

SYNOPSIS

PERSONAL INCOME TAX – BURDEN OF PROOF -- In a hearing before the West Virginia Office of Tax Appeals on a petition for refund, the Petitioners bear the burden of proving that the State Tax Commissioner is incorrect and that they are entitled to the refund requested. *See* W. Va. Code § 11-10A-10(e) [2002] and 121 C.S.R. 1, § 63.1 (Apr. 20, 2003).

PERSONAL INCOME TAX – STATUTE OF LIMITATIONS -- The Petitioners failed to comply with W. Va. Code § 11-10-14-(l)(1), by either filing a claim for refund within three years of the due date of their 1997 West Virginia personal income tax return or within two years of the date that they paid their 1997 West Virginia personal income tax.

PERSONAL INCOME TAX – STATE TAX COMMISSIONER NOT ESTOPPED TO ASSERT STATUTE OF LIMITATIONS -- The Tax Commissioner is not estopped to assert that the Petitioners failed to comply with the statute of limitations, W. Va. Code § 11-10-14-(l)(1), because of an act of a prior State Tax Commissioner that was unauthorized by law and was, therefore, *ultra vires*.

FINAL DECISION

This matter is before the Office of Tax Appeals on a petition for refund filed by the Petitioners in accordance with the provisions of W. Va. Code §§ 11-10A-8(2) and 11-10A-9(a).

FINDINGS OF FACT

1. Some time prior to June 27, 1997, one of the Petitioners, won by playing the West Virginia Lottery.¹
2. At the time that the Petitioner won the lottery, W. Va. Code § 29-22-22 was in effect, providing that in lottery winnings were not subject to state and local taxes in West Virginia.

¹ After all, you can't win if you don't play.

3. For reasons that are more fully discussed below, the State Tax Commissioner withheld taxes from the Petitioner's lottery winnings.

4. In filing their 1997 West Virginia Personal Income Tax Return, Form WVIT-140, the Petitioners complied with the instructions contained in said return, reporting the lottery winnings as taxable income and paying the tax on said winnings. *See* Petitioners' Exhibit 5, p. 3.

5. In the spring of 2004, one of the Petitioners, became aware of the existence of W. Va. Code § 29-22-22, and the fact that it was in effect in 1997.

6. On or about March 10, 2004, the Petitioners filed a claim for refund for the taxes on the lottery winnings, in the form of an amended West Virginia Personal Income Tax Return, Form WVIT-140X, for 1997. Their amended return reduced their reported taxable income by the amount of their lottery winnings.

7. The Petitioners' claim for refund was denied. *See* Petitioners' Exhibit No. 2. The claim for refund was denied on the grounds that the Petitioners failed to file said claim within the three-year time limit provided by the applicable statute of limitations, W. Va. Code § 11-10-14(I)(1).

8. Assistant Director of the Internal Auditing Division testified that the Petitioners' claim for refund was denied solely on the grounds that the Petitioners did not file their claim for refund within the period of the statute of limitations. She testified that if the Petitioners had filed their claim within the period of the statute of limitations, they would have received a refund.

9. In response to the denial of their claim for refund, the Petitioners filed the petition for refund that is the subject of this matter.

DISCUSSION

At the time of the institution of the lottery, in 1986, two sections of the West Virginia Code related to the exemption of lottery winnings from taxation under the West Virginia personal income tax. W. Va. Code § 29-22-22 provided, “No state or local taxes of any type whatsoever shall be imposed upon any prize awarded by the state lottery.”² However, lottery winnings were required to be reported as taxable for purposes of the federal personal income tax. As a consequence, absent a modification removing them from federal adjusted gross income, they were included in W. Va. adjusted gross income for purposes of the West Virginia personal income tax. *See* W. Va. Code § 11-21-12(a). The mechanism chosen by the West Virginia Legislature for deducting lottery winnings from federal adjusted gross income was W. Va. Code § 11-21-12(c)(11), which provided a modification reducing federal adjusted gross income in arriving at West Virginia adjusted gross income. This subsection provided that there was to be subtracted from federal adjusted income, “The amount of any lottery prize awarded by the West Virginia state lottery commission, to the extent properly included in gross income for federal income tax purposes.”

In 1993, the West Virginia Legislature eliminated the modification reducing federal adjusted gross income by the amount of lottery prizes awarded by the West Virginia state lottery commission. W. Va. Code § 11-21-12(c)(11) was amended to read:

The amount of any lottery prize awarded by the West Virginia state lottery commission, to the extent properly included in gross income for federal income tax purposes: Provided, That for taxable years beginning after the thirty-first day of December, one thousand nine hundred ninety-two, this modification shall not be made for lottery prizes awarded by the West Virginia state lottery commission[.]”

² By its express terms, this provision provided state lottery winnings a blanket exemption from all forms of state and local taxation.

Consequently, for taxable years beginning January 1, 1993 and thereafter, there was no apparent modification reducing federal adjusted gross income by the amount of lottery prizes. It appears that the Legislature intended to eliminate the exemption of lottery winnings from state and local taxation. However, W. Va. Code § 29-22-22, exempting lottery prizes from all state and local taxation, remained in effect.

It was the 1993 amendment to W. Va. Code § 11-21-12(c)(11) that resulted in the State of West Virginia withholding personal income tax from lottery prize winnings, including those of the Petitioner. *See* Petitioners' Exhibit 1, p. 4. Consistent with the Legislature's apparent intention, it appears that the State Tax Commissioner amended the West Virginia Personal Income Tax Return, Form WVIT-140, to eliminate the modification for tax years 1993 and thereafter. *See* Petitioners' Exhibit 6. The Petitioners complied with the express directions contained in the instructions of the 1997 West Virginia Personal Income Tax Return, WVIT-140, which states that lottery winnings are fully taxable for purposes the West Virginia personal income tax. *See* Petitioners' Exhibit 5, p. 3.

The Petitioner, testified that it was not until the spring of 2004 that she became aware of the existence of W. Va. Code § 29-22-22, and realized that lottery winnings were still exempt from West Virginia personal income tax. She testified that she became aware of the exemption only upon learning that the Legislature was contemplating repealing W. Va. Code § 29-22-22, which it ultimately did. Upon learning of the existence of § 29-22-22, the Petitioners promptly filed their claim for refund, in the form of the amended return.

The State Tax Commissioner denied the Petitioners' claim for refund on the grounds that they had not timely filed their claim for refund. W. Va. Code § 11-10-14-(l)(1) provides, in relevant part:

(l) Limitation on claims for refund or credit.

(1) *General rule.* -- Whenever a taxpayer claims to be entitled to a refund or credit of any tax (or fee), additions to tax, penalties or interest imposed by this article, or any article of this chapter, or of this code, administered under this article, paid into the treasury of this state, *the taxpayer shall*, except as provided in subsection (d) of this section, *file a claim for refund*, or credit, *within three years after the due date of the return in respect of which the tax (or fee) was imposed*, determined by including any authorized extension of time for filing the return, *or within two years from the date the tax, (or fee), was paid, whichever of the periods expires the later*, or if no return was filed by the taxpayer, within two years from the time the tax (or fee) was paid, and not thereafter. (Emphasis added.)

The Petitioners filed their claim for refund in 2004, not quite six years after they filed their 1997 personal income tax return. This is well in excess of three years after the due date of their 1997 personal income tax return. It is clear that the Petitioners did not comply with the provisions of W. Va. Code § 11-10-14 (I)(1) and did not timely file their claim for refund.

The Petitioners contend that the Tax Commissioner misled them into believing that lottery winning were not exempt from the West Virginia personal income tax. They maintain that they were misled by the publishing of the 1993 West Virginia personal income tax return, which stated that one of the new developments of West Virginia income tax law was the repeal of the exemption for lottery winnings from the personal income tax, even though W. Va. Code 29-22-22 remained in full force and effect. *See* Petitioner's Exhibit No. 6. They also maintain that they were misled by the instructions contained in the 1997 West Virginia personal income tax return, which expressly stated that lottery winnings were taxable for purposes of the West Virginia personal income tax. *See* Petitioner's Exhibit No. 5. Although the Petitioner representing the Petitioners at the hearing, as a layperson, did not use the term, the Petitioners, in effect, take the position that the State Tax Commissioner is estopped from asserting the applicability of the statute of limitations because they were misled by the erroneous information contained in the tax return.

“A state is not bound by the unauthorized acts of public officers. Their misconduct is no estoppel against the state.” Syl. pt. 5, *Samsell v. State Line Dev. Co.*, 154 W. Va. 48, 174 S.E.2d 318 (1970); and syl. pt. 5, *State v. Chilton*, 49 W. Va. 453, 39 S.E. 612 (1901). The doctrine of estoppel should be applied cautiously, only when equity clearly requires that it be done, and this principle is applied with especial force when one undertakes to assert the doctrine of estoppel against the state. See Syl. pt. 7, *Samsell v. State Line Dev. Co.*, *supra*. Because a state or one of its political subdivisions is not bound by the legally unauthorized acts of its officers; all persons must take note of the legal limitations upon the power and authority of its officers. *Samsell v. State Line Dev. Co.*, *supra* at 59, 174 S.E.2d at 325; *Cunningham v. Wood County Court*, *supra*. at 309-10, 134 S.E.2d at 729; *Schippa v. Liquor Control Comm.*, 132 W. Va. 51, 54, 53 S.E.2d 609, 611 (1948); *Armstrong Products Corp. v. Martin*, 119 W. Va. 50, 53, 192 S.E. 125, 127 (1937); *State v. Conley*, 118 W. Va. 508, 531, 190 S.E. 908, 918 (1937); *City of Beckley v. Wolford*, *supra* at 393, 140 S.E. at 345 (1927); *Coberly v. Gainer*, 69 W. Va. 699, 703, 72 S.E. 790, 792 (1910); Syl. pts 4 & 5, *State v. Chilton*, 49 W. Va. 453, 39 S.E. 612 (1901); and *Totten v. Nighbert*, 41 W. Va. 800, 805; 24 S.E. 627, 629 (1896).

The State or one of its subdivisions acting in a governmental capacity, as opposed to performing a proprietary function, is not subject to the law of equitable estoppel. *McMillian v. Berkeley Co. Planning Comm.*, 190 W. Va. 458, 465, 438 S.E.2d 801, 808, 438 S.E.2d 801, 808 (1993); *Martin v. Pugh*, 175 W. Va. 495, 503, 334 S.E.2d 633, 641 (1985) (particularly good discussion); *Cunningham v. Wood County Court*, 148 W. Va. 303, 309-10, 134 S.E.2d 725, 729 (1964); *Cawley v. Bd. of Trustees*, 138 W. Va. 571, 583, 76 S.E.2d 683, 690 (1953); and *City of Beckley v. Wolford*, 104 W. Va. 391, 393, 140 S.E. 344, 345 (1927). Taxation is a function that is a governmental function, as opposed to a proprietary function. *City of Beckley v. Wolford*, *supra*. at 393, 140 S.E. at 344. Therefore, any unauthorized or *ultra vires* act of the State Tax

Commissioner may not act as an estoppel against the State in the enforcement of the law, including the statute of limitations.

In the present matter, the Petitioners argue that the State Tax Commissioner is estopped from asserting that they filed their claim for refund after the expiration of the three year statute of limitations. They maintain that they were misled by the incorrect instructions contained in the 1997 tax return,³ and that the Tax Commissioner was the purveyor of the incorrect instructions. However, in light of well-established principles of law articulated by the West Virginia Supreme Court of Appeals, the State Tax Commissioner is not estopped to deny the validity of *ultra vires* act of one of her predecessors. The issuance of mistaken instructions is an *ultra vires* mistaken act of the former Tax Commissioner, which is not authorized by law. It is a mistake that was undertaken in the performance of a governmental function, not a proprietary function. Consequently, the State is not estopped from enforcing the statute of limitations against the Petitioners.

In the same vein, it was incumbent upon the Petitioners to note the limitations on the authority of the State Tax Commissioner to prepare an income tax return form that is inconsistent with the statutes with which it purports to conform. The State Tax Commissioner is not authorized to do so and his or her act in doing so was *ultra vires*. The Petitioners had the ability to discover the existence of W. Va. Code § 29-22-22 and bring it to the attention of the State Tax Commissioner. However, instead of researching the law and making their own determination as to the correct status of the law, they simply followed the Tax Commissioner's erroneous instructions. Unfortunately, they did so at their own peril. It is unfortunate that the Petitioners did not avail themselves of the exemption provided by law. However, their failure to do so is as

³ The incorrect instructions set out in the 1997 West Virginia Personal Income Tax Return are the result of a mistake by a predecessor of the current Tax Commissioner. Clearly that predecessor intended to comply with the

much a result of their own neglect as it is the result of neglect on the part of the Tax Commissioner.

Also of some relevance is *Bradley v. State Tax Commissioner*, 195 W. Va. 180, 465 S.E.2d 180 (1995), wherein, at Syllabus Point 3, the Supreme Court held that estoppel applies when a party is induced to act or to refrain from acting because of reasonable reliance on another party's misrepresentation or concealment of a material fact. In elaborating on this principle in its opinion, the Court stated that in order for application of the doctrine of equitable estoppel to toll the running of the statute of limitations, there must have been some misrepresentation or affirmative conduct by the State Tax Commissioner that induced the taxpayers to refrain from challenging the Commissioner's decision. *Id.* at 185, 465 S.E.2d 180. In this matter, the Petitioners point to no misrepresentation or affirmative conduct by the State Tax Commissioner that induced the Petitioners to refrain from challenging the taxability of lottery winnings.⁴ To the contrary, the Petitioners voluntarily paid the tax, and made no effort to discover whether or not there was some provision of the West Virginia Code that provided that said winnings were exempt from taxation. They did nothing to attempt to determine whether or not they were entitled to a refund. In addition, the State Tax Commissioner did not misrepresent or

1993 amendment passed by the Legislature. As did the Petitioners and, so it seems, the Legislature, the Tax Commissioner missed the existence of the W. Va. Code § 29-22-22.

⁴ The Tax Commissioner often takes positions respecting statutes with which taxpayers disagree. By law, taxpayers have the opportunity to take positions with respect to statutes and to disagree with the State Tax Commissioner. A taxpayer who disagrees with the Tax Commissioner may undertake to challenge the Tax Commissioner's decision position through the appropriate legal processes.

In this matter, the Petitioners could have done the necessary and appropriate research respecting the taxability of lottery winnings. Had they done so, they could have discovered that W. Va. Code § 29-22-22 exempts lottery winnings from all state and local taxation. The next logical step would have been for them to take the steps in 1998 that they did not take until early 2004. Nothing that the Tax Commissioner did induced the Petitioners to refrain from taking the necessary procedural steps to obtain a ruling from the Tax Commissioner or an appropriate court that their lottery winnings were exempt from personal income tax and that they were due a refund.

affirmatively conceal the provisions of W.Va. Code § 29-22-22; like the taxpayer the commissioner apparently was unaware of that statute.⁵

CONCLUSIONS OF LAW

1. In a hearing on a petition for refund before the West Virginia Office of Tax Appeals, the burden of proof is on the Petitioners to show that they are entitled to the refund. *See* W. Va. Code § 11-10A-10(e).

2. The Petitioners were required to file a claim for refund within three years of the due date of the return in respect of which the tax was imposed or within two years of the date that they paid the tax for which they seek a refund, whichever expires later. W. Va. Code 11-10-14 (l)(1).

3. The Petitioners filed their claim for refund in 2004, nearly six (6) years after the due date of the return in respect of which the tax was imposed.

4. The Tax Commissioner is not estopped to assert that the Petitioners failed to comply with the statute of limitations, W. Va. Code § 11-10-14(l)(1), because of an act of a prior State Tax Commissioner that was unauthorized by law and was, therefore, *ultra vires*.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the petition for refund of personal income tax filed by the Petitioners for calendar year 1997, for tax in the amount should be and is hereby **DENIED**.

⁵ Curiously, *Bradley* does not mention the governmental v. proprietary function distinction for purposes of

applying, or not, equitable estoppel against state government.