

STATE OF WISCONSIN
TAX APPEALS COMMISSION

HARLAN SPRAGUE DAWLEY, INC.,

DOCKET NO. 02-S-416 (P)

Petitioner,

vs.

**RULING AND ORDER
ON MOTION FOR PARTIAL
SUMMARY JUDGMENT**

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

ROGER W. LEGRAND, COMMISSIONER:

This matter comes before the Commission on a motion for partial summary judgment filed by respondent, the Wisconsin Department of Revenue, on September 28, 2007. Petitioner is represented by Attorneys Joseph C. Chappelle and Mark J. Crandley, Barnes & Thornburg LLP, and Attorney David D. Wilmoth, Quarles & Brady LLP. Respondent is represented by Attorney Linda M. Mintener. Both parties filed briefs with supporting documents regarding the motion.

JURISDICTIONAL FACTS

1. As the result of a field audit, Respondent issued a sales/use tax assessment against Petitioner on March 6, 1996, for the period 1991 through 1994 (the "period at issue") in the amount of \$152,239.12 in tax, plus \$47,788.39 in interest (calculated to May 5, 1996), and \$38,059.79 in penalty for a total of \$238,087.30 (the "assessment"). (Affidavit of Linda M. Mintener dated September 27, 2007 ("Mintener Aff.") ¶ 2, Ex. 1.)

2. On or about May 8, 1996, Petitioner filed a petition for

redetermination dated May 6, 1996 objecting to the assessment. (Mintener Aff. Ex. 2.)

3. In a Notice of Action dated October 7, 2002, Respondent denied Petitioner's petition for redetermination in part and granted it in part, giving Petitioner credit for certain use tax paid in Iowa. Respondent issued a corrected amount due of \$128,611.82 in tax, plus \$141,833.29 in interest and \$32,152.96 in negligence penalty, for a total amount due of \$302,598.07, with interest calculated to December 4, 2002. (Mintener Aff. Ex. 3.)

4. On November 29, 2002, Petitioner filed a petition for review with the Commission, which Respondent answered on December 17, 2002.

MATERIAL FACTS¹

5. Petitioner is an Indiana corporation that has been doing business in Wisconsin since 1980.

6. During the period at issue, Petitioner was in the business of breeding, raising and selling specific pathogen-free, genetically defined animals to the biomedical research community. (Affidavit of John A. Baxter II dated February 14, 2008 ("Baxter Aff."), ¶ 3.) These animals included mice, rats, dogs and cats, which were sold to various institutions and laboratories for use in research activities.

7. Petitioner bred and raised its animals in a strictly controlled and monitored environment created by sophisticated machines, equipment and operating procedures. (Baxter Aff. ¶ 5.) The breeding and rearing of these animals took place in an isolated environment in which Petitioner's equipment filtered the air and water, maintained temperature, humidity and fresh air supply, and established specific hours

¹ All facts are for the period at issue, unless otherwise noted.

of light and darkness. (Baxter Aff. ¶ 7.)

8. The strict control of the animals' environment occurred and was maintained through equipment built into Petitioner's buildings, such as its autoclaves, HVAC equipment, air and water filtering systems, and other pieces of equipment that monitored and controlled the air, temperature, humidity and light to which the animals were exposed. (Baxter Aff. ¶ 9.)

9. During the period at issue, Petitioner employed approximately 200 persons in Wisconsin and had animal operations at five locations in Dane County, Wisconsin. (Mintener Aff., Ex. 1.)

10. Petitioner has held a Wisconsin sales tax permit since 1980. (Mintener Aff. ¶ 7, Ex. 5-6.)

11. Petitioner has not paid Wisconsin sales or use tax on any of the items at issue in this matter. (Mintener Aff. Ex. 1.)

12. During the period at issue, Petitioner produced feed for its animals at its location in Madison, Wisconsin, including vitamin and mineral mixes.

RESPONDENT'S MOTION

On September 28, 2007, Respondent filed a motion for partial summary judgment on the following issues, on the grounds that there is no genuine issue of material fact regarding each issue and that Respondent is entitled to summary judgment as a matter of law with respect to each issue:

1. Whether Petitioner's activities of breeding and raising laboratory animals to sell for research purposes are properly considered as "the business of farming" so as to exempt Petitioner's machines and

certain other items used exclusively and directly in its animal activities from sales/use tax under the farming exemption of § 77.54(3)(a) and/or (3m), Stats.

2. Whether, even if Petitioner's animal operations were considered to constitute manufacturing activities pursuant to § 77.54(6)(a), Stats., the buildings that house Petitioner's animal operations and administrative activities can be considered "machines" or "specific processing equipment" and may thus be exempt from sales/use tax under § 77.54(6)(a), Stats.

3. Whether the raw ingredients and supplies that Petitioner incorporated into and/or destroyed in its manufacture of animal feed mixes and its final feed products that Petitioner used and stored in Wisconsin, sent outside Wisconsin for further processing, and ultimately consumed in Wisconsin by feeding them in final food products to its animals in its Wisconsin operations were "destined for sale" so that Petitioner's purchase of said ingredients may be exempt from sales/use tax under § 77.54(2), Stats.

4. Whether the raw ingredients and supplies that Petitioner purchased in Wisconsin, incorporated into and/or destroyed in its manufacture of animal feed mixes in its Wisconsin feed manufacturing plant, sent out of state for additional processing, and ultimately consumed outside Wisconsin by feeding said mixes as part of final feed products to its animals in its out-of-state operations were "destined for sale" so that

Petitioner's purchase of said ingredients may be exempt from sales/use tax under § 77.54(2), Stats.

5. Whether Respondent violated the U.S. Constitution when -- based on Petitioner's Wisconsin "storage" and "use" on or after October 1, 1991, as defined in § 77.51(18) and (22)(a), Stats., (eff. 10/1/91) -- Respondent assessed use tax on Petitioner's costs for the ingredients that Petitioner incorporated in Wisconsin into its animal feed mixes that it stored and used in Wisconsin before sending the feed mixes to another state or states for use outside Wisconsin.

6. Whether Respondent made any adjustments or assessments under the pre-October 1991 version of § 77.51(18), Stats., which excepted from the definition of "storage" "the keeping or retention in this state for any purposes except . . . subsequent use solely outside this state of tangible personal property purchased from a retailer."

7. Whether Petitioner's sales of animals and feed to persons or businesses from whom it did not take or have on file an exemption certificate are subject to sales tax pursuant to § 77.52(1), Stats.

8. Whether Respondent made any assessments herein against United Vaccines, Inc. after Petitioner, on January 1, 1992, spun its United Vaccines Division off into a separate corporation, and whether any of Respondent's assessment of tax for United Vaccines Division's transactions is beyond the statute of limitations.

9. Whether, even if Petitioner's animal operations are found to

constitute manufacturing and/or farming activities, its trucks, forklifts, similar items, and the items related thereto (such as the “Forklift,” “Reach Truck,” and “Straight Trailers & Hyster 500LB Clamps” listed on Schedule 3 of the Audit Report) that Petitioner used for transportation and/or for loading and unloading in its shipping and receiving areas are eligible for the manufacturing exemption of § 77.54(6)(a) or the farming exemption of § 77.54(3)(a) and/or (3m), Stats.

10. Whether, even if Petitioner’s animal operations were found to be manufacturing and/or farming activities, Petitioner’s Wisconsin purchase or use of items that control the temperature in its buildings which housed its animal operations can be exempt under §§ 77.54(6)(a), 77.54(2) and/or 77.54(3)(a) or (3m), Stats.

11. Whether any periods included in the assessment at issue are beyond the statute of limitations.

12. Whether Respondent properly imposed the 25% negligence penalty pursuant to § 77.60(3), Stats., in this matter.

13. Whether Respondent is entitled to a setoff against any portion of the assessment that may be invalidated in a final dispositive decision in this matter for Respondent’s stale claim for use tax on Petitioner’s purchase of utilities, which Respondent failed to assess during the audit that gave rise to the assessment at issue in this matter.

RULING²

Summary judgment is warranted where “the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” Wis. Stat. § 802.08(2). A party moving for summary judgment has the burden to establish the absence of a genuine, that is, disputed, issue as to any material fact. *Grams v. Boss*, 97 Wis. 2d 332, 338-39, 294 N.W.2d 473 (1980). Any doubts as to the existence of a genuine issue of material fact are to be resolved against the moving party. *Id.* at 338-339 (citations omitted). Respondent is the moving party and thus has the burden of proving that there is no genuine issue of material fact with respect to each issue submitted for summary judgment.

Respondent’s sales and use tax field audit assessments are presumed to be correct, and Petitioner has the burden of proving the assessment to be incorrect. Wis. Stat. § 77.59(2). Under Wisconsin law, it is presumed that all sales of tangible personal property are subject to sales or use tax until the contrary is established. Wis. Stat. §§77.52(1) and (3) and 77.53(1); *H. Samuels Co. v. Dep’t of Revenue*, 70 Wis. 2d 1076 at 1077-1078, 236 N.W.2d 250 (1975). Statutes granting tax exemptions are a matter of legislative grace and must be strictly construed against granting an exemption. *Ladish Malting Co. v. Dep’t of Revenue*, 98 Wis. 2d 496, 502, 297 N.W. 2d 56 (1980); *Ramrod, Inc. v. Dep’t of Revenue*, 64 Wis. 2d 499, 504, 219 N.W. 2d. 604 (1974). All doubts regarding the application of a tax exemption must be resolved against the exemption and in favor of

² All statutes and administrative rules cited herein were effective for the period at issue in the assessment, unless otherwise noted.

taxability. *Wisconsin Dep't. of Revenue v. Greiling*, 112 Wis. 2d 602, 605, 334 N.W. 2d. 118 (1983). In this case, Respondent disallowed certain exemptions from sales/use tax claimed by Petitioner during a field audit.

1. Farming Exemption Under § 77.54(3)(a) and/or (3m), Stats.

In the first issue submitted by Respondent for partial summary judgment, Petitioner claims exemption from sales/use tax under § 77.54(3)(a) and/or (3m), Stats., which exempt the following :

The gross receipts from the sales of and the storage, use or other consumption of tractors and machines, including accessories, attachments and parts therefore, used exclusively and directly in the business of farming, including dairy farming, agriculture, horticulture, floriculture and custom farming services

[and]

The gross receipts from the sale of and the storage, use or other consumption of the following items if they are used exclusively by the purchaser or user in the business of farming; including dairy farming, agriculture, horticulture, floriculture and custom farming services:

- (a) Seeds for planting.
- (b) Plants.
- (c) Feed.
- (d) Fertilizer.
- (e) Soil conditioners.
- (f) Animal bedding.
- (g) Sprays, pesticides and fungicides.
- (h) Breeding and other livestock.
- (i) Poultry.
- (j) Farm work stock.
- (k) Baling twine and baling wire.
- (l) Containers for fruits, vegetables, grain, hay, silage and animal wastes.
- (m) Plastic bags, plastic sleeves and plastic sheeting used to store or cover hay or silage.

§ 77.54(3)(a) and (3m), Stats. (respectively).

Wisconsin Administrative Code § Tax 11.12(2)(f) provides the definition of “farming” applicable under § 77.54(3) and (3m), Stats., as follows in relevant part: “Farming does not include . . . breeding or raising dogs, cats, other pets or animals intended for use in laboratories” Wis. Admin. Code § Tax 11.12(2)(f).

Petitioner argues that the breeding and raising of animals for research purposes is the business of farming. However, under the clear language of Rule Tax § 11.12(2)(f), Petitioner’s activities were excluded from the applicable definition of “farming,” and Petitioner therefore cannot claim the exemption. In addition, the analysis of the statutes regarding the term “in the business of farming” lists “dairy farming, agriculture, horticulture, floriculture, and custom farming services” as qualifying for the exemption. § 77.54(3m), Stats. Nowhere does the statute enumerate the breeding and raising of animals to sell for research purpose as a business of farming activity qualifying for an exemption.

“Administrative rules enacted pursuant to statutory rule-making authority have the force and effect of law.” *DaimlerChrysler Services North America LLC v. Wis. Dep’t of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-782 (WTAC 2004), *aff’d*, 2006 WI App. 265, 726 N.W.2d 312 (Ct. App. 2006). In this case, Rule § Tax 11.12(2)(f) was properly promulgated by Respondent pursuant to its rule-making authority. To escape application of Rule § Tax 11.12(2)(f), Petitioner asks the Commission to invalidate the Rule on the grounds that it conflicts with the statute it interprets. (Pet. Brief, pp. 6-7.) We find no such conflict. The fact that Rule § Tax 11.12(2)(f) defines “farming” less broadly than it might have does not show that the rule conflicts with the statute.

Under the applicable rules of construction, a statute granting an

exemption must be strictly construed against granting the exemption, with any doubts to be resolved in favor of taxability. Because Petitioner's activities were not specifically included within the terms of the exemption sought, and indeed were excluded under Rule § Tax 11.12(f), we conclude that the breeding and raising of animals to sell to researchers does not qualify for the farming exemption under either § 77.54(3)(a) or (3m), Stats.

2. Manufacturing Exemption Under § 77.54(6)(a), Stats.

In its Brief, Respondent notes: "This Motion for Partial Summary Judgment does not address Petitioner's claim for an exemption for its entire animal operation under the manufacturing exemption of § 77.54(6)(a), Stats., an issue that Respondent deems to be too fact-specific for summary judgment." (Resp. Brief, p. 12 n. 6.) However, in paragraphs (2), (3), (4), (7), (9) and (10) of its Motion, Respondent requests summary judgment on issues that are closely related to the question of whether Petitioner's animal operation qualifies for the manufacturing exemption. Because these issues are so closely related, we find that genuine issues of material fact remain to be resolved with respect to these issues.

3. Other Issues Raised in Respondent's Motion

In its briefs, Petitioner generally did not dispute Respondent's arguments regarding the issues listed below. For that reason and the reasons stated above, the Commission finds with respect the following additional issues:

- (a) Respondent did not assess any tax on Petitioner's out-of-state use of its feed mixes or final feed products, and thus the assessment does not violate the U.S. Constitution on those grounds. (No. 5,

Respondent's Motion for Partial Summary Judgment.)

(b) Respondent did not make any adjustments or assessments under the pre-October 1991 version of § 77.51(18), Stats., for "Storage" of feed ingredients. (No. 6, Respondent's Motion for Partial Summary Judgment.)

(c) No Wisconsin statute of limitations bars Respondent's adjustments in the assessment related to United Vaccines. (No. 8, Respondent's Motion for Partial Summary Judgment.)

(d) No Wisconsin statute of limitations has run for any of the adjustments made in the assessment. (No. 11, Respondent's Motion for Partial Summary Judgment.)

(e) The Commission will not rule on whether Respondent properly imposed the 25% negligence penalty pursuant to Section 77.60(3), Stats., in this matter until the remaining issues in this matter have been resolved. (No. 12, Respondent's Motion for Partial Summary Judgment.)

(f) Similarly, the Commission will not rule on whether Respondent is entitled to a set-off against any portion of the assessment that might be invalidated pending the final resolution of all remaining issues. (No. 13, Respondent's Motion for Partial Summary Judgment.)

ORDER

1. Respondent's motion for partial summary judgment is granted as to the issues raised in paragraphs (1), (5), (6), (8) and (11) of that motion. Specifically,

the Commission finds that:

(a) During the period at issue, Petitioner's breeding and raising of animals for laboratory research purposes did not constitute "the business of farming" and its machines and supplies used in those operations did not qualify for the farming exemption provided under § 77.54(3)(a) or (3m), Stats.; and

(b) The assessment at issue in this matter does not violate the U.S. Constitution or any Wisconsin statute of limitations.

2. Respondent's motion for partial summary judgment is denied with respect to all other issues raised in that motion, based on the Commission's determination that genuine issues of material fact remain to be resolved regarding those issues.

3. The Commission will contact the parties to arrange a telephone status conference to discuss further proceedings in this matter.

Dated at Madison, Wisconsin, this 3rd day of November, 2008.

WISCONSIN TAX APPEALS COMMISSION

David C. Swanson, Chairperson

Roger W. Le Grand, Commissioner

Thomas J. McAdams, Commissioner