

PARKVIEW SAND & GRAVEL INC 97S148 TAC

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FILED Wisconsin Tax Appeals Commission <div style="border: 1px solid black; padding: 5px; text-align: center;"> <b>JUN 22 1999</b> </div> Darlene Skolaski Deputy Clerk
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**STATE OF WISCONSIN**  
**TAX APPEALS COMMISSION**

<b>PARKVIEW SAND &amp; GRAVEL, INC.,</b> W208 S8905 Hillendale Drive Muskego, WI 53150	*	
	*	DOCKET NO. 97-S-148
Petitioner,	*	
vs.	*	<b>RULING AND ORDER</b>
<b>WISCONSIN DEPARTMENT OF REVENUE</b> P.O. Box 8933 Madison, WI 53708	*	<b>AWARDING SUMMARY</b>
	*	<b>JUDGMENT</b>
Respondent.	*	

**THOMAS M. BOYKOFF, COMMISSIONER:**

This matter is before the Commission on the motion of the Wisconsin Department of Revenue ("respondent") for summary judgment on the ground that there is no genuine issue as to any material facts. Both parties have submitted affidavits and briefs on the motion. Parkview Sand & Gravel, Inc., ("petitioner") appears by Attorney Carl L. Dubin of Dubin, Balistreri & Schelble, S.C., Milwaukee, Wisconsin. Respondent appears by Attorney Linda M. Mintener, Madison, Wisconsin.

Having considered the entire record, the Commission finds, rules, and orders as follows:

## UNDISPUTED MATERIAL FACTS<sup>1</sup>

### 1. Jurisdictional and Background Facts<sup>2</sup>

1. Petitioner is a Wisconsin corporation based in Muskego, Wisconsin. It is engaged in operating a sand and gravel pit involving manufacturing operations.

2. Respondent conducted a sales and use tax field audit of petitioner for the four fiscal years ending March 31, 1992, 1993, 1994, and 1995. Respondent determined that petitioner had correctly reported all sales which were subject to sales tax but had not reported or paid any use tax on any of its purchases. Under date of June 13, 1996, respondent assessed petitioner \$46,261.12 (comprised of \$29,229.41 in use tax, \$9,724.34 in interest, and \$7,307.37 in penalties).

3. Under date of August 8, 1996, petitioner filed with respondent a petition for redetermination which stated in part:

The first area of disagreement is with the stupidity of trying to tax the Backhoe and related refurbishing. The entire assessment must be appealed to determine transaction by transaction where negligence occurred and if Parkview Sand & Gravel, Inc. was negligent....

4. Under date of February 6, 1997, in its Notice of Action, respondent denied the petition for redetermination, stating in part:

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<sup>1</sup> All facts relate to the period under review (i.e., fiscal years 1992-1995) unless otherwise stated.

<sup>2</sup> Several prior procedural motions were filed in this case, including respondent's motion to dismiss the petition for review for failure to state a claim on which relief may be granted, respondent's motion to dismiss petitioner's amended petition for review, and a motion to compel discovery. These motions and the Commission's actions on them largely account for the lengthy time period of this case.

The link belt backhoe, backhoe bucket and repairs are not exempt under sec. 77.54(6)(a), Wis. Stats. since they are not used directly and exclusively in manufacturing.

Regarding the negligence penalty, the Notice of Action stated:

... Negligence is inadvertence as distinguished from intentional tax evasion.... [I]t is our position that the negligence penalty was properly imposed and the reasons given for failure to report use tax do not constitute reasonable cause.

5. Under date of April 5, 1997, petitioner filed a petition for review with this commission. The two issues involved are (A) the applicability of the use tax to the backhoe and (B) the negligence penalty.

6. On November 20, 1998, respondent filed a motion for summary judgment on the ground that there is no genuine issue as to any material fact and that respondent is entitled to judgment as a matter of law.

## **2. Facts Relating To The Backhoe**

7. Respondent's June 13, 1996 assessment included an assessment of use tax on petitioner's June 17, 1991 purchase of a backhoe and on the repairs, equipment, and parts relating to that backhoe.

8. The backhoe was kept at petitioner's Rochester, Wisconsin, location. Too large to fit in the wash plant there, it was used in areas adjoining petitioner's crushing operations and wash plant. The backhoe was used for:

- Developing new settling ponds (30.8%)
- Excavating silt from settling ponds (35.2%)

- Stripping and restoration (33.0%)<sup>3</sup>
- Loading customers' trucks (1.0%)

9. Petitioner developed new settling ponds (a/k/a silt ponds, sewerage ponds, and discharge ponds) by using the backhoe to excavate all the earth and materials in a designated area to create a place to catch the water (which was used in the manufacturing process) and byproducts from the wash plant manufacturing operation. Petitioner excavated rock from the ground, put it through the crushing process, then moved it through the wash plant. Discharged water that had been used to wash rock was caught and stored in a settling pond dug by the backhoe, along with the discharged silt and sand that resulted from that washing. Petitioner developed at least one new settling pond each year.

10. Petitioner also used its backhoe to extract from its existing settling ponds the silt and clay (the byproduct of its manufacturing operation) that had collected in the ponds as a result of washing dirt and debris off the rock and stone. The silt and clay were extracted from the ponds to prolong the ponds' useful lives.

11. Petitioner re-used most of the materials it extracted in the process of establishing new settling ponds; it used most of the materials in the restoration of its excavated areas and sold only a small portion, since the

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<sup>3</sup> Both parties' briefs state that the backhoe was used 30.0% for stripping and restoration of land. An examination of an exhibit and the recalculation of this percentage reflects that the backhoe was used 33.0% for stripping and restoration.

demand for the removed materials was low. Petitioner did not perform any manufacturing processes on the materials that its backhoe removed from its settling ponds. Petitioner did not remove any gravel from its settling ponds with its backhoe.

12. Petitioner's backhoe stripped overburden (i.e., removed topsoil, clay, and other containments) from the area to be excavated. Removed topsoil, clay, and other containments were then stockpiled for restoration of excavated areas after the excavation. Petitioner extracted stone to comply with legal requirements and to prevent erosion and dust. Then the backhoe returned the stripped materials and the materials removed from the settling ponds, to re-landscape the areas dug out by its extraction activities.

13. The backhoe was occasionally used to load material removed from its settling ponds onto a customer's truck. This occasional use amounted to 1% of the backhoe's use. This loading is not a manufacturing activity.

### **3. Facts Relating To The Negligence Penalty<sup>4</sup>**

14. Petitioner did not report or pay any use tax to respondent.

15. Respondent's assessment imposed the 25% negligence penalty on the entire assessment under Wis. Stat. § 77.60(3). Respondent's reasons included:

- Items on which use tax was assessed were not in the "gray area" of whether or not use tax applies.
- Petitioner did not have a system of recording and

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<sup>4</sup> Facts related to the negligence penalty are for the 4-year period under review unless otherwise stated.

reporting use tax, although it has both exempt manufacturing uses and taxable uses for many of the items purchased.

- Petitioner had been previously audited and assessed use tax.

16. Items which petitioner purchased from out-of-state sellers on which petitioner did not report or pay use tax to respondent included paper, office supplies, stationery, paper towels, and Christmas cards.

17. Petitioner had no system of recording or reporting use tax. Petitioner trusted and relied on its suppliers to collect sales tax on its purchases.

18. Petitioner replied to the sales/use tax question on its 1991 through 1995 Wisconsin franchise/income tax returns by checking the "No" box following the question: "Did you purchase any taxable tangible personal property or taxable services for storage, use, or consumption in Wisconsin without payment of a state sales or use tax?" The "Yes" and "No" boxes were followed by the sentence: "If yes, you owe Wisconsin use tax."

19. Respondent conducted at least one use tax audit of petitioner prior to the one giving rise to this case. Results of that audit were contested by petitioner unsuccessfully in *Parkview Sand & Gravel, Inc. v. Wisconsin Department of Revenue*, Wis. Tax Rep. (CCH) ¶ 200-617 (Dane Co. Cir. Ct. 1970).

## ISSUES

1. Is petitioner's 1991 purchase of a backhoe (and safety attachments and repair or replacement parts) which it used in its gravel business exempt from the use tax under Wis. Stat. § 77.54(6)(a)?
2. Was petitioner negligent in failing to report use tax and filing incorrect use tax returns during the period under review? If so, did petitioner show that its filing an incorrect use tax return was for good cause?

### APPLICABLE WISCONSIN STATUTES

**77.54 General exemptions.** There are exempted from the taxes imposed by this subchapter:

\* \* \*

**(6)** The gross receipts from the sale of and the storage, use or other consumption of:

(a) Machines and specific processing equipment and repair parts or replacements thereof, exclusively and directly used by a manufacturer in manufacturing tangible personal property and safety attachments for those machines and equipment.

\* \* \*

**(6m)** For purposes of sub. (6)(a) "manufacturing" is the production by machinery of a new article with a different form, use and name from existing materials by a process popularly regarded as manufacturing. "Manufacturing" includes but is not limited to:

(a) Crushing, washing, grading and blending sand, rock, gravel and other minerals.

**77.60 Interest and penalties.**

\* \* \*

**(3)** If due to neglect an incorrect return is filed, the entire tax finally determined shall be subject to a penalty of 25% ... of the tax exclusive of interest or other penalty. A person filing an incorrect return shall have the burden of proving that the error or errors were due to good cause and not due to neglect.



## CONCLUSIONS OF LAW

1. There is no genuine issue of material fact, and this matter is appropriate for summary judgment as a matter of law. Wis. Stat. § 802.08(2) and (3).

2. Petitioner's 1991 purchase for use in its gravel business of a backhoe and safety attachments and repair or replacement parts is not exempt from the use tax under Wis. Stat. § 77.54(6)(a).

3. Petitioner is liable for the penalty under Wis. Stat. § 77.60(3) because it negligently filed incorrect returns for the four fiscal years in the period under review, and the errors on the returns were not due to good cause.

## RULING

The standard for determining whether summary judgment should be granted was recently stated in *Johnson v. Blackburn*, 220 Wis. 2d 260, 270 (Ct. App. 1998), as follows (without citations):

Summary judgment is appropriate in cases where there is *no genuine issue of material fact* and the moving party has established entitlement to judgment as a matter of law.... If a dispute of any material fact exists, or if the material presented on the motion is subject to conflicting factual interpretations or inferences, summary judgment must be denied....  
[Emphasis added.]

### 1. The Backhoe

Statutes granting tax exemptions are matters of legislative grace and must be strictly construed against granting the exemption. *Ladish Malting Co. v. Wisconsin Department of Revenue*, 98 Wis. 2d 496, 502, 297 N.W. 2d 56

(1980); *Ramrod, Inc. v. Wisconsin Department of Revenue*, 64 Wis. 2d 499, 504, 219 N.W. 2d 604 (1974). Additionally, Wis. Stat. § 77.54(6r) states that "The exemption under ... [§ 77.54(6)] shall be strictly construed". The exemption statute currently under review is Wis. Stat. § 77.54(6)(a).

A taxpayer claiming an exemption must show that the exemption's terms clearly apply to it. *Midcontinent Broadcasting Company of Wisconsin, Inc. v. Wisconsin Department of Revenue*, 98 Wis. 2d 379, 390, 297 N.W. 2d 191 (1980). The burden of bringing the transaction in question within the exact terms of the exemption is on the person claiming the exemption, and any doubts are to be resolved in favor of taxation. *Madison Aerie No. 623 Fraternal Order of Eagles, Inc. v. City of Madison*, 275 Wis. 472, 476, 82 N.W. 2d 207 (1957); *Ladish*, at 502; *Ramrod*, at 504-505.

For petitioner's backhoe and the safety attachments and repair parts purchase to be exempt under § 77.54(6)(a), the backhoe must be (1) a machine or specific processing equipment; (2) used by a manufacturer; (3) used "exclusively" in manufacturing tangible personal property; **and** (4) used "directly" in manufacturing tangible personal property. § 77.54(6)(a).

Petitioner's backhoe is clearly a machine. Petitioner uses the machine and is a "manufacturer". The procedure which raw stone material goes through after its extraction from the ground has long been recognized as a "manufacturing" process. See, *Wisconsin Department of Revenue v. Edward Kraemer & Sons, Inc.*, Wis. Tax Rep. (CCH) ¶ 202-162 (Dane Co. Cir. Ct. 1983).

In addition, "manufacturing" is defined, for this exemption statute, to include "[c]rushing, washing, grading and blending sand, rock, gravel and other minerals." Wis. Stat. § 77.54(6m)(a).

Petitioner uses its backhoe in activities that this commission concludes are *not* covered by the definition of "manufacturing" and, therefore, are not exempt from use tax under § 77.54(6)(a). These nonmanufacturing activities include stripping and restoration of land before and after extracting stone (33%), excavation of earth and materials to create new settling ponds (30.8%), and loading silt onto customers' trucks (1%).

For purposes of this use tax exemption, "manufacturing" is the production by machinery of a new article with a different form, use and name from existing materials by a process popularly regarded as manufacturing." Wis. Stat. § 77.54(6m). In *Kraemer, supra*, the Court stated that manufacturing smaller stones from large stones begins after stone is extracted from the ground.

Petitioner argues that "manufacturing" includes processes occurring before stone extraction and after the raw stone is processed. Prior-to-extraction activities that petitioner asserts constitute part of the manufacturing process include stripping land prior to stone extraction. Petitioner also asserts that manufacturing includes the post-extraction activity of restoring areas from which stone was removed and loading silt onto the

trucks of people who purchase it.<sup>5</sup>

This commission concludes that the above activities are not part of the process of manufacturing raw stone into various types of stone with a different form, use and name from existing materials by a process popularly regarded as manufacturing. The above activities for which the backhoe is used occur *prior to* and *after* the steps comprising manufacturing under § 77.54(6m)(intro). The backhoe does not "directly" affect stone during its transformation from raw stone to its various gradations of end product stone.

Petitioner's reliance upon several Wisconsin Supreme Court cases is misplaced. In *DOR v. Greiling*, 112 Wis. 2d 602, 334 N.W. 2d 118 (1983), the Court concluded that a greenhouse was a "machine" used in floriculture and was entitled to the farm exemption under Wis. Stat. § 77.54(3). The Court describes an exempt machine as one "whose utility is principally and primarily a *significantly contributive factor* in the actual manufacture or production of the product itself." *Greiling*, at 607 [emphasis added]. However, the current case does not involve defining a "machine". Rather, the issue is whether the backhoe is used exclusively and directly in manufacturing.

## **2. The Negligence Penalty**

Respondent imposed the 25% negligence penalty because it concluded that petitioner "due to neglect [filed] an incorrect return.... A person

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<sup>5</sup> Because petitioner's backhoe is used in significant non-manufacturing activities which do not qualify it for the subject exemption, it is not necessary for the Commission to determine whether the excavation of silt from settling ponds is part of "manufacturing" under § 77.54(6m).

filing an incorrect return shall have the burden of proving that the error or errors were *due to good cause and not due to neglect.*" Wis. Stat. § 77.60(3).

[Emphasis added.]

Negligence in filing an incorrect use tax return has been described as "failure to use ordinary care as well as violations of statutory duties."<sup>6</sup> The record in this case supports respondent's assertion that petitioner should have been aware of the requirement of reporting and paying use tax to respondent.

Several factors demonstrate petitioner's negligence in filing incorrect use tax returns. Petitioner should have known of its statutory obligation.

First, petitioner was audited for use tax and was assessed additional use tax for the period April 1, 1964 through December 31, 1966. On September 8, 1967, respondent issued to petitioner an assessment of additional use tax. Accountant Gayle R. Dvorak and an attorney represented petitioner in litigating the appeal of the assessment. Petitioner ultimately lost the dispute. *See, Parkview Sand & Gravel, Inc. v. Wisconsin Department of Revenue*, Wis. Tax Rep. (CCH) ¶ 200-617 (Dane Co. Cir. Ct. 1970).

Second, petitioner had no internal system of recording and reporting use tax during the current audit period.

Third, the following question appeared on petitioner's annual franchise/income tax returns for the four years under review: "Did you

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<sup>6</sup> *Reid & Associates, Inc., v. Wisconsin Department of Revenue*, (CCH) ¶ 200-617 (Dane Co. Cir. Ct. 1970).

purchase any taxable tangible personal property or taxable services for storage, use or consumption in Wisconsin without payment of a state sales or use tax?" On each tax return, petitioner responded "No". That inquiry should have alerted petitioner to the taxability of tangible personal property which was purchased without paying a sales or use tax, for example, to an out-of-state seller.

Petitioner contends that the majority of items for which use tax was assessed were "not in the gray area".<sup>7</sup> The implication appears to be that it was not negligence for petitioner to not know that these items were subject to use tax. But, to the contrary, many items on which use tax was assessed were clearly subject to sales tax; and if sales tax was not paid, use tax was due. These items include paper, office supplies, stationery, paper towels, and Christmas cards. Petitioner knew or should have known that purchases of these items of tangible personal property were clearly taxable. Not reporting or paying use tax on their purchase constitutes negligence.

To show that this negligence penalty does *not* apply, "A person filing an incorrect return shall have the burden of proving that the error or errors were due to good cause and not due to neglect." § 77.60(3). Petitioner advances three arguments to meet its burden of proof.

First, petitioner contends that it "trusted and relied on its

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<sup>7</sup> Affidavit of Gayle R. Dvorak, CPA, January 18, 1999, page 2, submitted with petitioner's brief opposing respondent's motion for summary judgment, dated January 19, 1999.

suppliers to collect sales tax on its purchases" (petitioner's brief, p. 8); that its business is closely monitored by its accountant who is experienced in the field of sales/use taxes; and that respondent's auditors did not apply the negligence penalty in a prior sales/use tax audit of petitioner's books and records (and the method and practice of keeping them had not changed since petitioner's formation).

The duty of filing correct and complete sales/use tax returns rests on petitioner. It may not delegate this requirement and thereby avoid responsibility for compliance with the law. Petitioner's assertions that compliance was not its own fault because it relied upon its suppliers, its accountant or respondent's auditors are not persuasive.

This commission has not accepted the "it's the accountant's fault" defense as "reasonable cause" and rejects it again. *Anthony J. Kryshak v. Wisconsin Department of Revenue*, Wis. Tax Rep. (CCH) ¶ 203-084 (1989), concurring opinion, p. 14,357. See, also, *Wimmer Construction, Inc. v. Wisconsin Department of Revenue*, 1998 Wisc. Tax LEXIS 36 (WTAC Oct. 22, 1998) and cases cited therein.

A taxpayer has the duty of complying with the sales/use tax law. "It was not reasonable for petitioner's owners and officers to rely on the determination of the prior audit as a clean bill of health for all future transactions." *Wimmer Construction, Inc.*, *supra*, p. 6. It is even more unreasonable in the instant case because a use tax liability resulted from and was upheld on a

prior appeal.

Second, petitioner asserts "good cause" by stating its reliance on its accountant's statement to it that the majority of transactions to which use tax was assessed "were not in the gray area". This argument is rejected above and does not constitute "good cause" for filing incorrect sales/use tax returns.

Third, petitioner requests reversal of the negligence penalty because "petitioner believed in good faith that it was entitled to the exemption". Petitioner's brief, p. 9. This commission holds that a good faith belief which is incorrect does not constitute "good cause" to void the penalty.

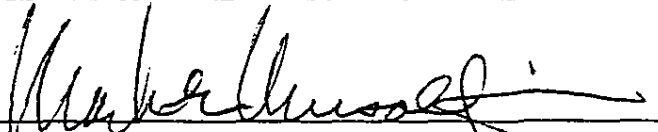
Therefore,

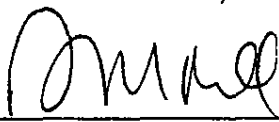
**IT IS ORDERED**

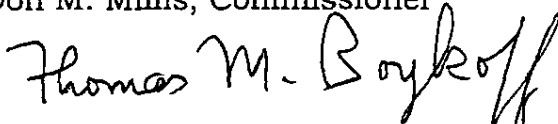
That respondent's motion for summary judgment is granted, and its action on the petition for redetermination is affirmed.

Dated at Madison, Wisconsin, this 22nd day of June, 1999.

**WISCONSIN TAX APPEALS COMMISSION**

  
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Mark E. Musolf, Chairperson

  
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Don M. Millis, Commissioner

  
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Thomas M. Boykoff, Commissioner

ATTACHMENT: "NOTICE OF APPEAL INFORMATION"