

No. A05-970

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STATE OF MINNESOTA  
IN SUPREME COURT

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Carol Dreyling and Roger A. Dreyling,

Relators,

vs.

Commissioner of Revenue,

Respondent.

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**RESPONDENT'S BRIEF AND APPENDIX**

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MACK & DABY P.A.  
John E. Mack  
Atty. Reg. No. 65973

26 Main Street  
New London, MN 56273  
(320) 354-2045

ATTORNEYS FOR RELATORS

MIKE HATCH  
Attorney General  
State of Minnesota

CRAIG R. ANDERSON  
Assistant Attorney General  
Atty. Reg. No. 1764

445 Minnesota Street, Suite 900  
St. Paul, MN 55101-2127  
(651) 296-3424

ATTORNEYS FOR RESPONDENT

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## LEGAL ISSUES

1. Did Respondent Commissioner of Revenue correctly determine that throughout 1998, 1999, and 2000, Relator Roger Dreyling was a resident of Minnesota for income tax purposes?

The trial court held in the affirmative.

The most apposite authorities include: Minn. Stat. § 290.01, subd. 7 (2004);<sup>1</sup> Minn. Rules 8001.0300 (2005); *Manthey v. Comm'r of Revenue*, 468 N.W.2d 548 (Minn. 1991); *Sandberg v. Comm'r of Revenue*, 383 N.W.2d 277 (Minn. 1986); *Comm'r of Revenue v. Stamp*, 296 N.W.2d 867 (Minn. 1980); and *Miller v. Comm'r of Taxation*, 240 Minn. 18, 59 N.W.2d 925 (1953).

2. Relators, sophisticated taxpayers, based their Minnesota income tax returns on a facially invalid claim that Relator Roger Dreyling was a nonresident, and thus substantially under-reported their Minnesota taxable income throughout the relevant period. Relators failed to keep adequate tax records, and when the Commissioner audited their returns, declined to provide some of the information requested by the auditors. In these circumstances, was the Commissioner's assessment of fraud penalties justified?

The trial court held in the affirmative.

The most apposite authorities include: Minn. Stat. §§ 289A.37, subd. 3, 289A.60, subd. 6, and 290.01 subd. 7 (2004); Minn. Rules 8001.0300 (2005); *Wyberiala v. Comm'r*

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<sup>1</sup> For convenience this brief will, unless otherwise indicated, refer to the current editions of the Minnesota Statutes and Rules. The relevant provisions of these latest editions are essentially identical to those in effect during the period in question in this case.

*of Revenue*, 587 N.W.2d 832 (Minn. 1998); *F-D Oil Co. v. Comm'r of Revenue*, 560 N.W.2d 701 (Minn. 1997); *State v. Enyeart*, 676 N.W.2d 311 (Minn. Ct. App. 2004), review denied (Minn. May 18, 2004), cert. denied, \_\_\_ U.S. \_\_\_, 125 S.Ct. 310 (2004); and *McGraw v. Comm'r*, 384 F.3d 965 (8th Cir. 2004).

## STATEMENT OF THE CASE

In this case, Relators Carol<sup>2</sup> and Roger Dreyling, who are spouses, appealed to the Tax Court from an October 10, 2003, Order (RA at A1)<sup>3</sup> of Respondent Commissioner of Revenue. The Commissioner issued that Order following an audit of Relators' joint Minnesota income tax returns for the 1998, 1999, and 2000 taxable years ("audit period"). Relators' returns for each of these three years claimed that Relator Roger Dreyling was a resident of Alaska, a state with no income tax. The Commissioner concluded that to the contrary, Roger Dreyling had been a resident of Minnesota for income tax purposes throughout the audit period. He assessed additional income taxes, fraud and substantial understatement penalties, and interest for the audit period totaling \$30,905.19 (RA at A8).<sup>4</sup>

On October 27, 2004, this case came on for trial in St. Cloud, Minnesota, before the Tax Court, the Honorable Sheryl A. Ramstad presiding. On February 25, 2005, the Tax Court issued its Findings of Fact, Conclusions of Law, and Order (App. A1), affirming the assessment in its entirety.<sup>5</sup>

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<sup>2</sup> Carol Dreyling is a party to this proceeding only because she and Roger Dreyling filed joint income tax returns for the period in question.

<sup>3</sup> This abbreviation refers to Respondent's Appendix, *infra*.

<sup>4</sup> Relators have inadvertently included in their Appendix ("App.") copies of an Order of Respondent and Tax Court appellate documents relating to a later assessment for the 2001 and 2002 taxable years. See App. A40-A51. Relators' separate appeal from that subsequent assessment is still pending in the Tax Court.

<sup>5</sup> The Tax Court's decision is available at 2005 WL 473893.

Relators brought a post-trial motion (App. A30) for amended findings and conclusions or a new trial. In an Order dated April 19, 2005 (App. A35),<sup>6</sup> the Tax Court denied this motion.

Relators timely obtained a Writ of Certiorari (App. A57) from this Court to review the Tax Court's decision. Relators filed their Brief and Appendix (Rel. Br.) on June 27, 2005.

### STATEMENT OF FACTS

The Tax Court has thoroughly summarized (App. A2-A10 and A35-A36) the relevant facts in this case. The Commissioner concurs in that factual summary.

Roger Dreyling was born in Minnesota in 1938 and grew up in this state. In 1966, he graduated from the University of Minnesota Medical School (App. A2). Shortly thereafter, he established a medical practice as a family physician in Paynesville, Minnesota. Dr. Dreyling maintained his medical practice in Paynesville until his retirement in 1997 (App. A2).

In 1958, Relators married. In 1981, they purchased a home located at 15995 Concord Road in Paynesville and have lived in the residence since that time, treating it as their homestead for property tax purposes (App. A3). Relators also own three parcels of real property located in St. Louis County, Minnesota. In 2002, Relators applied for homestead tax treatment of a portion of the St. Louis County property. Relators have

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<sup>6</sup> See 2005 WL 937363.

also owned other Minnesota commercial and agricultural properties located in Stearns and Kandiyohi Counties throughout the Audit Period (App. A3).

After Dr. Dreyling retired from his medical practice at the end of 1997, he worked briefly as a physician in Alaska in 1998 and 1999 under temporary employment agreements with two separate tribal organizations. The total duration of this employment in 1998 was from June 28 to July 22, or less than a month, and in 1999, from February 1-28 and March 2 to April 10, or approximately nine weeks (App. A3). Compensation for these services was mailed to his Paynesville address (App. A3). While Dr. Dreyling was performing his duties in Alaska, his employers provided him with temporary housing in the form of rent-free apartments (App. A3). Aside from his work for the two tribal organizations, Dr. Dreyling has never practiced medicine in Alaska (App. A3-A4).

Dr. Dreyling spent the duration of 1998 and 1999 traveling in Alaska, at his Minnesota home, and in Florida (App. A4). On one or more occasions in 1998 and 1999, Carol Dreyling accompanied Dr. Dreyling on visits to Alaska (App. A4).

As a condition of his temporary employment, Dr. Dreyling obtained a medical license in Alaska, which he kept in effect during 1998 and 1999 (App. A35). Throughout the audit period, Dr. Dreyling also kept his Minnesota medical license current (App. A2). On several occasions, he returned to Minnesota from Alaska to take continuing medical education courses during 1998 and 1999 (App. A8).

Dr. Dreyling obtained resident fishing and hunting licenses in Alaska during 1998 and 1999 (App. A35). He also obtained an Alaska driver's license in 1998 and surrendered his Minnesota driver's license for the purpose of obtaining this license (App.

A36). The process of surrendering his Minnesota license resulted in the corner of the Minnesota license being clipped. Rather than destroying his Minnesota driver's license, Dr. Dreyling continued to use this license to receive benefits in Minnesota in 2000, such as obtaining resident hunting and fishing licenses (App. A36). His Alaska driver's license listed an address at Mail Boxes, Etc. in Alaska (App. A36).

In 1999, Dr. Dreyling registered one motor vehicle in Alaska, which he had originally purchased in Minnesota and sold to a Minnesota resident on December 21, 1999 (App. A36). During the audit period, Dr. Dreyling owned and registered several motor vehicles in Minnesota. Throughout this period, virtually all of his insurance, banking, financial and other business activities were centered in Minnesota (App. A3). During the audit period, Relators belonged to several golf clubs and community organizations in Minnesota and Florida (App. A3).

In June of 1998, Dr. Dreyling registered to vote in Alaska and remained a registered voter of Alaska until 2001 when he registered to vote in Florida (App. A4). He never voted in Alaska, maintaining that he felt he was not an informed voter in 1998 or 1999, and that he was physically present in Minnesota during the 2000 election (App. A4). He did not vote in Minnesota during the years in question. Carol Dreyling continued to vote in Minnesota after 1998 (App. A4).

Dr. Dreyling testified (Tr. 115) that while he was in Alaska, he "constantly" looked at the possibility of acquiring residential property. At no time during the audit period, however, did Relators come into ownership of any real property in Alaska (App. A7).

During the audit giving rise to this appeal, Relators provided some records and credit card information in support of Dr. Dreyling's claim that he was absent from Minnesota for more than 183 days during each year in the audit period (App. A5). However, these records were not sufficiently detailed to permit a determination of the precise number of days Dr. Dreyling was absent from Minnesota during any given year inasmuch as the credit card statements failed to indicate who signed the receipts for purchases made using the card (App. A9). Dr. Dreyling declined to provide bank records and other financial information requested by the Auditor (App. A5). One of the bases for the fraud penalty assessment was Relators' refusal to cooperate with requests for additional information, along with Dr. Dreyling's electing nonresident status without sufficient documentation (App. A5).

Relators' joint Minnesota income tax returns for the years 1998, 1999, and 2000 represented that Carol Dreyling was a Minnesota resident and Roger Dreyling a nonresident for each year (App. A9). In his October 10, 2003 Order, the Commissioner determined that Dr. Dreyling had been a Minnesota resident for each of the three years and adjusted Relators' income tax liability accordingly. The Commissioner assessed fraud and substantial understatement penalties as well.

At trial, Dr. Dreyling withdrew his appeal of the income tax and interest adjustments for the 2000 taxable year (App. A6). He admitted that during 2000 he had been present in Minnesota for 183 days or more (Tr. 10, 142). He continued to challenge the fraud penalty assessment for that year.

In its February 25 and April 19, 2005 Orders, the Tax Court respectively affirmed the Commissioner's assessment in its entirety and denied Relators' post-trial motion for amended findings and conclusions or a new trial. The instant certiorari proceeding followed.

## ARGUMENT

### I. STANDARD OF REVIEW

Minn. Stat. § 271.06, subd. 7 (2004), makes the Minnesota Rules of Civil Procedure, where practicable, applicable to Tax Court proceedings. Thus, on appeal from a Tax Court order, “[f]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses.” Minn. R. Civ. P. 52.01.

In applying this standard, this Court has stated: “On an attack on findings of the trial court, the question on appeal is whether the evidence sustains the findings, using all possible inferences supporting the findings.” *Georgopolis v. George*, 237 Minn. 176, 182, 54 N.W.2d 137, 141 (1952); *accord*, *State Dept. of Public Welfare v. Thibert*, 279 N.W.2d 53, 56 (Minn. 1979) (trial court's findings must be affirmed if supported by evidence and its reasonable inferences, viewed in light most favorable to prevailing party); *First Trust Co. v. Union Depot Place, Limited Partnership*, 476 N.W.2d 178, 182 (Minn. Ct. App. 1991), *rev. denied* (Minn. Dec. 13, 1991) (same).

In appeals from decisions of the Tax Court and its predecessors, this Court has consistently held that “our jurisdiction in reviewing fact questions is limited to

determining whether there is reasonable evidence to sustain the findings.” *Red Owl Stores, Inc. v. Comm’r of Taxation*, 264 Minn. 1, 9-10, 117 N.W.2d 401, 407 (1962), quoted in *Morton Buildings, Inc. v. Comm’r of Revenue*, 488 N.W.2d 254, 257 (Minn. 1992). “Where sufficient evidence exists upon which the Tax Court could reasonably base its conclusion, this court will uphold the Tax Court’s decision.” *World Plan Executive Council v. County of Ramsey*, 560 N.W.2d 87, 88 (Minn. 1997) (internal quotes omitted).

Especially where issues of credibility are involved, “this court does not substitute its judgment for that of the tax court on questions of fact, leaving the factual findings undisturbed where the evidence, as a whole, supports the decision.” *Manthey v. Comm’r of Revenue*, 468 N.W.2d 548, 550 (Minn. 1991). See also *F-D Oil Co. v. Comm’r of Revenue*, 560 N.W.2d 701, 706 (Minn. 1997) (trial court’s decision must be affirmed if supported by sufficient evidence; Tax Court is in best position to evaluate credibility and sincerity of witnesses).

Relators nonetheless argue (Rel. Br. at 31) that because many of the historical facts in the instant case are undisputed, the Tax Court’s decision is subject to *de novo* review. This is incorrect. The trial court based its conclusions, both as to Dr. Dreyling’s residency during the period in question and the appropriateness of the penalty assessments, on permissible inferences drawn from the testimony of witnesses whose credibility the trial court had the opportunity to evaluate, as well as from documentary evidence. The trial court’s findings on these issues are not clearly erroneous; to the

contrary, the record fully supports those findings. This Court should affirm the Tax Court's decision.

## **II. FOR INCOME TAX PURPOSES, ROGER DREYLING WAS A MINNESOTA RESIDENT THROUGHOUT THE AUDIT PERIOD.**

### **A. Introduction.**

Minn. Stat. § 290.17 (2004) establishes rules under which a portion of the income of non-resident individuals and businesses may be allocated to jurisdictions other than Minnesota. However, section 290.17, subd. 1(a) states: "the income of a resident individual is not subject to allocation outside this State." Minn. Stat. § 290.014, subd. 1 (2004), provides: "all net income of a resident individual is subject to tax under this chapter." Minn. Stat. § 290.01, subd. 7 (2004), provides in part:

- (a) The term "resident" means any individual domiciled in Minnesota. ...
- (b) "Resident" also means any individual domiciled outside the State who maintains a place of abode in the State and spends in the aggregate more than one-half of the tax year in Minnesota. ... The term "abode" means a dwelling maintained by an individual, whether or not owned by the individual and whether or not occupied by the individual, and includes a dwelling place owned or leased by the individual's spouse.

Thus, a person is a Minnesota resident in a given year for income tax purposes if either of the following conditions is met: (1) the person is domiciled in Minnesota throughout the year; or (2) the person maintains a place of abode in Minnesota and is present here for at least 183 days during the year. For all three years comprising the audit period, Roger Dreyling satisfied both of these criteria.

**B. Roger Dreyling Was A Minnesota Domiciliary Throughout The Audit Period.**

The Commissioner's rule implementing Minn. Stat. § 290.01, subd. 7 (2004), is Minn. R. 8001.0300 (2005). Minn. R. 8001.0300, subpt. 2 (2005) adopts the traditional common law definition of domicile:

The term "domicile" means the bodily presence of an individual person in a place coupled with an intent to make such place one's home. The domicile of any person is that place in which that person's habitation is fixed, without any present intention of removal therefrom, and to which, whenever absent, that person intends to return.

A person who leaves home to go into another jurisdiction for temporary purposes only is not considered to have lost that person's domicile. But if a person moves to another jurisdiction with the intention of remaining there permanently or for an indefinite time as a home, that person has lost that person's domicile in this state.

Except for a person covered by the provisions of the Soldiers' and Sailors' Civil Relief Act of 1940, ... the presumption is that the place where a person's family is domiciled is that person's domicile. The domicile of a spouse is the same as the other spouse unless there is affirmative evidence to the contrary or unless the husband and wife are legally separated or the marriage has been dissolved. ...

The mere intention to acquire a new domicile, without the fact of physical removal, does not change the status of the taxpayer, nor does the fact of physical removal, without the intention to remain, change the person's status. The presumption is that one's domicile is the place where one lives. An individual can have only one domicile at any particular time. A domicile once shown to exist is presumed to continue until the contrary is shown. An absence of intention to abandon a domicile is equivalent to an intention to retain the existing one. No positive rule can be adopted with respect to the evidence necessary to prove an intention to change a domicile but such intention may be proved by acts and declarations, and of the two forms of evidence, acts must be given more weight than declarations.

In furtherance of these principles, Minn. R. 8001.0300, subpt. 3, lists twenty-six nonexclusive factors to consider in determining whether a person is domiciled at a given time in Minnesota. These factors are:

- A. location of domicile for prior years;
- B. where the person votes or is registered to vote, but casting an illegal vote does not establish domicile for income tax purposes;
- C. status as a student;
- D. classification of employment as temporary or permanent;
- E. location of employment;
- F. location of newly acquired living quarters whether owned or rented;
- G. present status of the former living quarters, i.e., whether it was sold, offered for sale, rented, or available for rent to another;
- H. whether homestead status has been requested and/or obtained for property tax purposes on newly purchased living quarters and whether the homestead status of the former living quarters has not been renewed;
- I. ownership of other real property;
- J. jurisdiction in which a valid driver's license was issued;
- K. jurisdiction from which any professional licenses were issued;
- L. location of the person's union membership;
- M. jurisdiction from which any motor vehicle license was issued and the actual physical location of the vehicles;
- N. whether resident or nonresident fishing or hunting licenses purchased;
- O. whether an income tax return has been filed as a resident or nonresident;
- P. whether the person has fulfilled the tax obligations required of a resident;
- Q. location of any bank accounts, especially the location of the most active checking account;
- R. location of other transactions with financial institutions;
- S. location of the place of worship at which the person is a member;
- T. location of business relationships and the place where business is transacted;
- U. location of social, fraternal, or athletic organizations or clubs or in a lodge or country club, in which the person is a member;
- V. address where mail is received;
- W. percentage of time (not counting hours of employment) that the person is physically present in Minnesota and the percentage of time (not counting hours of employment) that the person is physically present in each jurisdiction other than Minnesota;
- X. location of jurisdiction from which unemployment compensation benefits are received;
- Y. location of schools at which the person or the person's spouse or children

attend, and whether resident or nonresident tuition was charged; and Z. statements made to an insurance company, concerning the person's residence, and on which the insurance is based.

Decisions of both this Court and the Minnesota Tax Court have long applied the common law approach in determining domicile. Thus, in *Miller v. Comm'r of Taxation*, 240 Minn. 18, 19, 59 N.W.2d 925, 926 (1953), this Court restated the traditional definition of domicile as "bodily presence in a place coupled with an intent to make such place one's home." Subsequent decisions have applied this definition in various settings. See *Manthey v. Comm'r of Revenue*, 468 N.W.2d 548 (Minn. 1991); *Sandberg v. Comm'r of Revenue*, 383 N.W.2d 277 (Minn. 1986); *Comm'r of Revenue v. Stamp*, 296 N.W.2d 867 (Minn. 1980); *Wolf v. Comm'r of Revenue*, Docket No. 7068, 1999 WL 640030 at \*2 (Minn. T.C. Aug. 17, 1999).

In the instant case, these principles lead to the inescapable conclusion that Roger Dreyling was a Minnesota domiciliary throughout 1998, 1999, and 2000. Concededly, Dr. Dreyling was a Minnesota domiciliary as of the end of calendar year 1997. He contends little more than that because he worked for a few months and spent some leisure time in Alaska during 1998 and 1999, he established an Alaska domicile throughout that period. This claim is inconsistent with Minn. R. 8001.0300, and must be rejected. Indeed, the instant case "is a paradigm of [Minnesota] domiciliary residence." *State v. Enyeart*, 676 N.W.2d 311, 321 (Minn. Ct. App. 2004), *rev. denied* (Minn. May 18, 2004), *cert. denied*, \_\_\_ U.S. \_\_\_, 125 S.Ct. 310 (2004).

Despite Roger Dreyling's travels to Alaska, the record shows that throughout 1998, 1999, and 2000, the center of his family, business and social life remained in

Minnesota. In particular, Relators have presented no evidence whatsoever to rebut the presumption in Minn. R. 8001.0300, subpt. 2, that a person's domicile is that of his or her spouse and family.<sup>7</sup> This failure alone requires a determination that Dr. Dreyling remained a Minnesota domiciliary throughout the audit period. *See State v. Mattmiller*, 2004 WL 1244040 at \*6 (Minn. Ct. App. June 4, 2004), *rev. denied*, (Minn. Aug. 17, 2004), *cert. denied*, \_\_\_ U.S. \_\_\_, 125 S.Ct. 663 (2004) (in criminal prosecution, domicile of defendant's family in Minnesota showed that defendant was likewise domiciled here); *Wolf v. Comm'r of Revenue*, Docket No. 7068, 1999 WL 640030 at \*2 (Minn. T.C. Aug. 17, 1999) (applying same presumption in civil case).

The courts have repeatedly emphasized the importance, in determining domicile, of the twenty-six factors listed in Minn. R. 8001.0300, subpt. 3. *See Manthey v. Comm'r of Revenue*, 468 N.W.2d 548, 550 (Minn. 1991) (quoting rule); *Sandberg v. Comm'r of Revenue*, 383 N.W.2d 277, 283 (Minn. 1986) (trier of fact should consider criteria set out in Minn. R. 8001.0300, subpt. 3); *State v. Mattmiller*, *supra* at \*6 (discussing rule); *State v. Enyeart*, 676 N.W.2d at 319 (same). These factors overwhelmingly support the decisions of the Tax Court and Commissioner in the present case.

Prior to 1998, Dr. Dreyling was a Minnesota domiciliary (factor A). Though he registered to vote in Alaska, he never voted there during the period in question (factor B).

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<sup>7</sup> In *United States v. Minnesota*, 97 F.Supp.2d 973 (D. Minn. 2000), the court held that as applied to persons covered by the Federal Soldiers' and Sailors' Civil Relief Act, this spousal and family domiciliary presumption was preempted by that federal statute. The Commissioner has since slightly modified the text of Minn. R. 8001.0300, subpt. 2 to take this holding into account. The decision has no application in the instant case.

As the trial court observed (App. A14): “Voter registration and participation are relevant to determining one’s domicile precisely because lack of participation in a community’s electoral process suggests an absence of ties to that community.” Relators have offered no reasonable explanation as to why Roger Dreyling took the step of registering to vote in Alaska in 1998 but never gained sufficient interest in local affairs to exercise the franchise in Alaska.<sup>8</sup>

Dr. Dreyling’s employment in Alaska during the period in question was both brief and temporary (factors D and E). His living quarters in Alaska were likewise temporary, and failed to compare with his Minnesota home, which the Dreylings continued to treat as homestead property for tax purposes throughout the period in question (factors G and H).

Roger Dreyling testified (Tr. 114-115) that he investigated purchasing real property in Alaska (factor I). For reasons not detailed, however, he never acquired real property there. In no other case decided by this Court or the Minnesota Tax Court has a taxpayer attempted to establish domicile in a jurisdiction where he or she had as fleeting an interest in real property as Dr. Dreyling did here.

Throughout the period in question Dr. Dreyling maintained driver’s and professional licenses in both Minnesota and Alaska (factors J and K). Dr. Dreyling used his clipped Minnesota driver’s license for identification purposes. The trial court

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<sup>8</sup> Daryl Piltz, who supervised the Commissioner’s audit in this case, testified at trial (Tr. 170) that in his experience, a person sometimes registers to vote but does not vote, merely as a part of an effort to establish a tax residence in another jurisdiction.

properly gave weight to the possession of this clipped driver's license in demonstrating Dr. Dreyling's Minnesota residency. Indeed, "[r]ather than destroying his Minnesota driver's license, Dr. Dreyling continued to use this license to receive benefits in Minnesota in 2000, such as his resident hunting and fishing licenses." App. A36. Dr. Dreyling obtained resident recreational licenses in both Minnesota and Alaska (factor N).

During the audit period Dr. Dreyling registered all but one motor vehicle in Minnesota — and this latter vehicle was both purchased and eventually sold in Minnesota (factor M). Relators state (Rel. Br. 28) that only Carol Dreyling used the motor vehicles Roger Dreyling registered in Minnesota. The record contains no evidence to support this claim. To the contrary, the record compels the inference that during his frequent returns to Minnesota throughout the audit period, Dr. Dreyling regularly used these Minnesota-registered vehicles.

During the period in question, Roger Dreyling's banking, financial, and other business activity all took place almost entirely within Minnesota (factors Q, R, and T). Relators' athletic and social club memberships were located in either Minnesota or Florida, but not in Alaska (factor U). Dr. Dreyling received some mail during the period in question in Alaska at a Mail Boxes, Etc. address. Otherwise, Relators received mail throughout this period in Minnesota and Florida (factor V). In this vein, Dr. Dreyling's tribal employers in Alaska sent his paychecks only to the Paynesville address (App. A8).

Dr. Dreyling was physically present for substantial parts of 1998, 1999 and 2000 in Minnesota (factor W). The educational courses Dr. Dreyling took in order to keep his medical license in force were all located in Minnesota (factors C and Y). Finally, Dr.

Dreyling purchased all insurance policies during the period in question in Minnesota (factor Z).

In Rel. Br. at 24-30, Relators engage in an extended discussion of these twenty-six factors as assertedly applied to Dr. Dreyling's situation. This discussion essentially invites this Court to re-weigh the evidence concerning these factors, and reach a conclusion different from the one at which the trial court arrived. That is a role which this Court clearly cannot play.

The trial court found (App. A21): "the vast majority of the factors listed in Minn. R. 8001.0300 subpt. 3 point to the conclusion that Dr. Dreyling was domiciled in Minnesota in 1998 and 1999. While some of the factors are more susceptible to argument than others, clearly factors 1, 4, 5, 6, 7, 9, 10, 13, 17, 18, 19, 21, and 22 mitigate towards Minnesota residency." These findings are not clearly erroneous. This court should affirm them.

A change in one's domicile requires both physical removal to a new location and a demonstrated intent to make that place one's new home. In the instant case, Dr. Dreyling has failed to satisfy the second of these two requirements.

This case is strikingly similar to *Manthey v. Comm'r of Revenue, supra*. The appellant there had been a worker on the Alaska pipeline with substantially stronger ties to Alaska than those developed by Dr. Dreyling. Unlike Dr. Dreyling, Manthey had (a) voted in Alaska, (b) performed jury duty in Alaska, (c) joined community organizations there, (d) purchased real property, (e) engaged in everyday commerce, (f) received benefits from the Alaska Permanent Fund, and (g) obtained a certificate of Alaska

residence for preferential hiring purposes. *See* 468 N.W.2d at 549. Like most pipeline workers, however, Manthey's presence in Alaska was tied to construction projects, and inherently temporary. In affirming the Tax Court's rejection of Manthey's claim of Alaska domicile, this Court stated, 468 N.W.2d at 550:

One may ... live in another state for a period of time without affecting or altering domiciliary status in Minnesota. ... Because the intent to remain in a fixed place is determinative, mere physical removal is insufficient. The inquiry focuses on intent, examining actions and words to discover that intent. ... Manthey never intended to uproot himself from Minnesota.

At trial, Relators' own expert, Alan Haben, testified (Tr. 104-105) that a person such as a pipeline worker was unlikely to be able to establish an Alaska domicile:

Q. You give the taxpayer the information as to what the State's requirements are then they -- they -- or they and you make a decision together about what kind of a return to file?

A. Yes, except where the factors are overwhelmingly against the taxpayer. In that case, I will tell them that they do not qualify as a non-resident and the majority of those cases may have dealt with the pipeline work back in the 80's in Alaska.

The trial court aptly stated (App. A25): "[T]he purpose of Dr. Dreyling's visits to Alaska was 'to get the lay of the land'" (internal quotations omitted). Dr. Dreyling similarly testified at trial (Tr. 114) that he never formed the intent to make Alaska his new home:

Q. And did that have any effect on your state of mind as to whether or not it would cut towards residency, or not?

A. Well, I assumed that I would become a resident of Alaska because I wanted to move up there on a permanent basis but there is many things I had to check out and I didn't want to cut all my strings to Minnesota.

Q. So you wanted to make sure Alaska was going to work out?

A. Yeah, I didn't want to burn my bridges.

The record therefore belies Relators' contention that during the audit period, Dr. Dreyling established an Alaska domicile. This Court should affirm the Commissioner's domicile determination.

**C. Relators Have Failed To Establish That Roger Dreyling Was Absent From Minnesota For At Least 183 Days During Any Year In The Audit Period.**

Minn. Stat. § 290.01, subd. 7(b) (2004) provides that for income tax purposes, a person is a resident of Minnesota for any taxable year in which the taxpayer maintains an abode in Minnesota and spends at least half of the taxable year in this state. There is no dispute that throughout the audit period, the Dreylings maintained an abode in Minnesota.

Minn Stat. § 290.01 subd. 7(b) (2004) provides in part: "Individuals shall keep adequate records to substantiate the days spent outside the state." Similarly, Minn. R. 8001.0300, subpt. 5 (2005) requires a taxpayer with a Minnesota abode, who claims to have been absent from this state for at least half of a taxable year, to document that claim with adequate records. Relators have not satisfied this requirement. In certain instances, Dr. Dreyling declined to provide relevant records which the auditor had requested. The materials Dr. Dreyling did supply were insufficient to permit a determination of the number of days during any year in which Dr. Dreyling had been present in Minnesota. *See* App. A9. Relators appear not to contend otherwise.

Relators ask this Court to cure the deficiencies in these records by accepting Dr. Dreyling's testimony as to the number of days in which he was outside Minnesota. As the trial court correctly held (App. A22): "The vagaries of memory and the potential for self-serving testimony provide ample justification for the rule's requirement that such a

claim be independently documented.” Relators have not supplied this documentation. This Court should affirm the Tax Court’s holding that irrespective of domicile, Dr. Dreyling was a resident of Minnesota for tax purposes throughout the audit period.

### **III. THE TAX COURT PROPERLY AFFIRMED THE COMMISSIONER’S PENALTY ASSESSMENTS.**

#### **A. Introduction.**

Pursuant to Minn. Stat. § 289A.60, subd. 6 (2004), the Commissioner assessed a 50% fraud penalty in this case for each of the three years in the audit period. For the 1998 and 2000 taxable years, the Commissioner also imposed the 20% penalty for a substantial underpayment of income taxes, authorized by Minn. Stat. § 289A.60, subd. 4 (2004).<sup>9</sup> Relators challenge those assessments.

Minn. Stat. § 289A.37, subd. 3 (2004), states: “A return or assessment of tax made by the commissioner is prima facie correct and valid. The taxpayer has the burden of establishing its incorrectness or invalidity in any related action or proceeding.” Relators have the burden of demonstrating that the Commissioner’s assessment, including imposition of these penalties, was incorrect. *See Wybierala v. Comm’r of Revenue*, 587 N.W.2d 832, 834 (Minn. 1998); *F-D Oil Co. v. Comm’r of Revenue*, 560 N.W.2d 701, 704 (Minn. 1997). Relators have not satisfied that burden.

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<sup>9</sup> For the 1999 taxable year, Relators’ underpayment of income taxes did not meet the 10% or \$5,000 threshold set out in section 289A.60, subd. 4. The Commissioner accordingly did not assess a 20% penalty under that subdivision for the 1999 taxable year.

**B. Fraud Penalties.**

Minn. Stat. § 289A.60, subd. 6 (2004), states in relevant part: “If a person files a false or fraudulent return, or attempts in any manner to evade or defeat a tax ... there is imposed on the person a penalty equal to 50 percent of the tax, less amounts paid by the person on the basis of the false or fraudulent return, due for the period to which the return related.” The record does not show that Relators deliberately omitted or attempted to conceal items of federal gross income from their returns for the audit period. Therefore, Relators contend (Rel. Br. 9-22) the Commissioner’s civil fraud penalty assessment was legally impermissible.

Relators did, however, misallocate a portion of their taxable income for each year to Alaska, a state without an income tax. Relators argue (Rel. Br. 3) that this conduct did not violate section 289A.60, subd. 6, but that “all Dr. Dreyling did was run a theory up a flagpole to see if the Commissioner would salute it.” However, the “theory” underlying a tax return must possess some threshold level of plausibility. In particular, this Court has declined to review criminal convictions for false tax residency claims, even though the taxpayers omitted no item of federal gross income on their relevant returns. *See State v. Enyeart*, 676 N.W.2d 311 (Minn. Ct. App. 2004), *rev. denied* (Minn. May 18, 2004), *cert. denied*, \_\_\_ U.S. \_\_\_, 125 S.Ct. 310 (2004); *State v. Mattmiller*, 2004 WL 1244040 (Minn. Ct. App. June 4, 2004), *rev. denied* (Minn. Aug. 17, 2004), *cert. denied*, \_\_\_ U.S. \_\_\_, 125 S.Ct. 663 (2004). Relators contention on this score is accordingly unavailing.

Until 1998, Roger Dreyling had no relevant contact with Alaska. For portions of the audit period, Dr. Dreyling “physically change[d] his place of abode and [attempted

to] go ... through the motions of establishing a new [Alaska] domicile ... ." *Manthey v. Comm'r of Revenue*, No. 5238, 1990 WL 73501 at \*5 (Minn. T.C. May 16, 1990) *aff'd.*, 468 N.W.2d 548 (Minn. 1991), quoted by the trial court (App. A27). Dr. Dreyling's activities in Alaska were limited to a few brief periods of temporary employment and recreational travel around the state. Carol Dreyling rarely accompanied Roger on these visits.

Minimal inquiry on Dr. Dreyling's part would have informed him that his contacts with Alaska did not overcome the presumption in Minnesota law that for tax purposes, a person's domicile remains that of his or her spouse and family. Following such an inquiry, Dr. Dreyling would also have known that in order to effect a change in domicile, a person must undertake to make a new jurisdiction his or her home, through efforts far more substantial than those Dr. Dreyling was willing to make. Despite both of these impediments, Relators' returns throughout the audit period claimed that Roger Dreyling was an Alaska resident. The result was a persistent and substantial understatement of Relators' Minnesota taxable income.

During the audit in this case, Dr. Dreyling was partially, but not fully, cooperative. At certain points, he declined to provide the auditor with requested documents. Relators' suggestion (Rel. Br. 19) that the requested information was somehow privileged or otherwise irrelevant finds no support in the record. Relators' alternative plea (Rel. Br. 18-19 and n. 5) that the Commissioner could have subpoenaed these documents is beside the point. The issue here is not whether the Commissioner could have compelled Dr. Dreyling to produce this material. A taxpayer whose position has merit should be more

than willing to come forward, when reasonably so requested by a taxing authority, with material that would shed light on the taxpayer's situation. The trial court correctly held (App. A9) that the records this sophisticated taxpayer did supply to the Commissioner were inadequate to bear out his claims that he was an Alaska domiciliary and had been absent from Minnesota for more than one-half of each taxable year during the audit period.

It is well settled, even at the federal level where the IRS has the burden of proof,<sup>10</sup> that the presence of one or more of these factors may support imposition of a fraud penalty. Thus, in *Merritt v. Comm'r*, 301 F.2d 484, 487 (5th Cir. 1962), the court stated:

Mere understatement of income, standing alone, is not enough to carry the burden cast upon the Commissioner in seeking to recover fraud penalties. But each case is to be considered in the light of its own facts. Consistent and substantial understatement of income is by itself strong evidence of fraud. This proof, coupled with the showing that the records were both incomplete and inaccurate, and that the petitioner did not supply ... all of the data necessary for maintaining complete and accurate records, is enough to warrant the Tax Court finding fraud.

Similarly, the Eighth Circuit has recently observed: "Because fraudulent intent is rarely established by direct evidence, it may be established through circumstantial evidence ... . Accordingly, we look for 'badges of fraud' to determine whether there is substantial circumstantial evidence to support a finding of specific intent to evade taxes." *McGraw v. Comm'r*, 384 F.3d 965, 971 (8th Cir. 2004) (citations omitted). *See also, e.g., Day v. Comm'r*, 975 F.2d 534, 538-39 (8th Cir. 1992) (consistent and substantial income understatement, along with other factors, supported imposition of fraud penalties); *Said v.*

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<sup>10</sup> *See* 26 U.S.C. § 7454(a).

*Comm'r*, T.C. memo 2003-147, 2003 WL 21205252 (May 22, 2003), *aff'd*, 2004 WL 2383293 (9th Cir. Oct. 25, 2004) (consistent income understatement, inadequate records, failure to cooperate with taxing authorities, and taxpayer's educational level constituted circumstantial evidence supporting imposition of fraud penalties); *New Corner Bar, Inc. v. Comm'r of Revenue*, No. 7221-R, 2001 WL 1007811 at \*7-\*11 (Minn. T.C., Aug. 29, 2001), and (denying post-trial motion) 2001 WL 1667251 at \*3 (Minn. T.C., Dec. 12, 2001) (discussing relevant factors and collecting cases); *Reed v. Comm'r of Revenue*, No. 4285, 1985 WL 6217 at \*2 (Minn. T.C., Dec. 3, 1985) (same).

Here, the Commissioner properly considered similar factors in deciding to assess fraud penalties. The Tax Court's affirmance of the Commissioner was fully supported by the record. "A Tax Court finding of fraud is one of fact which will be overturned only if it is not supported by substantial evidence on the record as a whole, or if it is clearly erroneous or induced by an erroneous view of the law." *Scallen v. Comm'r*, 877 F.2d 1364, 1369 (8th Cir. 1989). Applying this standard in the case at bar, this Court should uphold the Tax Court's decision.

### **C. Underpayment Penalties.**

Minn. Stat. § 289A.60, subd. 4 (2004) provides that when, irrespective of the taxpayer's state of mind, there is a "substantial underpayment" of income taxes, "there must be added to the tax an amount equal to 20% of the amount of [the] underpayment ... ." An underpayment is "substantial" when it exceeds the greater of (1) 10% of the tax required to be shown on the return, or (2) \$5,000 in the case of an individual.

Relators' returns for the 1998 and 2000 taxable years produced substantial underpayments, within the meaning of section 289A.60, subd. 4. The Commissioner assessed penalties for these two taxable years pursuant to that subdivision. The Tax Court affirmed these assessments (App. A27). Unless grounds exist for abatement of the penalties, these assessments were correct as a matter of law, and this Court should also affirm them.

Section 289A.60, subd. 4 offers three possible bases for reducing or abating a penalty under that subdivision. They are: (1) the existence of substantial authority for the taxpayer's treatment of a given item; (2) disclosure of relevant facts affecting an item's tax treatment on the return or an accompanying statement; or (3) a showing that the taxpayer had reasonable cause for the understatement and was acting in good faith.

In the instant case, none of these grounds warrants reduction or abatement of the underpayment penalties. There is no substantial authority to support Roger Dreyling's position that he was a tax resident of Alaska for any year during the audit period. The facts relevant to Dr. Dreyling's nonresidency claims were not disclosed on his returns. Finally, Relators have not demonstrated reasonable cause for abatement of any portion of the Commissioner's penalty assessment.<sup>11</sup>

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<sup>11</sup> Dr. Dreyling consulted with his CPA, Mr. Haben, with respect to his nonresidency claims. The upshot of this brief consultation was an off-the-cuff ratification by Mr. Haben of a return position Dr. Dreyling had already decided to adopt. Such limited interaction between taxpayer and tax advisor cannot provide reasonable cause for abatement of a penalty. See *Stelzner v. Comm'r of Revenue*, 621 N.W.2d 736, 741-43 (Minn.), cert. denied, 534 U.S. 825, 122 S.Ct. 63 (2001), (cited by the trial court at App. A26) (where taxpayer did not actually seek professional advice, mere employment of expert to help prepare returns did not warrant abatement of penalties).

**IV. THE COMMISSIONER HAS COMPLIED WITH APPLICABLE PROCEDURAL REQUIREMENTS.**

Relators finally contend (Rel. Br. 20) that the Commissioner has not satisfied the requirements of Minn. Stat. § 271.06, subd. 3 (2004) and Rule 9.02 of the Minnesota Rules of Civil Procedure. Relators do not appear to argue that this alleged non-compliance requires reversal of the Tax Court's decision. In any event, for the reasons stated by the trial court (App. A24-25), Relators' claims are factually incorrect<sup>12</sup> and legally without merit. This Court should likewise reject those claims.

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<sup>12</sup> Relators assert (Rel. Br. 20) that they did not timely receive copies of the Commissioner's Return and Answer to their Tax Court Notice of Appeal. As the trial court found (App. A24), copies of these documents were timely mailed to Relators' counsel.

**CONCLUSION**

For the foregoing reasons, this Court should affirm in all respects the Tax Court's February 25, 2005, Order in the instant case.

Dated: July 29, 2005

Respectfully submitted,

MIKE HATCH  
Attorney General  
State of Minnesota



CRAIG R. ANDERSON  
Assistant Attorney General  
Atty. Reg. No. 1764

445 Minnesota Street, Suite 900  
St. Paul, MN 55101-2127  
(651) 296-3424

ATTORNEYS FOR RESPONDENT

The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2) (with amendments effective July 1, 2007).