximum allowable income of \$24,680. (Exh. 1).

Petitioner appealed claiming that he was entitled to claim the "Business Bad Debt of an Employee" as other income on line 21 of his federal tax return. He submitted Form 1099 C, a Cancellation of Debt form, to substantiate the negative \$161,474 number.

The issues in the case are whether there was an actual "Business Bad Debt of an Employee" which qualified for a bad debt deduction and if so whether Petitioner was able to substantiate the amount of the bad debt he claimed on his federal and state 2010 income tax returns. After analyzing the evidence, we conclude that Petitioner failed to prove by clear, convincing, and satisfactory evidence that a debt existed between FAES and himself and that he failed to substantiate the amount of the purported debt which he claimed. Therefore, the Petitioner was not entitled to take a "Bad Debt Deduction" and report it as negative income on his 2010 federal tax return.

We conclude that the Department's adjustment action is correct and is affirmed.

Income tax assessments are presumptively correct, and the burden of proof is on the Petitioner to establish that they are incorrect. *Dept. of Taxation v. O.H. Kindt Mfg. Co.*, 13 Wis.2d 258, 268, 108 N.W.2d 535 (1961); and *Woller v. Dept. of Taxation*, 35 Wis.2d 227, 232, 151 N.W.2d 170 (1967). Deductions and exemptions are matters of legislative grace and as such are strictly construed. *Comet Co. v. Dep't of Taxation*, 243 Wis. 117 (1943).

The person asserting a deduction must be able to identify an express provision and show that he is clearly within the terms of the law. *Ramrod, Inc. v. Dep't of Revenue*, 64 Wis. 2d 499, 504, 219 N.W. 2d. 604 (1974).

The Internal Revenue Service has allowed employees of corporations to take a bad debt deduction on a federal return if the taxpayer was in a trade or business and the bad debt was proximately related to such a trade, or business. *United States v. Generes*, 405 U.S. 93, 96 (1972). For Petitioner to prevail in this case, he must prove the existence of a bona-fide business debt between himself as creditor and the employer corporation as debtor and that the purpose of the debt was to protect or enhance the taxpayer's trade of business.

Petitioner claims that he made loans to the company totaling \$161,474 from 2005 to 2010. (Petition for Review, Ex. C). But he could provide no written substantiation for the existence of the loans to the company. There were no

notes signed, no terms discussed for repayment, no proof that money was actually transferred from Petitioner to the corporation. Gerald Morris, the President of FAES, filed an affidavit and testified there was a written Memorandum of Understanding regarding the loans, but he claims that such Memorandum was seized by the U.S. Trustee in Bankruptcy, and not returned. Petitioner stated that he does not have a copy. The Commission finds the testimony regarding the Memorandum of Understanding lacked credibility. The U.S. Trustee made a diligent inquiry into the financial affairs of FAES and reported that there were no assets to administer, and the bankruptcy judge closed the case. There is no reason why copies of any documents seized during the bankruptcy would not be returned upon request.

Petitioner then attempted to substantiate the amount of the "loans" by providing a loan summary of unreimbursed cash and credit loans from 2005 to 2010. (Petition for Review, Ex. C). These purport to be cash payments and credit card payments he claimed that he personally made on behalf of the company. There were no receipts nor records presented to show these payments, what they were for, and whether they were expected to be repaid. In summary, Petitioner has not met his burden of proving by clear, satisfactory, and convincing evidence that he made loans to the company, what the terms were, what the purpose of the loans was, and whether they were repaid. The Commission concludes that Petitioner improperly took a "Bad Debt Deduction" of \$161,474 on his 2010 federal tax return.

Furthermore, Petitioner incorrectly reported the "Bad Debt Deduction" on line 21 of his federal tax return as "other income." Petitioner justifies this by filing Form 1099-C, a Cancellation of Debt form, in which he as creditor purportedly cancels a debt of \$161,474 to FAES. Petitioner mistakenly interpreted the instructions to line 21 to allow a creditor who cancels a debt to include the amount of cancelled debt as taxable income. In fact, the instructions to line 21 are clear that the imputed income attributed to the debtor from the cancellation of the debt may be taxable income to the debtor. The creditor is not receiving any income from the cancellation, actual or imputed.

This "Business Bad Debt of an Employee" is reported as a miscellaneous itemized deduction for federal purposes. Since we have found that no bona fide loans existed between Petitioner and FAES, no bad debt of an employee deduction was warranted.

The Department correctly adjudged Petitioner's 2010 income tax returns to disallow his reduction of \$161,474 in gross income. After that adjustment was made, Petitioner's gross income exceeded the statutory limit for claiming a homestead credit.

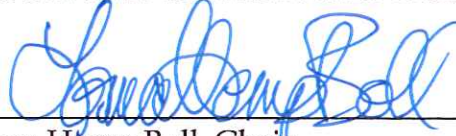
Therefore,

IT IS ORDERED

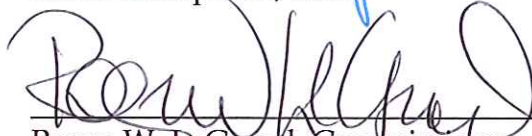
1. The Department's action on the Petition for Redetermination is affirmed.
2. The Petition for Review filed by Petitioner is dismissed.

Dated at Madison, Wisconsin, this 31st day of July, 2014.

WISCONSIN TAX APPEALS COMMISSION



Lorna Hemp Boll, Chair



Roger W. DeGrand, Commissioner



David D. Wilmoth, Commissioner

ATTACHMENT: NOTICE OF APPEAL INFORMATION

WISCONSIN TAX APPEALS COMMISSION
5005 University Avenue - Suite 110
Madison, Wisconsin - 53705

NOTICE OF APPEAL INFORMATION

**NOTICE OF RIGHTS FOR REHEARING OR JUDICIAL REVIEW, THE TIMES ALLOWED
FOR EACH, AND THE IDENTIFICATION OF THE PARTY TO BE NAMED AS
RESPONDENT**

A taxpayer has two options after receiving a Commission final decision:

Option 1: PETITION FOR REHEARING BEFORE THE COMMISSION

The taxpayer has a right to petition for a rehearing of a final decision within 20 days of the service of this decision, as provided in Wis. Stat. § 227.49. The 20-day period commences the day after personal service on the taxpayer or on the date the Commission issued its original decision to the taxpayer. The petition for rehearing should be filed with the Tax Appeals Commission and served upon the other party (which usually is the Department of Revenue). The Petition for Rehearing can be served either in-person, by USPS, or by courier; however, the filing must arrive at the Commission within the 20-day timeframe of the order to be accepted. Alternatively, the taxpayer can appeal this decision directly to circuit court through the filing of a petition for judicial review. It is not necessary to petition for a rehearing first.

AND/OR

Option 2: PETITION FOR JUDICIAL REVIEW

Wis. Stat. § 227.53 provides for judicial review of a final decision. Several points about starting a case:

1. The petition must be filed in the appropriate county circuit court and served upon the Tax Appeals Commission either in-person, by certified mail, or by courier, and served upon the other party (which usually is the Department of Revenue) within 30 days of this decision if there has been no petition for rehearing, or within 30 days of service of the order that decides a timely petition for rehearing.
2. If a party files a late petition for rehearing, the 30-day period for judicial review starts on the date the Commission issued its original decision to the taxpayer.
3. The 30-day period starts the day after personal service or the day we mail the decision.
4. The petition for judicial review should name the other party (which is usually the Department of Revenue) as the Respondent, but not the Commission, which is not a party.

For more information about the other requirements for commencing an appeal to the circuit court, you may wish to contact the clerk of the appropriate circuit court or the Wisconsin Statutes. The website for the courts is <http://wicourts.gov>.

This notice is part of the decision and incorporated therein.