

STATE OF MINNESOTA

IN SUPREME COURT

Supreme Court File No. A05-970

Tax Court File No. 7622-R

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CAROL DREYLING AND ROGER A. DREYLING,

Relators,

vs.

COMMISSIONER OF REVENUE,

Respondent.

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RELATORS' REPLY BRIEF

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If a boxing match ends in a split decision and the winner scores a 98-95 victory on the decisive card, the loser can hardly be accused of throwing the contest. Where the State has to expend the first eleven pages of its argument arguing that the factors used to determine domicile cut somewhat in the Commissioner's favor, the relator spends 12 pages indicating that the balance of such factors is in Dr. Dreyling's favor, and the Administrative Law Judge spends about the same amount of space indicating they tip in the Commissioner's direction,<sup>1</sup> later reversing her determination on two of them, the ultimate "call" is simply too close to warrant a finding of fraud. The only possible room left for a finding of fraud in either the boxing match or the tax return is a determination that the boxer or the taxpayer somehow cheated. But Dr. Dreyling submitted over 280 pages of detailed information to the Department of Revenue; submitted to hours and hours of interrogation; and the State is not able to point to one falsehood that he uttered or one fact

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<sup>1</sup>The trial court found, "[t]he 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, 9, 10, 13, 17, 18, 19, 21 and 22 mitigate [sic] towards Minnesota residency." (A-21) But these factors total 13, and there are 26 factors. In boxing, 13 out of 26 is known as a draw. Moreover, in response to relator's motion for amended findings, the trial court withdrew two of the adverse findings. In boxing, 15 out of 26 points is known as a win.

that he concealed.<sup>2</sup> If the Commissioner is able to make a determination of fraud on this sort of record, the tax-paying populous had better be aware that it is submitting its returns to the equivalent of George Orwell's Ministry of Information.

The State devotes eleven pages in its principal memorandum to the argument that Dr. Dreyling's claim of non-residency is incorrect. It devotes just over three to its claim that it was fraudulent.

When the State does address the fraud issue, it uses three criminal cases to argue the proposition that a taxpayer may be guilty of fraud even if he does not exclude of federal gross income on his relevant returns. It is instructive to examine those cases, because they demonstrate how gross a taxpayer's misconduct must be to qualify as fraudulent. First, consider *State v. Enyeart*, 676 N.W.2d 311 (Minn. App. 2004). In that case, the defendant, who claimed Alaska rather than Minnesota residence, told numerous lies to the tax officials. He made claims of actually being in Alaska when he was in fact in Minnesota:

Using Enyeart's flight schedules, bank records, Federal Aviation Administration records, and court documents, the state calculated the number of days Enyeart was present in Minnesota during the last three months of 1997 and the calendar years 1998, 1999, and 2000. The

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<sup>2</sup>In fact, the State concedes, "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."

state attributed a day to Minnesota residency only if there was evidence that Enyeart was beginning or ending a flight in Minnesota or that he was conducting business in the state (closing a loan or attending a doctor's appointment, for example). The state did not count days in which Enyeart flew into or out of Minnesota in transit to another state or days in which Enyeart conducted business in another state. The state documented that in 1998 Enyeart spent 194 days in Minnesota and only twelve full days in Alaska. In 1999, Enyeart was in Minnesota 144 days and in Alaska two full days. In 2000, Enyeart was in Minnesota 186 days and in Alaska two partial days.

(*Id.* at 317)

And again:

Branaman admitted that Enyeart essentially wrote the letter that actually went to the DOR. The first page of the letter on Enyeart's hard drive outlines the history of their friendship and Branaman's gratitude to Enyeart for providing him a place to stay in Minneapolis in the early years of their employment. At the bottom of the first page, the letter states "we have had the opportunity to experience the following in Alaska together." At the top of the second page Enyeart wrote: "(use your imagination here)" and left ten blank lines.

(*Id.* at 318)

Consider next *State v. Mattmiller*, 2004 WL 1244040 (Minn. App. Jun4 4, 2004). The defendant admittedly lied about his whereabouts, hid relevant information from the taxing officials, and had been disciplined for lying. Moreover, he did not pay Minnesota income tax at all, unlike Dr. Dreyling, who duly allocated to Minnesota that portion of his income which he believed subject to Minnesota tax. Compare the list of his derelictions with Dr. Dreyling's:

Here, there is substantial evidence to support the

jury's verdict finding appellant guilty of failure to pay motor vehicle tax. Appellant admitted at trial that he gave false information on an Oregon vehicle registration application. Even though he testified that it was not his intent to avoid Minnesota motor vehicle tax, the jury could have inferred that appellant registered his vehicles in Oregon to avoid paying the tax. Credibility determinations are left to the jury.

There is also substantial evidence to support the guilty verdicts on the other six counts. Appellant was required to pay Minnesota state income tax if he either was domiciled in Minnesota or maintained a place of abode in the state and spent in the aggregate more than one-half of the days in the relevant tax years in Minnesota. Minn. Stat. § 290.01, subd. 7. First, there is adequate evidence to suggest that appellant is domiciled in Minnesota because his family is in Minnesota, which creates a presumption that appellant is also domiciled in Minnesota. Minn. R. 8001.0300, subp. 2. The factors used to determine domicile also indicated that appellant was domiciled in Minnesota. Minn. R. 8001.0300, subp. 3. For instance, (1) appellant has a permanent job based in Minnesota; (2) appellant recently moved into a new house in Minnesota and sold real property that he previously owned in Washington; (3) appellant does not rent any property in Washington; (4) the only real property appellant owns is in Minnesota; (5) appellant's vehicles are insured and physically located in Minnesota; (6) none of appellant's vehicles are licensed or located in Washington; (7) appellant receives mail in Minnesota and has mail forwarded to his Minnesota address; (8) appellant made statements on mortgage applications indicating that he is a Minnesota resident; and (9) several items discovered during the execution of a search warrant at appellant's Minnesota residence indicated that it was his permanent home.

(*Id.* at 5)

This is what real fraud looks like.

Moreover, in *Enyeart* and *Mattmiller* the District Court would have been required to dictate to the jury some standards which

would, in part at least, define what fraud is. Unfortunately, the opinions in these two cases does not include any reference to the jury instructions, and there is no J.I.G. defining tax fraud. However, it is probable that the Court took its central instructions from J.I.G. 26.06, which is the closest approach to a fraud instruction, which reads, in relevant part:

Third, the defendant intentionally made a representation to [the taxing authorities] in order to obtain the [relevant exemption];

Fourth, the defendant knew or believed that the representation was false.

Fifth, the defendant intended that [the taxing authorities] believe the representation to be true.

Sixth, [the taxing authorities] believed the representation was true, and, in reliance on that representation, gave the defendant [a tax advantage].

The rubber hits the road with the word "representation." Minnesota courts have said over and over that in order to constitute fraud, a misrepresentation must be a misrepresentation of fact. Under Minnesota law, the elements for fraud a false representation pertaining to a material past or present fact susceptible of human knowledge. *Florenzano v. Olson*, 387 N.W.2d 168 (Minn. 1986); *InterRoyal Corp. v. Lake Region Equipment Co.*, 241 N.W.2d 486 (Minn. 1976). A statement of opinion is not fraud. *Rother v. Hiniker*, 294 N.W.644 (Minn. 1940).

Misrepresentations of law are not fraud. *Northernaire Products, Inc. v. County of Crow Wing*, 244 N.W.2d 279 (Minn. 1976). Dr. Dreyling's assertion that he was not a Minnesota resident for purposes of tax liability was not a fact; it was an opinion and it was an opinion concerning the legal effect of known facts.

There are exceptions to the opinion/legal effect doctrine, but they are not applicable to this case. First, an opinion may constitute fraud if it is given by an expert and is presented to an unsophisticated victim. Dr. Dreyling is not a tax lawyer and the Minnesota Department of Revenue is hardly unsophisticated in tax matters. Again, an opinion may be the basis of fraud if it is reasonably understood and relied on by the representee to be a statement of fact and if a true relationship of trust and confidence exists between the parties. This does not apply here either. It is doubtful if the Department of Revenue relies on the unsupported word of any taxpayer at all, and in any event, a "true relationship of trust and confidence" hardly exists between the Department and the citizen. Indeed, it is safe to say that an adversarial relationship presumptively exists. The motto of the Department might well be "Noli Credere, immo Probare." Similarly, the rendering of a representation of law may be actionable if they are mixed questions of law and fact, and where the party making the expectation has reason to believe the other party is likely to understand the representation as one

containing an implicit fact. In the instant case, the representation was a "pure" one of law because the facts were laid before the Commissioner, and the Commissioner was expected to be learned in the law, or to consult those who were.<sup>3</sup> So the rule that misrepresentations must be those of fact applies here, and unlike *Enyeart* and *Mattmiller*, Dr. Dreyling did not misrepresent or conceal a single fact. To permit a finding of fraud under these circumstances is to stretch the meaning of fraud to the breaking point.

There is a fair amount of extrinsic evidence that the Department of Revenue never really considered that Dr. Dreyling was acting fraudulently. It never opened a criminal investigation nor sought the aid of criminal authorities. It never searched his home or homes. It never questioned his wife. subpoenaed his records, threatened him with prosecution, or otherwise acted as if it considered his actions to be criminal. It should be noted that the strictures of Minn. Stat. § 289A.63 are labeled "Criminal Penalties," and while they may be utilized

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<sup>3</sup>The State asserts: "During the audit in this case, DR. Dreyling was partially, but not fully cooperative." (Respondent's Brief, p. 22.) Under the circumstances, it is hard to imagine what greater cooperation would have looked like. To be sure, when the Commissioner started looking for intimate records concerning his medical condition and the like, Dr. Dreyling finally drew the line. But cooperation does not have to extend to repeated, burdensome and irrelevant demands. The State, at trial and on appeal, is unable to point to one document or other piece of evidence which it lacks and which it needed to try to make its case.

civilly as well, their application is chiefly reserved for the sort of criminal misconduct not at issue here. No rational observer could imagine that a fair jury would have convicted Dr. Dreyling on the sort of evidence proffered here, and the State knew enough not to try. The penalties of this statute should not be taken as an invitation to create a "Criminal Law Lite," which would permit the Commissioner to take non criminal-behavior and stigmatize it with the same statutory label simply because the statutory scheme to stigmatize it administratively requires a lower degree of proof.

Moreover, even some of the cases relied on by the State indicate how tenuous a finding a fraud is in this case. In its argument against Dr. Dreyling's claim that he should prevail on the underlying issue of residence, the State cites the case of *Manthey v. Commissioner of Revenue*, 468 N.W.2d 548 (Minn. 1991), where the Supreme Court upheld - barely - a determination by the Commissioner of Revenue that a pipeline worker who left his family to work on the Alaska pipeline was a Minnesota resident for tax purposes. While *Manthey* was decided in favor of the Commissioner, it was so decided only because of the presumption that attends the Commissioner's findings. The Court went out of its way to say: "None of the facts escape equivocation entirely, and the tax court could easily have ruled the other way." (*Id.* at 550)

It is worth noting that even though *Manthey* had a weaker case than Dr. Dreyling, the Commissioner made no attempt to claim fraud in that case. Indeed, the State explicitly says of it: "[T]his case is strikingly similar to *Manthey*...." If the instant case is "strikingly similar to *Manthey*," what justifies the Commissioner's attempt to assert fraud here and not in *Manthey*? Naturally, the Commissioner has some discretion in attempting to assert fraud in some cases and not the other. But fraud is a very weighty charge, one which appears in the criminal penalties section of the tax law; it should not be brought lightly or in a fit of pique. Consistency, not to speak of common fairness, demands that where something as serious as fraud is implicated, the Commissioner's policy not be excessively arbitrary. Moreover, if this case is "strikingly similar to *Manthey*" and "the tax court could easily have ruled the other way" in *Manthey*, it is hard to see where there is anything in the instant case which approaches fraud.

## II.

DR. DREYLING WAS AN ALASKA RESIDENT FOR TAX PURPOSES DURING THE RELEVANT PERIOD FOR WHICH HE FILED MINNESOTA TAX RETURNS.

With regard to the State's primary contention - that Dr. Dreyling was a Minnesota residence for tax purposes during the period in question - the respondent is unpersuasive. The State

claims "Dr. Dreyling's employment in Alaska during the period in question was both brief and temporary" (Respondent's Brief, p. 15) That is unfair. He practiced medicine on Indian reservations in Alaska for many, many months. He did not practice medicine in Minnesota during this time period at all. The State says "His living quarters in Alaska were likewise temporary," ignoring the fact that there were many of them and that cumulatively his residence in those quarters was substantial. The State claims, "Throughout the period in question Dr. Dreyling maintained driver's and professional licences in both Minnesota and Alaska (Respondent's Brief, p. 15). Yet this ignores the fact that he only used his Alaska medical license and his Alaska driver's license, and effectively surrendered the Minnesota license by clipping it.

The State claims, "During the period in question, Roger Dreyling's banking, financial and other business activity all took place almost entirely within Minnesota (Respondent's Brief, p. A6). This is simply wrong. His principle business activity - gainful employment - took place entirely in Alaska. Much of his banking took place in Alaska.

If the quantitative analysis of Dr. Dreyling's residence split about evenly between Minnesota and Alaska, the qualitative analysis cuts strongly in favor of Alaska. First and foremost, although the State argues, "Dr. Dreyling was physically present

for substantial parts of 1998, 1999 and 2000 in Minnesota" (Respondent's Brief, P. 16) it does not quarrel with the fact that "Dr. Dreyling had been in Minnesota for 149 days in 1999 and 146 days in 2000 (T-177). He was also present for more than 183 days in Alaska in 1998 (Appellant's Brief, p. 8)." Nor did it quarrel with the fact that Dr. Dreyling was in Alaska more than 181 days during 1999 and 2000. As against this, the assertion that Dr. Dreyling's sojourn in Alaska was brief and temporary will not pass muster.

The State makes much of *Manthey*, 468 N.W.2d 548 (Minn. 1991). In that case, the Court held that a pipeline worker who moved to Alaska for several years was a Minnesota resident for tax purposes. Probably crucial in the Supreme Court's decision was this paragraph:

Until 1981, Manthey and his wife filed Minnesota resident income tax returns even though Manthey spent most of his time in Alaska. After Alaska repealed its individual income tax, Act to Repeal Individual Income Tax, ch. 1, 2980, Alaska Sess. Laws (2d Special Session) codified at Alaska Stat. § 43.20.021 (1990)), Manthey filed no Minnesota resident income tax returns from 1981 until he returned permanently in 1986.

(*Id.* at 549)

The obvious attempt to take advantage of Alaska tax law only after it became favorable simply does not appear in Dr. Dreyling's case. *Manthey* is a stronger case for the State than the instant one. First, Manthey and his wife, who remained in

Minnesota all during the time Manthey was working on the pipeline, did not file Minnesota income tax returns at all, unlike the Dreylings, who filed Minnesota forms but requested an exemption. Second, Manthey, unlike Dr. Dreyling, provided total financial support for his wife and had two minor children living in Minnesota. Third, the moneys Manthey sent paid ordinary living expenses, which Dr. Dreyling's did not. Fourth, Manthey maintained his Minnesota driver's license, which Dr. Dreyling did not. Fifth, Manthey, unlike Dr. Dreyling, never testified that he intended to purchase property in Alaska and permanently relocate there. And finally, pipeline work, unlike medicine or retirement, is inherently transient labor. As Dr. Dreyling's accountant testified:

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 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.

(T-104, 105)

Because pipeline work is inherently transitory and because Mr. Manthey never took any interest in Alaska other than that work, he lost. Even at that, the Commissioner, in *Manthey*, only

just prevailed.

The additional facts which favor Alaska residence tip the balance, even on review, in Dr. Dreyling's favor.

CONCLUSION

The fraud penalties should be abated altogether. Thus, the 1998 assessment and penalties should be abated altogether as well. Likewise, the remaining taxes, penalties and interest should be abated.

Dated: August 7<sup>th</sup>, 2005

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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).