

STATE OF MINNESOTA

IN SUPREME COURT

Supreme Court File No. A05-970

Tax Court File No. 7622-R

---

CAROL DREYLING AND ROGER A. DREYLING,

Relators,

vs.

COMMISSIONER OF REVENUE,

Respondent.

---

---

RELATORS' BRIEF AND APPENDIX

---

MACK & DABY P.A.  
John E. Mack  
Atty. Reg. No. 65973  
26 Main Street  
New London MN 56273  
(320) 354-2045  
ATTORNEY FOR RELATOR

MINNESOTA COMMISSIONER OF REVENUE  
Daniel A. Salmone  
600 North Robert Street  
St. Paul MN 55146-7100  
(651) 556-6003

STATE ATTORNEY GENERAL  
Michael Hatch  
Atty. Reg. No. 42158  
102 State Capitol  
St. Paul MN 55155  
(612) 296-6196  
ATTORNEY FOR APPELLANT

TABLE OF CONTENTS

Table of Contents . . . . . i

Index to Appendix . . . . . ii

Table of Authorities . . . . . iii

Legal Issues . . . . . v

INTRODUCTION . . . . . 1

STATEMENT OF THE CASE AND FACTS . . . . . 5

ARGUMENT:

I. A TAXPAYER WHO NEITHER MAKES FALSE REPRESENTATIONS  
OF FACT ON HIS TAX RETURNS NOR CONCEALS ANY  
MATERIAL FACTS ON THOSE RETURNS CANNOT BE LIABLE  
FOR CIVIL FRAUD PENALTIES PURSUANT TO MINN. STAT. §  
289A.SUBD. 60. . . . . 9

II. DR. DREYLING WAS NOT A RESIDENT OF MINNESOTA  
DURING THE YEARS IN DISPUTE. . . . . 22

CONCLUSION . . . . . 33

INDEX TO APPENDIX

Findings of Fact, etc. . . . . A-1

Motion for New Trial, etc. . . . . A-30

Order on Motion for New Trial, etc. . . . . A-34

Appeal to Tax Court . . . . . A-40

Return & Answer to Appeal to Tax Court . . . . . A-48

Petition for Writ of Certiorari . . . . . A-52

Statement of the Case . . . . . A-53

Writ of Certiorari . . . . . A-57

TABLE OF AUTHORITIES

| <u>MINNESOTA STATUTES:</u>   | <u>PAGE #</u> |
|--|---------------|
| Minn. Stat. § 271.06 . . . . .   | 20            |
| Minn. Stat. § 289A.02 . . . . .  | 4             |
| Minn. Stat. § 289A.36 . . . . .  | 15            |
| Minn. Stat. § 289A.60 . . . . .  | Passim        |
| Minn. Stat. § 290.01 . . . . .   | Passim        |
| Minn. Stat. § 290A.03 . . . . .  | 5, 26         |
| Minn. Stat. § 291.005 . . . . .  | 5             |
| Minn. Stat. § 609.52 . . . . .   | 15            |
| <br><u>MINNESOTA CASES:</u>  |               |
| <i>F-D Oil v. Commissioner of Revenue,</i><br>560 N.W.2d 701 (Minn. 1997) . . . . .                  | 15, 16        |
| <i>Fischer v. Division W. Chinchilla Ranch,</i><br>310 F.Supp 424 (D.Minn. 1970) . . . . .           | 2             |
| <i>Florenzano v. Olson,</i><br>387 N.W.2d 168 (Minn. 1986) . . . . .                                 | 11, 12        |
| <i>InterRoyal Corporation v. Lake Region Equipment Co.,</i><br>241 N.W.2d 486 (Minn. 1976) . . . . . | 2             |
| <i>Jones' Estate v. Kvamme,</i><br>449 N.W.2d 428 (Minn. 1989) . . . . .                             | 2             |
| <i>Kennedy v. Flo-Tronics, Inc.,</i><br>143 N.W.2d 827 (Minn. 1966) . . . . .                        | 10            |
| <i>Luther v. Commissioner of Revenue,</i><br>588 N.W.2d 502 (Minn. 1999) . . . . .                   | 32            |
| <i>Miller v. Commissioner of Taxation,</i><br>59 N.W.2d 925 (Minn. 1953) . . . . .                   | 30            |

|   |        |
|---|--------|
| <i>State v. Edwards,</i><br>227 N.W. 495 (Minn. 1929) . . . . .                       | 2      |
| <i>Wilson v. Commissioner of Revenue,</i><br>656 N.W.2d 547 (Minn. 2003) . . . . .    | 21, 31 |
| <i>Wybierala v. Commissioner of Revenue,</i><br>587 N.W.2d 832 (Minn. 1998) . . . . . | 16, 17 |

LEGAL ISSUES PRESENTED AND RESULTS BELOW

I.

MAY A TAXPAYER WHO NEITHER MAKES FALSE REPRESENTATIONS OF FACT ON HIS TAX RETURNS NOR CONCEALS ANY MATERIAL FACTS ON THOSE RETURNS BE LIABLE FOR CIVIL FRAUD PENALTIES PURSUANT TO MINN. STAT. § 289A.SUBD. 6?

The Tax Court Held: In the Affirmative.

Most Apposite Statutes:

Minn. Stat. § 289A.60

Minn. Stat. § 290.01

Most Apposite Cases:

*InterRoyal Corporation v. Lake Region Equipment Co.*,  
241 N.W.2d 486 (Minn. 1976)

*Fischer v. Division W. Chinchilla Ranch*, 310 F.Supp 424  
(D.Minn. 1970)

*Kennedy v. Flo-Tronics, Inc.*, 143 N.W.2d 827 (Minn. 1966)

*Florenzano v. Olson*, 387 N.W.2d 168 (Minn. 1986)

II.

WAS DR. DREYLING WAS A RESIDENT OF MINNESOTA DURING THE YEARS IN DISPUTE?

The Tax Court Answered: In the Negative.

Most Apposite Statutes:

Minn. Stat. § 289A.60

Minn. Stat. § 290.01

Most Apposite Cases:

*Miller v. Commissioner of Taxation*, 59 N.W.2d 925 (Minn.  
1953)

*Luther v. Commissioner of Revenue*, 588 N.W.2d 502 (Minn.  
1999)

*Wilson v. Commissioner of Revenue*, 656 N.W.2d 547 (Minn.  
2003)

## INTRODUCTION

For better or worse, the legislature has chosen to vest the Supreme Court with direct appellate jurisdiction over decisions of the Minnesota Tax Court. Since the establishment of the Minnesota Court of Appeals, the Supreme Court has functioned principally to state and harmonize the law and to set precedent, while the Court of Appeals has been concerned primarily to determine and correct error. Many, perhaps most Tax Court cases involve issues which allege ordinary error and present few novel issues with statewide impact. This is not such a case.

Dr. Dreyling's case presents a question of high importance and great statewide impact. That question is, can a taxpayer - or anyone else, for that matter - be successfully charged with fraud when they have made no false statements of fact and have concealed no relevant facts from the government?

The Department of Revenue's rules do not include a definition of fraud. Rather, the State uses some rather subjective guidelines which are not set forth in either statute or rule:

Q. Were you present when I asked if you could bring along the standards that the State of Minnesota, department of Revenue, uses for determining fraud?

A. Yes.

Q. And as her supervisor, do you know whether or not those standards were brought to trial today?

A. We have the Badges of Fraud. We do not have - We are not quite sure what you mean by "standard."

Q. When reviewing fraud, don't you have a document or some sort of a manual that is going to tell, "here are the factors of fraud that you should be examining when you are looking for fraud"?

A. We look to the statute, 289.60 [sic].

Q. Okay. But you don't have anything that indicates what conduct would or wouldn't constitute fraud?

A. Well, the statute states that it would be filing a false or fraudulent return or attempting to defeat or evade a tax.

Q. So you are just following the statute without any interpretation then, correct.

A. We are using professional judgment.

(T-162)

One should not be branded a fraud based upon the unfettered "professional judgment" of those charged with collecting as much revenue as possible. In such a subjective atmosphere, the least the Courts should require of the State is that it apply the common law of fraud in determining whether tax fraud has been committed. Under the Minnesota case law, fraud consists of a false representation of material fact susceptible of knowledge, or the concealment or suppression of the truth. *InterRoyal Corporation v. Lake Region Equipment Co.*, 241 N.W.2d 486 (Minn. 1976); *Jones' Estate v. Kvamme*, 449 N.W.2d 428 (Minn. 1989). As a general rule, a misrepresentation of law is not actionable. *State v. Edwards*, 227 N.W. 495 (Minn. 1929). Similarly, a statement of opinion or conjecture is not fraud. *Fischer v. Division W. Chinchilla Ranch*, 310 F.Supp 424 (D.Minn. 1970).

In the instant case, neither the Commissioner nor the tax court is able to point to a single instance where the taxpayer made a false statement to the taxing authorities, nor concealed a material truth from them. Rather, the Tax Court concluded:

The Commissioner does not contend that Appellants deliberately omitted or attempted to conceal items of their gross income but rather, that they intentionally misallocated a portion of their taxable income for each year to Alaska. In support of this position, the Commissioner argues that until 1998, Dr. Dreyling had no contact with Alaska yet he went through the motions of trying to establish a domicile there to avoid his Minnesota tax liability. Further, because Dr. Dreyling's activities in Alaska were limited to a few brief periods of temporary employment and recreational travel around the state and Mrs. Dreyling rarely accompanied him on these visits, the Commissioner contends that Dr. Dreyling should have known 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. We agree.

(A-24)

But as this statement acknowledges, all Dr. Dreyling did was run a theory up a flagpole to see if the Commissioner would salute it. He provided the taxing authorities with all the information necessary to determine whether his theory was correct or not. He concealed nothing material which would prevent the Commissioner from determining whether or not he was a Minnesota resident. He did not try to deceive the taxing authorities about anything at all. He just disagreed with them as to the effect of the laws and regulations relating to residence.

Now it is true that a taxpayer who presents all the facts to

the taxing authorities may nonetheless be liable for raising frivolous arguments or advancing vexatious or absurd arguments. See, e.g., Minn. Stat. 289A.60 subd. 7. Similarly, if a taxpayer disregards the rules relating to the provisions of applicable tax law, but does not try to defraud the Commissioner, he is liable for certain (relatively minor) penalties. See, e.g., Minn. Stat. § 289A.60 subd. 5.

Indeed, Federal taxing authorities even require taxpayers who are advancing a position which is against the weight of present authority to specifically indicate to the IRS that they are doing so. But the penalties for making frivolous or specious arguments are much less than for making fraudulent claims, and they are less precisely because they only waste the authorities' time - they do not mislead them.

The quotation from the Tax Court decision set forth above might be defensible if the Commissioner were employing a definition of "fraud" which differed substantially from that which has developed in the common law. Or the statutes or rules could have developed a category of tax misconduct called, say, "Schmaud," and defined that term in a way which differed substantially from the common law's understanding of "fraud."

But the statutes and the rules which govern fraud penalties do no such thing. The laws which govern those fraud penalties - Minn. Stat. § 289A.60, subd. 6, Minn. Stat. § 289A.02, Minn.

Stat. § 290.01, § 290A.03, or § 291.005 - do not contain definitions of either "fraud" or "fraudulent." Because § 289A.63 subd. 2 includes criminal penalties for violations similar to those set forth in § 289A.60 6, it is safe to say that the legislature meant to import the common law of fraud, civil and criminal, to interpret those sections of the tax code. Surely the law would not tolerate convicting someone of a felony who had no intent to deceive, lie, or conceal. But if that is so, the law should not tolerate branding a well-respected physician and his wife with the label "fraud" when all they attempted to do was argue the legal effect of the information which they laid before the Commissioner.

#### STATEMENT OF THE CASE AND FACTS

Dr. Roger Dreyling filed taxes as a non-resident for tax years 1998, 1999, 2000 and 2001. He was audited by the Minnesota Department of Revenue, which concluded that he was a resident of Minnesota for all these years, and determined that he owed back taxes, interest, and fraud penalties pursuant to Minn. Stat. § 289A.60 subd. 6. Dr. Dreyling appealed to the Tax Court. A hearing was held in St. Cloud on October 27<sup>th</sup>, 2004 (A-1). On February 25<sup>th</sup>, 2005, the Tax Court issued Findings and Conclusions upholding the Commissioner of Revenue in all respects. Dr. Dreyling brought a motion for a new trial and amended findings (A-31), which motion resulted in several

modifications of the original order, but continued to uphold the Commissioner (A-35). On or about May 16<sup>th</sup>, 2005, Dr. Dreyling sought and obtained a Writ of Certiorari.

Perhaps oddly for a case involving fraud penalties, the facts of this case are not in serious dispute. And because many of the facts will be integrated into the argument set forth below, only a sketch of the more salient facts will be outlined here.

Dr. Dreyling graduated from the University of Minnesota Medical School in 1966 and since obtaining his license, practiced as a physician in Paynesville, Minnesota (A-2). He retired from practice in Minnesota in 1997 (T-113). He decided to practice medicine in Alaska and took steps to become licensed there (T-111). In 1998, he took a job working as a physician on several Indian reservations in Alaska (A-3). While his wife remained behind in the family home in Paynesville, Minnesota, he continued to work in Alaska. Having determined that he would not practice in Minnesota any more, he sold or began the process of selling several of his Minnesota properties, including an apartment building and his interest in the Paynesville Clinic. (T-114, 137). He decided that he would become a permanent resident of Alaska, but did not want to cut all his ties with Minnesota (T-114).

He and his wife looked to purchase residential property in

Alaska (T-115). He obtained a Chevrolet Suburban and titled it in Alaska (T-115). He listed his residence as 125 Main Street, Ketchikan.

He was not always practicing medicine on the reservation. While not employed there, he remained in Alaska and arranged for his own housing, obtaining a Mailboxes Etc. box in Alaska (T-116). He obtained a fishing boat in Alaska and registered it there (T-117). He registered to vote in Alaska and obtained an Alaska driver's license (T-122).

Dr. Dreyling began to experience health problems, and decided to retire in Florida rather than Alaska (T-130). In 2001, he moved from Alaska to Florida, surrendered his Alaska driver's license, and obtained a Florida driver's license. He moved two of his vehicles to Florida and registered them there (T-136). He bought a home in Florida, where he now resides much of the time (T-131).

Prior to filing taxes for 1998, he reviewed the possibility of filing for non-resident status with his accountant, Alan Habben (T-132). Both he and Mr. Habben concluded that he had been outside the State of Minnesota longer than 183 days in 1998 and 1999 and was thus eligible to file taxes as a non-resident (T-132, 133). However, he concluded that his wife would not qualify as a non-resident, and she continued to homestead the property in Paynesville and pay taxes as a Minnesota resident (T-

139).

Dr. Dreyling was audited for tax years 1999, 2000 and 2001. The Department of Revenue did calculations and determined 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.

After the audit began, Dr. Dreyling furnished the Commissioner with all the information the Department of Revenue requested at the time. He furnished his credit card statements, which showed where he was when he charged merchandise (T-119). He furnished the department with information regarding legal residence (T-122). He provided the department with Minnesota, Florida and Alaska driver's license information (T-119). He provided it with motor vehicle and voter registration information (T-122). He provided the Department with a list of boats, snowmobiles and automobiles that he owned (T-123). He authorized the department to obtain all his tax returns from his accountant (T-123). He provided information regarding his physicians and dentists (T-124). He provided copies of airline and travel agency statements (T-125). He provided a copy of his agreement with the Ketchikan Indian Association (T-126). Only when the Department asked for all his banking information did he balk (because it was hardly relevant to the residence issue), and even then he said that he would be willing to provide anything

specific or respond to a subpoena (T-121). The Department concluded that because Dr. Dreyling refused to provide the Department with one of its requests, he was *ipso facto* committing fraud,<sup>1</sup> Although it had previously determined that Dr. Dreyling's 1998 tax return was not subject to audit because of the statute of limitations, it mushroomed his refusal to turn over bank records without a subpoena into a fraud claim and audited his 1998 returns as well. It concluded that Dr. Dreyling was a Minnesota resident for 1998, 1999, 2000 & 2001, and his claim to the contrary was fraudulent. This action followed.

#### ARGUMENT

##### I.

A TAXPAYER WHO NEITHER MAKES FALSE REPRESENTATIONS OF FACT ON HIS TAX RETURNS NOR CONCEALS ANY MATERIAL FACTS ON THOSE RETURNS CANNOT BE LIABLE FOR CIVIL FRAUD PENALTIES PURSUANT TO MINN. STAT. § 289A.SUBD. 6.

---

<sup>1</sup>Q. Is it your position that because Doctor dreyling refused to give you information you could obtain elsewhere, that that constitutes fraud?

A. It is my position that when a taxpayer fails to provide the information that they are attempted to defeat or evade a tax.

(T-178)

This, of course, is legal nonsense. If the legislature wanted to make a refusal to provide all information requested by the Commissioner into an automatic attempt to defeat a tax, it would not have provided subpoena power (with the concomitant right of the taxpayer to move to quash an inappropriate subpoena). Indeed, a blanket right of the Department of Revenue to obtain any document it requested, no matter how privileged or irrelevant, would raise serious 4<sup>th</sup> amendment issues.

The Commissioner acknowledges that Dr. Dreyling did not make any false statements of fact on his tax returns, and did not conceal any material facts on them.

Q. .... What is the false statement?

A. I would say the false statement is filing as a non-resident.

Q. So electing non-resident status would be a false statement?

A. On this situation, yes.

(T-14)

And again:

Q. .... On page 30, you said he made false statements and earlier you testified that because he filed a 91 - or NR1 non-resident form?

A. Yes.

Q. What other false statement did he make?

A. I don't recall.

(T-58)

But filing the wrong form is not a false statement. It is, at worst, an attempt to make a claim that is ultimately unsuccessful. It is not a claim of fact. As the Supreme Court said in an important footnote to *Kennedy v. Flo-Tronics, Inc.*, 143 N.W.2d 827 (Minn. 1966):

As a general rule, in order to constitute actionable fraud, a false representation must relate to a matter of fact which either exists in the present or has existed in the past. It must also relate to a fact which is susceptible of knowledge; otherwise there is

nothing in relation to which the person making it could state what he knew to be untrue.

The principle is fundamental that fraud cannot be predicated upon what amounts to, as a matter of law, or in factual cases is found by the triers of the facts to be, the mere expression of an opinion which is understood by the representee to be only such or cannot reasonably be understood to be anything else. 23 Am Jr., Fraud and Deceit, § 27.

(*Id.* at 828)

The statement "I was not a resident of the State of Minnesota" is not a statement of fact. It is a conclusion, and under the circumstances here, a conclusion of law. "I was in Alaska for 100 days," or "I had an Alaska driver's license" are statements of fact - but all such statements made by Dr. Dreyling were true. Indeed, the State appears to admit as much, arguing that a state of mind is not a question of fact:

Q. There is enough factors here that Doctor Dreyling did do to allow him to say in his own mind, "You know, I think I'm a non-resident," wouldn't you agree?

Mr. Anderson: Objection, Your Honor, that would call for speculation as to what Doctor Dreyling was thinking.

(T-41)

Now if the State is correct and what Dr. Dreyling was thinking was irrelevant to whether he filed a fraudulent return, the State has a very different definition of fraud in mind that the definition ordinarily used by courts, where the state of mind of the individual under investigation lies at the heart of the fraud claim. In those ordinary cases, fraud is all about what

the individual was thinking. As this Court said in *Florenzano v. Olson*, 387 N.W.2d 168 (Minn. 1986):

Fraudulent intent is, in essence, dishonest or bad faith. What the misrepresented **knows** or **believes** is the key to proof of intent. ... Our explication of the **states of mind** that constitute fraudulent intent parallels that of the Restatement (Second) of Torts. Under the Restatement formulation, a misrepresentation is made with fraudulent intent if the maker:

- (a) knows or believes that the matter is not as he represents it to be,
- (b) does not have the confidence in the accuracy of his representation that he states or implies, or
- (c) knows that he does not have the basis for his representations that he states or implies.

(*Id.* at 173; italics supplied)

But if the taxing authorities are using a definition of fraud which differs markedly from the common law of fraud, they have a duty to spell out what that definition is. As noted above, there is no definition of "fraud" or "fraudulent" in the tax laws themselves. So in order to obtain some sort of idea of what constitutes fraud as set forth in Minn. Stat. § 289A.60 subd. 5, it is helpful to look at that provision, and the context in which it occurs. § 289A.60 subd. 6 states:

If a person files a false or fraudulent return, or attempts in any manner to evade or defeat a tax or payment of tax, there is imposed on the person a penalty equal to 50% of the tax, less amounts paid by the person on the basis of the frauds or fraudulent return, due for the period to which the return related.

Now it is possible to get some idea of what the legislature had in mind by "false or fraudulent return" by comparing such a dereliction with other misbehavior condemned under § 289A.60. Contrast, for example, the lesser dereliction of "Frivolous return" under Minn. stat. § 289A.60 subd. 7:

If an individual files what purports to be a tax return required by chapter 290 but which does not contain information on which the substantial correctness of the assessment may be judged or contains information that on its face shows that the assessment is substantially incorrect and the conduct is due to a position that is frivolous or a desire that appears on the purported return to delay or impede the administration of Minnesota tax laws, the person shall pay a penalty of the greater of 1,000 or 25% of the amount of tax required to be shown on the return. In a proceeding involving the issue of whether or not a person is liable for this penalty, the burden of proof is on the commissioner.

Even applying the State's version of what Dr. Dreyling allegedly did, his derelictions were far less than this. He filed what purported to be the required tax return. He included all the information necessary to determine whether, prima facie, he was required to pay the tax indicated, or some greater or lesser amount. His return does not state a position that is frivolous, nor is there anything on the return which indicates a desire to delay or impede the administration of the Minnesota tax laws. Yet he was assessed a fraud penalty under subd. 6 - a penalty greater than he could have received for the lesser offense of frivolous tax return. Put another way, he not only did not commit tax fraud - he did not even file a frivolous

return.

Consider another lesser dereliction, intentional disregard of the law or rules under subd. 5:

If part of an additional assessment is due to negligence or intentional disregard of the provisions of the applicable tax laws or rules of the commissioner, but without intent to defraud, there must be added to the tax an amount equal to ten percent of the additional assessment.

Even the State is sufficiently wary about its fraud claim to argue that if there is no fraud found, a subd. 5 penalty is appropriate (T-12). And the State was right to be wary. Consider the words "intentional disregard of the provisions of the applicable tax laws or rules of the commissioner" and compare them with what the Commissioner said Dr. Dreyling did. If Dr. Dreyling's dereliction was filing as a non-resident as the Commissioner alleges, then his dereliction was a disregard of the provisions of the tax law which would have directed him to file as a resident.<sup>2</sup> But if this is so, it is a "pure" violation of

---

<sup>2</sup>The State also sometimes argues - half-heartedly, the Relator would argue - that his refusal to submit further information to the Commissioner after a lengthy argument over his returns indicates fraud. As noted at T-183, "We look at the totality of the audit and the most important false statement he made was that he was a resident of Alaska. He refused to provide information." There are two problems with this claim. First, § 289A.60 relates to penalties for derelictions in the filing (or failure in filing) tax returns, not penalties for acts which occur after the returns are filed, such as failure to cooperate with an audit. So Mr. Dreyling's "fraud," if committed at all, had been committed before he stopped sending further documents to the Commissioner. Second, the State did not present any other evidence from the audit which suggested that any of the facts

subd. 5 unless accompanied by a false statement or a concealment of a fact - neither of which the State alleges. By including the words "without intent to defraud" in § 289A.60 subd. 5, the legislature made clear that a mere misinterpretation of the law, whether willful or otherwise, is sufficient to invoke subd. 5 penalties, but not subd. 6 penalties. The Commissioner and the Tax Court Judge misinterpreted § 289A.60.

It is useful to compare this case with two cases which really did involve fraud under any definition of that term. In *F-D Oil v. Commissioner of Revenue*, 560 N.W.2d 701 (Minn. 1997) the relator had been convicted of criminal fraud which was committed by some employees by skimming cash from the employer, charging customers one amount for labor as reflected in the work orders but entering a lesser amount into the computerized record system. Here, there were obviously false statements of fact - how much money had been charged and received - and obvious concealments of material fact - how much cash went into the system. The *F-D* scheme was fraud on any definition of the term, including Minn. Stat. § 609.52 subd. 2(3). What is notable about *F-D* is that the Court used the common law concepts of fraud in finding the penalty appropriate:

---

presented in either the tax returns or the audit was false. See, e.g., T-184: "I do not know what else is incorrect in the tax return because we have not reviewed the other information - and not audited it, let's put it that way."

Relators underreported income by skimming; F-D Oil maintained two separate record systems for tracking of loan and inventory; work orders were rung into the cash register as "no sale" so no record was made on the cash register tape; Anderson entered a lower amount of labor into the computer record system than the amount charged to customers; F-D Oil's records were 'manipulated'; the testimony of Anderson, Fleming, and Fries was "not credible" and their explanation of the discrepancies was "ridiculous"; and the commissioner's assessment was reasonable in the light of the fact that F-D Oil's records were destroyed.

(*Id.* at 708)

This is what real tax fraud looks like - not the carefully-considered claim of non-residence submitted by Dr. Dreyling in his argument with the Commissioner over domicile in the instant case.

Consider also *Wybierala v. Commissioner of Revenue*, 587 N.W.2d 832 (Minn. 1998). In *Wybierala*, the taxpayer was held to be liable for a fraud penalty when he charged sales taxes to customers without filing sales tax returns, failed to cooperate with the Commissioner by withholding documents and by failing to keep adequate records; attempted to evade tax by describing a sales tax as a "surcharge" and abused a resource recovery exemption certificate by claiming an exemption from sales tax for purchase of items not exempted by the certificate.

Clearly some of the taxpayer's actions involved what would be fraud under any definition. *Wybierala* charged customers a sales tax and then pocketed the money without reporting the sales tax receipts. This is fraudulent concealment of the worst sort.

Wybierala refused to pay the monies they had collected from customers to the State on the grounds that this was a surcharge, not a sale, which was clearly nonsense.<sup>3</sup> It had cash without reporting it. It lied about the use of items which it knew were not to be used in the processing of waste and were therefore subject to tax.

The only fact in Wybierala which remotely resembles the instant case is the taxpayer's failure to cooperate with the Commissioner. It is very doubtful if this fact, standing alone, would have resulted in fraud penalties to Wysteria either. Moreover, Dr. Dreyling's alleged "non-cooperation" was not of the sort which involved concealing anything from the Commissioner:

Q. So at the time you determined or decided that it was, that he had somehow committed a fraud, and he chose not to provide you with that information, it would be within his rights; wouldn't that be fair to say? He would be within his right to say, "I'm not going to give you that information" at that time?

A. We cannot force him to provide any information.

And his refusal to provide information was not a concealment, nor a false statement, but a dispute as to whether

---

<sup>3</sup>That said, if Wybierala had sent the moneys into the State and claimed on their return that they were entitled to the money back because the amount collected was "really" a surcharge rather than a sale, they might have been liable to a "frivolous return" penalty, but not a fraud penalty. What made Wybierala's actions fraudulent rather than frivolous was its failure to file on the money collected at all. Dr. Dreyling, unlike Wybierala, concealed nothing.

the Commissioner was entitled to the information:

Q. Then what actions after that when we go to the false statement, what other false statement is there?

A. Refusal to provide information.

Q. What is false about that?

A. As I stated earlier, we look to the fraud statute.<sup>4</sup>

Q. I'm asking what is false about refusing to provide?

A. Let me think on that. I guess he was very clear. He did not intend to provide information that we requested.

Q. But that is not a false statement?

A. I did not say that it was.

(T-182)

Nor did Dr. Dreyling refuse to provide information under circumstances which would give rise to an inference that he was hiding something which would prove that he knew he was not entitled to argue for Alaska residence:

Well, it was requested that I hand over all my banking information and my answer to that was, "I would be glad to provide something specific if you could tell me what you want." But I wasn't going to give them carte blanche to go through all my personal finances. I didn't believe they were entitled to it. And I was told that if I didn't, they could subpoena it and my answer to that was, "I don't have any problems. If you are entitled to it, feel free to subpoena it; that I

---

<sup>4</sup>What fraud statute? Minn. Stat. § 289A.60 subd. 6 does not make failure to provide information in an audit fraud.

wouldn't object to.<sup>5</sup>

(T-121)

This is hardly a refusal to turn over evidence. Dr. Dreyling had already furnished the commissioner with pounds of it. Besides, Dr. Dreyling had a point in calling a halt to what had become a burdensome and unreasonable snipe hunt. He was a physician. His records, including his financial records, likely included confidential patient information. And it is extremely unlikely that it would have revealed anything pertinent to where he was and when, which was the gist of the issue between the taxing authorities and himself. As an exercise, one might ask oneself - what more, in the records that he would not turn over without a subpoena, would likely have borne on the issue in this case? The answer is "probably nothing." One should not be held liable for fraud because one refuses to cooperate in a fishing expedition.

So the two cases this Court has decided with respect to §

---

<sup>5</sup>The Commissioner had the power to obtain any records that he felt to be pertinent. Minn. Stat. § 289A.36 states "In the administration of state tax law, the commissioner may: (1) administer oaths or affirmations and compel by subpoena the attendance of witnesses, testimony, and the production of a person's pertinent books, records, papers, or other data for inspection and copying...." See also, Minn. Stat. § 289A.36 subd. 2. So the Commissioner can hardly use non-cooperation as a "badge" of fraud when he had the ability to enforce such cooperation and failed to make use of it. Note that under § 289A.35 subds. 1 & 2, the Commissioner's examinations and investigations of the taxpayer and his records must be "reasonable" and "relevant."

289A.60 subd. 6 are not helpful to the State. They do little to define taxpayer fraud, because the fraud was so obvious that the conduct would constitute fraud under existing statutory and case law definitions. Not so in this case.

Many of the problems the State had in proving its case are related to procedural difficulties the State had in complying with important directives. Minn. Stat. § 271.06 subd. 3 requires pleadings to be submitted to the Tax Court within 30 days after the filing of the notice of appeal, and the relator's attorney was not so copied. Moreover, Minn. Stat. § 271.06 subd. 7 subjects Tax Court practice to the Rules of Civil Procedure except as otherwise specifically noted, and Minn.R.Civ.P. 9.02 states:

In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.

This was not done either. Now a failure in the initial pleadings to allege fraud with particularity might not be fatal in a Tax Court case (although our Courts have become rather strict regarding Rule 9.02 violations - see, e.g., *Berke v. Resolution Trust Corporation*, 483 N.W.2d 712 (Minn. App. 1992); *Westgor v. Grimm*, 318 N.W.2d 56 (Minn. 1982)). But the problem in this case is that it was unclear - and is still unclear - what Dr. Dreyling did that was fraudulent, or what the State alleges Dr. Dreyling did that was fraudulent. He filled out a tax return

which alleged he was a non-resident. But he never made a false statement of fact to the taxing authorities, and concealed nothing which would have negated his claim. The real question in this case is "what is tax fraud?" and without some sound theory grounded in a statutory or regulatory definition, a definition developed in case law, or a rule developed in a closely analogous case, the taxpayer has no idea why the Commissioner believes his actions to be fraudulent.

Although the taxpayer has the burden of proving to the Tax Court that he should not be assessed fraud penalties, one of the ways - perhaps the best way - he can prove that he should not be assessed fraud penalties is that the Commissioner does not have the foggiest idea of what constitutes tax fraud in close cases. In *Wilson v. Commissioner of Revenue*, 656 N.W.2d 547 (Minn. 2003), this Court restated the obvious: that while the review of the tax court's factual determinations is limited to whether there is reasonable evidence to sustain the findings, the Supreme Court has plenary power with respect to questions of law. With respect to the Commissioner's fraud claims, the question before this Court is almost entirely one of law: where, as here, the taxpayer makes no false statements and conceals no material facts, can the mere fact that his claim is rejected by the Commissioner sufficient to find him liable for fraud penalties? Given the absence of any definition of fraud, the absence of any

factual presentation of allegations against the taxpayer which would constitute fraud, the absence of any regulatory definition of fraud, and the disconnect between Dr. Dreyling's conduct and common law fraud, the answer must surely be "No."

II.

DR. DREYLING WAS NOT A RESIDENT OF MINNESOTA DURING THE YEARS IN DISPUTE.

Not only did Dr. Dreyling commit no fraud in his claim to be a resident of Alaska: his claim to be a resident of Alaska was correct. A previous version Minn. Stat. § 290.01 subd. 7 defined "resident" for tax purposes as prior to 1999:

The term "resident" means (1) any individual domiciled in Minnesota, except that an individual is not a "resident" for the period of time that the individual is a "qualified individual" as defined in section 911(d)(1) of the Internal Revenue Code, if the qualified individual notifies the county within three months of moving out of the country that homestead status be revoked for the Minnesota residence of the qualified individual, and the property is not classified as a homestead while the individual remains a qualified individual; and (2) 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, unless the individual or the spouse of the individual is in the armed forces of the United States, or the individual is covered under the reciprocity provisions in section 290.081.

Subd. 7 now reads:

The term "resident" means any individual domiciled in Minnesota....

....

"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....

Minn.R. 8001.0300 subp. 3 sets forth 26 considerations which are to be applied when determining domicile for tax purposes:

- A. the 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 organization of 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 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'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.

Any one of the items listed above will not, by itself, determine domicile.

Now consider these factors as they apply to Dr. Dreyling:

- A. the location of domicile for prior years;

Dr. Dreyling was domiciled in Minnesota until 1997, when he retired from his medical practice. He changed his domicile to Alaska in 1997 and except for returning to Minnesota for CME classes, he was resident in two other states, vis. Alaska and Florida. This fact suggests that Dr. Dreyling was not a Minnesota domiciliary after 1998.

B. where the person votes or is registered to vote, but casting an illegal vote does not establish domicile for income tax purposes;

Dr. Dreyling was registered to vote in Alaska in June of 1998 and retained that registration until 2001 when he registered to vote in Florida. This fact favors the determination that he was not a Minnesota resident after 1998.

C. status as a student;

Dr. Dreyling was not a student, so this fact neither supports nor undermines his claim to nonresident status.

D. classification of employment as temporary or permanent;

Dr. Dreyling retired as a Minnesota physician in October of 1997. He sold his holdings in a local pharmacy and three medical clinics. Because he was retired, any temporary employment is incidental to his primary employment status. Such temporary work as he had was in Alaska. If he had temporary or permanent employment in Minnesota during this time frame, this would be a different case. But he did not. Thus, this factor counts slightly in favor of non-resident status.

E. location of employment;

Such employment as Dr. Dreyling had was in Alaska. This counts heavily in favor of non-resident status.

F. location of newly acquired living quarters whether owned or rented;

Both parties agree that dr. Dreyling was physically present in Alaska. He used tribal apartments while employed as a physician. AS his credit card information discloses, he did not reside in temporary lodging such as motels or hotels. This consideration favors a finding of Alaska residence.

G. present status of the former living quarters, i.e., whether it was sold, offered for sale, rented, or available for rent to another;

Dr. Dreyling left his Minnesota home, but his wife continued to reside there. However, his wife also continued to pay taxes as a Minnesota resident. Dr. Dreyling returned to his Minnesota home only sporadically. This consideration is close, and probably counts neither for nor against Minnesota domicile.

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;

This consideration is unhelpful. Both Dr. Dreyling and his wife looked for property to purchase in Alaska, and he purchased a home in Punta Gorda, Florida. While Mrs. Dreyling continued to live in Paynesville, Dr. Dreyling did not. Minn. Stat. § 290A.03 subd. 13 provides:

When a homestead is owned by two or more persons as joint tenants or tenants in common, such tenants shall determine between them which tenant may claim the property taxes payable on the homestead.

Mrs. Dreyling claimed the property taxes so payable.

I. ownership of other real property;

Dr. Dreyling owns several non-homestead parcels of land in Minnesota and Florida. He was in the process of selling most of his holdings in Minnesota, and the process began in 1998. He sold his rental property in Minnesota and testified that he was not interested in returning to Minnesota to care for property. This conclusion cuts about evenly between residence and non-residence.

J. jurisdiction in which a valid driver's license was issued;

Dr. Dreyling had an Alaska drivers' license issued in 1998 and surrendered it to Florida in 2001 in order to obtain a Florida Driver's license. This factor militates heavily in favor of Alaska and Florida residence.

K. jurisdiction from which any professional licenses were issued;

Dr. Dreyling had both a Minnesota and an Alaska license to practice medicine. However, the license he utilized was the Alaska license and it was the license more recently obtained. Like many professionals, Dr. Dreyling liked to be licensed in a number of States, and did not want to surrender a professional license. This consideration favors Alaska residence, if only

slightly.

L. location of the person's union membership;

Dr. Dreyling was not a member of a union.

M. jurisdiction from which any motor vehicle license was issued and the actual physical location of the vehicles;

Dr. Dreyling had a 1999 Suburban which was licensed in Alaska. The vehicles licensed in Minnesota were used by his wife. This factor is a wash.

N. whether resident or nonresident fishing or hunting licenses purchased;

Dr. Dreyling purchased Minnesota hunting and fishing licenses in 2000, but did not purchase Minnesota licenses in 1999. This factor favors Minnesota residence in 2000 and militates against it for 1999.

O. whether an income tax return has been filed as a resident or nonresident;

Dr. Dreyling filed as a non-resident. This factor augurs for Alaska residence.

P. whether the person has fulfilled the tax obligations required of a resident;

There is no income tax in Alaska. One wonders whether the Commissioner would be challenging Dr. Dreyling's non-resident status, much less claiming fraud, if Alaska had an income tax.

Q. location of any bank accounts, especially the location of the most active checking account;

While his most active account was in Eden Valley, Minnesota, with the advent of online banking, this factor does not count for

much.

- R. location of other transactions with financial institutions;

There is no evidence one way or another on this factor.

- S. location of the place of worship at which the person is a member;

Dr. Dreyling indicated that he rarely attends church anywhere. One wonders whether the use of this criteria by a State agency offends the First Amendment.

- T. location of business relationships and the place where business is transacted;

Dr. Dreyling retired from his Minnesota practice and what business he has transacted has been on Indian reservations in Alaska. This factor militates in favor of Alaska residence.

- U. location of social, fraternal or athletic organization of clubs or in a lodge or country club, in which the person is a member;

Dr. Dreyling maintained his membership in the Koronis Hills Golf Club in Paynesville. This is the one factor that unambiguously favors Minnesota residence.

- V. address where mail is received;

Dr. Dreyling received his mail at Alaska Addresses. This factor suggests Alaska residence.

- W. percentage of time (not counting hours of employment) that the person is physically present in Minnesota and the percentage of time (not counting employment) that the person is physically present in each jurisdiction other than Minnesota;

Dr. Dreyling was physically absent from Minnesota 197 days in 1999 and present in Minnesota 168 days. This factor militate in favor of Alaska residency.<sup>6</sup>

X. location of jurisdiction from which unemployment compensation benefits are received;

Dr. Dreyling never was eligible for unemployment benefits.

Y. location of schools at which the person's spouse or children attend, and whether resident or nonresident tuition was charged; and

Neither Dr. Dreyling nor his wife attended school

Z. Statements made to an insurance company, concerning the person's residence, and on which the insurance is based.

The only vehicles which Dr. Dreyling noted as being in Minnesota for insurance purposes were those driven by his wife. He made no representations to any insurance company regarding the status of his own residence. This is a non-factor.

If sheer bean counting determined residence, Dr. Dreyling would have ten factors which argued in favor of non-residence, two that argued clearly in favor of Minnesota residence, and another two or three that cut in favor of Minnesota residence, but do not carry much weight. Thus, if Dr. Dreyling satisfies the 183-day rule of Minn. Stat. §290.01 subd. 7, he is entitled to file as a non-resident.

---

<sup>6</sup>In his final argument, Relator's attorney accidentally reversed these figures, and the Tax Court used this mistake as a crucial part of its opinion (A-20). To see that this was a mere error, and the Court should have known it, see A-9.

Moreover, the quality of the considerations favoring residence is better than the evidence militating against it. The basic issue here - domicile - is defined as physical presence in a place coupled with an intention to make the place one's home. *Miller v. Commissioner of Taxation*, 59 N.W.2d 925 (Minn. 1953). Thus, the fact that Dr. Dreyling was in Alaska more than Minnesota and intended to make it his home is a far more important factor in determining residence than, e.g., his continued membership in the Koronis Golf Club. Likewise, his registration to vote in Alaska and his refusal to vote in Minnesota, or his practice of medicine in Alaska and the sale of his practice in Minnesota, is far more indicative of his intentions than a hunting license.

Of course, the Tax Court found otherwise. It should be noted, however, that the Tax Court's determinations were based on precisely the same underlying facts as the arguments made by the relator and outlined above. Hence, the Court is not dealing with conflicting evidence and thus the Tax Court is not entitled to the presumption of regularity that would ordinarily insulate its findings of fact. Rather, the *Wilson* rule applies, because the Court is dealing with the application of the law to the facts, not the determination of whether the alleged facts are true or not.

Dr. Dreyling was not in Minnesota for 183 days in 1998,

1999, 2001, or thereafter. He was only in Minnesota for 183 days in 2000. Combined with the clear predominance of those factors militating against Minnesota domicile, the findings of the Tax Court were clearly erroneous.

There is something rather mean-spirited in both the actions of the Department of Revenue and the decision of the Tax Court. One of the troubling features in the Tax Court's analysis is its tendency to resolve every possible inference in favor of the Commissioner. Were the only determination in this case whether Dr. Dreyling entitled to claim non-residence for the years 1998 through 2001, this might simply be taken as a tendency of an agency to protect itself. But a fraud claim is involved here, and a reputation is at stake. When the Court says, "[c]learly factors 1, 4, 5, 6, 7, 9, 10, 13, 17, 18, 19, 21, and 22 mitigate [sic - the word should be "militate"] toward Minnesota residence, it has to make every "call" in favor of the Commissioner, include ones which no stretch of the imagination permit it to do. And even then, only half of the factors favor the State's position, and the Court, in its amended findings, even backed off on two of these. On this, no fair minded person could find fraud in such a close case.

Note in this regard the case of *Luther v. Commissioner of Revenue*, 588 N.W.2d 502 (Minn. 1999). In *Luther*, the Supreme Court held that the partial days the taxpayer spent in Minnesota

should count as "in state" days for the purposes of calculating the 183 requirement. But what is most interesting about the case is that neither the Commissioner nor the Supreme Court even suggested that penalties of any sort, much less fraud penalties, would be appropriate. If an incorrect claim of domicile subjects the taxpayer to fraud penalties, one would have expected them to have been imposed in *Luther*.

Of course, the Commissioner has the discretion to seek or waive penalties. But he must have some basis to do so. He cannot arbitrarily decide that someone he dislikes should be struck with penalties, while someone similarly situated can avoid them. That way lies corruption. So there must be some rational basis to seek or impose penalties. Refusal to turn over records which are undescribed and are sought as part of a fishing expedition is not such a rational basis. The Commissioner's representatives simply became angry, and decided to seek penalties which have no basis in the law.

Like the thirteen stroke of a crazy clock, the finding of fraud casts doubt not only upon itself, but upon the entire process. The Tax Court got the fraud finding entirely wrong, and because it was mesmerized by the finding of fraud, its determination on the underlying residence question was clouded by its determination of Dr. Dreyling's misbehavior. There was no such misbehavior, there was no fraud, and there was no error in

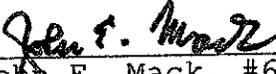
his calculations of residence. The Tax Court's determination should be reversed.

CONCLUSION

For these reasons, the determination of fraud and non-residence should be reversed, and Dr. Dreyling should be assessed no penalties, nor should have be required to pay additional taxes for 1998, 1999, and 2001. And because the taxpayer's actions were not fraudulent, the statute of limitations operates to forbid collection of 1998 taxes. The taxpayer deserves to prevail, and he should.

Dated: June 27<sup>th</sup>, 2005

MACK & DABY P.A.

  
\_\_\_\_\_  
John E. Mack, #65973  
26 Main St., P.O. Box 302  
New London MN 56273  
(320) 354-2045  
ATTORNEYS FOR RELATOR

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).