

STATE OF WISCONSIN
TAX APPEALS COMMISSION

BADGER STATE ETHANOL, LLC,

**DOCKET NOS. 06-S-199,
06-S-200, 06-S-201,
06-S-202 AND 07-S-45**

Petitioner,

vs.

RULING AND ORDER

WISCONSIN DEPARTMENT OF REVENUE,
Respondent.

DAVID C. SWANSON, COMMISSIONER:

This matter comes before the Commission on the following motions: (1) respondent's motion to dismiss petitioner's petitions for review in Docket Numbers 06-S-199, 06-S-200, 06-S-201 and 06-S-202; (2) petitioner's motion for leave to file a supplemental memorandum of law in response to respondent's motion to dismiss; and (3) petitioner's motion to consolidate Docket Number 07-S-45 with Docket Numbers 06-S-199 through 06-S-202. Petitioner, Badger State Ethanol, LLC, a Wisconsin limited liability company ("Badger State"), is represented by Attorney Robert L. Gordon of Michael Best & Friedrich LLP. Respondent, the Wisconsin Department of Revenue ("Department"), is represented by Attorney Linda M. Mintener.

PROCEDURAL HISTORY

On August 3, 2006, Badger State filed its petitions for review in Docket Numbers 06-S-199 through 06-S-202. On September 8, 2006, the Department filed its answer, accompanied by a notice of motion and motion to dismiss for failure to state a

claim upon which relief can be granted (“motion to dismiss”), with supporting affidavit, exhibits and brief. Badger State filed its response on November 1, 2006 and the Department filed its reply brief on November 22, 2006.

On December 11, 2006, Badger State filed a motion for leave to file a supplemental memorandum of law in opposition to the Department’s motion to dismiss (“motion for leave”), as well as the proposed supplemental memorandum. On January 9, 2007, the Department filed its objection to the motion for leave.

On March 19, 2007, Badger State filed the petition for review in Docket Number 07-S-45. On March 27, 2007, Badger State filed a motion to consolidate Docket Number 07-S-45 with Docket Numbers 06-S-199 through 06-S-202, and the Department filed its objection to that motion on April 2, 2007.

Based on the parties’ motions, supporting documents, and the entire record in these matters, the Commission finds, concludes, rules, and orders as follows:

JURISDICTIONAL AND MATERIAL FACTS

1. The petitioner in these matters is Badger State Ethanol, LLC, a Wisconsin limited liability company (“Badger State”). Badger State manufactures ethanol from corn and has been engaged in that business since 2002.

2. Badger State purchases and utilizes natural gas in the production of ethanol from corn.

3. Before 2005, Badger State paid no Wisconsin sales or use tax on its purchases of natural gas.

4. After determining that it owed Wisconsin use tax on certain purchases of natural gas made prior to 2005, Badger State applied for and was accepted

into the Department's Voluntary Disclosure Program. In connection with that application, Badger State executed an Agreement and Election to Precollect the Wisconsin Sales/Use Tax on December 16, 2005 (the "Agreement"). The Department executed the Agreement on January 3, 2006.

5. In the Agreement, the parties agreed as follows:

[Badger State] agrees to pay any tax due, late filing fees and interest at the annual rate of 18% on each of the prior years' quarterly returns. The Department agrees not to assess any negligence or other civil or criminal penalties for late filing for any of the prior periods. [Badger State] agrees to waive its right to appeal the late filing fee and interest. Full payment may be submitted with the returns, or must be submitted by the due date on the Department's notice of amount due issued after receipt of the returns. (Mintener Aff., Ex. 1.)

6. On or about December 22, 2005, pursuant to the application and Agreement, Badger State filed nine Wisconsin Sales and Use Tax Returns covering nine consecutive quarters, which were the fourth quarter of 2002 and all four quarters of 2003 and 2004 (the "2002-2004 Returns").

7. On the 2002-2004 Returns, Badger State reported total use tax due (plus \$180 in late filing fees) for the covered period in the amount of \$516,675.69.

8. Badger State remitted \$445,487.23 (including use tax, interest and \$180 in late filing fees) to the Department with the 2002-2004 Returns.

9. The Department accepted Badger State's payment of \$445,487.23 as partial payment of the total amount reported due on the 2002-2004 Returns.

10. On December 22, 2005, Badger State also filed a Form BCR Buyers Claim for Refund (the "Form BCR") with the Department claiming a refund of sales tax

paid in 2005 in the total amount of \$238,452.00. On April 6, 2006, Badger State filed a supplementary Form BCR revising the refund amount claimed to \$246,143.30 (the “2005 Refund Claim”).

11. In its 2005 Refund Claim, Badger State contends that its purchasing agent, US Energy Services, Inc., overpaid Wisconsin sales taxes on certain purchases of natural gas for Badger State, because some of the purchases at issue were either exempt from sales tax or otherwise non-taxable under Wis. Stats. §§ 77.54(26), 77.51(4)(b)5 and 77.51(15)(b)3.

12. In calculating the remittance sent with the 2002-2004 Returns, Badger State used the approximate amount of the 2005 Refund Claim made on Form BCR to partially offset the total amount due reported on those returns.

13. On March 15, 2006, the Department issued to Badger State Notices of Amount Due of unpaid use tax with respect to four of the nine 2002-2004 Returns (the “Notices of Amount Due”), specifically, the four returns for 2004 (the “2004 Returns”). The Notices of Amount Due determined that the following total amounts of use tax and interest remained due on the respective 2004 Returns: \$40,646.33 (1st quarter); \$64,799.67 (2nd quarter); \$68,123.77 (3rd quarter); and \$76,443.59 (4th quarter).

14. In issuing the Notices of Amount Due, the Department refused to credit Badger State’s 2005 Refund Claim against any portion of its use tax liability reported on the 2002-2004 Returns. Instead, the Department allocated Badger State’s partial payment of the amounts of use tax and late filing fees reported due on the 2002-2004 Returns to tax, interest and late filing fees for the covered period, and allocated the resulting deficiency in tax and interest to the 2004 Returns.

15. On or about May 12, 2006, Badger State filed a timely petition for redetermination with respondent of each of the four Notices of Amount Due.

16. On June 5, 2006, respondent issued to Badger State four Notices of Action respectively denying each of the four petitions for redetermination (the “Notices of Action”).

17. On July 24, 2006, the Department denied Badger State’s 2005 Refund Claim made on Form BCR.

18. On August 3, 2006, Badger State filed a petition for review with the Commission of the Department’s actions in each of the four Notices of Action, which were assigned Docket Numbers 06-S-199, 06-S-200, 06-S-201 and 06-S-202, respectively.

19. On September 15, 2006, Badger State filed a petition for redetermination of the Department’s denial of Badger State’s 2005 Refund Claim.

20. On March 14, 2007, the Department issued a Notice of Action denying Badger State’s petition for redetermination of the Department’s denial of the 2005 Refund Claim.

21. On March 19, 2007, Badger State filed a petition for review of the Department’s action on Badger State’s petition for redetermination of the denial of the 2005 Refund Claim, which was assigned Commission Docket Number 07-S-45.

22. Badger State admits that it is liable for the amounts of Wisconsin use tax that it reported on its 2004 Returns.

RULING

1. Badger State’s Motion for Leave

The Department filed its motion to dismiss with a brief in support of the motion. Pursuant to the Commission's Amended Briefing Order dated October 3, 2006, Badger State filed its brief in response to the motion on October 31, 2006 and the Department filed its reply brief on November 22, 2006. Arguing that the Department's reply brief contained a number of new arguments not offered in its initial brief, Badger State filed a motion for leave to file a supplemental memorandum in opposition to the motion to dismiss with its proposed supplemental memorandum. The Department filed an objection to that motion, which also included a brief in response to Badger State's proposed supplemental memorandum.

The Commission's standard practice is to require the submission of a brief or memorandum of law with any motion that is dispositive of a case, and then to order the submission of a brief in response to the motion by the non-moving party and a reply brief by the moving party. The Commission expects the parties to cover their arguments thoroughly in their main briefs, and for the moving party to follow the same lines of argument in its reply brief.

The Commission does not have a rule that prohibits submitting additional or supplemental briefs; however, the Commission discourages this practice in the interest of judicial economy. As cited by the Department, the Commission recently denied the petitioner's motion for leave to file a "surreply brief" in *Parisian, Inc. v. Wis. Dep't of Revenue*, Docket No. 05-S-52, Order Denying Motion for Leave to File a Surreply Brief (Oct. 21, 2005). In that case, the petitioner also argued that the Department had raised new arguments in its reply brief. The Commission denied the motion based on its finding that the arguments made in the Department's reply brief were not new

arguments, but instead “respond[ed] to the arguments raised by [petitioner] in its response brief, and repeat[ed] the arguments advanced in the Department’s motion for summary judgment and initial brief in support thereof.”

We reach the opposite conclusion here. Without reciting the many arguments offered in the parties’ various briefs, which are discussed below, we agree that the Department raises important new arguments in its reply brief that were not included in its initial brief. In the interest of fairness and to develop a more complete analysis of the legal issues involved in the Department’s motion to dismiss, the Commission grants Badger State’s motion for leave to file a supplemental memorandum in opposition to the Department’s motion, accepts Badger State’s supplemental memorandum and makes it a part of the record, and likewise accepts the Department’s brief included in its objection to Badger State’s motion for leave and makes it a part of the record.

2. The Department’s Motion to Dismiss

On September 8, 2006, the Department filed a notice of motion and motion to dismiss Docket Numbers 06-S-199 through 06-S-202 with a supporting brief arguing that Badger State failed to state a claim upon which relief can be granted, pursuant to Wis. Stat. § 802.06(2)(a)(6) and Wis. Admin. Code §§ TA 1.31(1) and 1.39.¹ Utilizing a number of theories, the Department generally argues that the Commission must dismiss these petitions because it lacks jurisdiction over the subject claims.

The Commission has jurisdiction to review actions of the Department

¹ In its notice of motion and motion to dismiss, the Department states that it will move to dismiss these actions at a date and time to be set by the Commission. Because the Commission has determined that no hearing on the motion is necessary, the Commission construes the motion as made.

pursuant to a timely petition for review filed by any person “who has filed a petition for redetermination with the department of revenue and who is aggrieved by the redetermination of the department of revenue” Wis. Stat. § 73.01(5)(a). Subject to judicial review, the Commission is “the final authority for the hearing and determination of all questions of law and fact” arising under certain enumerated statutes, including those governing sales and use tax under Wis. Stat. § 77.59(5m) and (6)(b). Wis. Stat. § 73.01(4)(a). Not included in that list is Wis. Stat. § 77.59(5), which governs offsets of sales and use tax deficiencies and refunds and related interest and penalties. Under that section, the Department “may offset the amount of any refund for a period, together with interest on the refund, against deficiencies for another period, and against penalties and interest on the deficiencies, or against any amount of whatever kind, due and owing on the books of the department from the person who is entitled to the refund.” Wis. Stat. § 77.59(5).

Badger State argues that the Commission has jurisdiction over the Department’s offset decisions by reference to Wis. Stat. § 77.59(6)(b), which states as follows: “Appeals from the department's redeterminations shall be governed by the statutes applicable to income or franchise tax appeals but all appeals from decisions of the tax appeals commission with respect to the taxes imposed by this subchapter shall be appealed to the circuit court for Dane County.” Wis. Stat. § 77.59(6)(b). Badger State essentially argues that this provision is a catch-all that provides the Commission with jurisdiction over every discretionary action taken by the Department pursuant to a redetermination. We do not agree.

The Commission’s jurisdiction is both granted and circumscribed by Wis.

Stat. § 73.01(4)(a). By not including Section 77.59(5) within the Commission's jurisdiction, the Legislature effectively excluded it. In addition, Section 77.59(5) specifically provides that decisions under that subsection are made at the Department's discretion. Consequently, we hold that the Department's decisions regarding offsets of sales and use tax deficiencies and refunds made under Wis. Stat. § 77.59(5) are made at the Department's discretion and generally are not subject to review by the Commission.

However, even where the statutes grant the Department discretion, the Commission has jurisdiction to review the Department's actions where there is a credible allegation that the Department has abused its discretion by acting in manner that is arbitrary, capricious or without reason. *See, e.g., Wis. Dep't of Revenue v. Sentry Financial Services Corp.*, 161 Wis. 2d 902, 910 n. 7, 469 N.W.2d 235 (Ct. App. 1991); *Drywall Service, Inc. v. Wis. Tax Appeals Com'n*, Wis. Tax Rptr CCH ¶200-758, Dane Co. Cir. Ct. No. 134-360 (Dec. 31, 1971). Thus, before granting the Department's motion, we must determine whether Badger State can make a credible allegation that the Department has abused its discretion in these cases.

Badger State does not dispute that it is liable for the full amount of use tax reported due on its 2004 Returns. Indeed, to be accepted into the Department's Voluntary Disclosure Program, Badger State executed an Agreement and Election to Precollect the Wisconsin Sales/Use Tax with the Department (the "Agreement") on December 16, 2005, which the Department accepted on January 3, 2006. In the Agreement, Badger State specifically agreed "to pay any tax due, late filing fees and interest at the annual rate of 18% on each of the prior years' quarterly returns," and further agreed "to waive its right to appeal the late filing fee and interest." Badger State filed its 2004 Returns pursuant to the Agreement.

Badger State contends that it has paid in full the amounts due on the 2004 Returns, because part of that amount is offset by the amount Badger State believes it is owed under the 2005 Refund Claim. In response, the Department argues that Badger State cannot unilaterally obtain an offset of an amount that both parties agree is due with a refund claim that the Department has denied.

Badger State's claim is analogous to a claim for equitable recoupment, a common law doctrine applied by the Commission in some prior cases involving disputes over offsets, although Badger State never refers to its claim as such. *See, generally, Oshkosh Truck Corp. v. Wis. Dep't of Revenue*, Wis. Tax Rptr CCH ¶400-811 (WTAC No. 03-I-343 (P), Feb. 11, 2005). Under that doctrine, the Department may reduce a timely claim for a tax refund by the amount of a deficiency assessment barred by the statute of limitations, or, if the Department makes a timely additional assessment against a taxpayer, the taxpayer may claim credit against the deficiency for a refund that would otherwise be barred by the statute of limitations. *American Motors Corp. v.*

Wis. Dep't of Revenue, 64 Wis.2d 337, 351, 219 N.W.2d 300, 307 (1974); *Wis. Dep't of Revenue v. Van Engel*, 230 Wis. 2d 607, 614, 601 N.W.2d 830 (Ct. App. 1999); *Dairyland Harvestore, Inc. v. Wis. Dep't of Revenue*, 151 Wis.2d 799, 447 N.W.2d 56 (Ct. App. 1989).

However, equitable recoupment can only apply where the refund and the tax assessment at issue arise from the same transaction or tax period. *Id.* That is clearly not the case here, where the deficiencies at issue arise from transactions and applicable use taxes reported on Badger State's 2004 Returns, and its refund claim arises from sales taxes on transactions reported and paid in 2005. Moreover, in *Van Engel*, the Court indicated that equitable recoupment would be "improper when the State did not inconsistently tax the taxpayer and when there was no conduct by the State preventing the taxpayer from timely claiming a credit." *Van Engel* at 618 (citations omitted). Here, the Department has not taxed Badger State on an inconsistent basis, and the Department did nothing to prevent Badger State from timely filing the 2005 Refund Claim, which is now also before the Commission in Docket Number 07-S-45. Thus, equitable recoupment would not apply in these cases.

Attempting to construct a similar rationale, Badger State hangs virtually its entire case on the Dane County Circuit Court bench opinion delivered in *Madison Gas & Electric Co. v. Wis. Dep't of Revenue*, Wis. Tax Rptr. CCH ¶400-332 (WTAC No. 97-I-55, December 15, 1997); *rev'd*, Dane Co. Cir. Ct. No. 97-CV-3415, Tr. at 63 (Transcript of Oral Argument and Decision on Motion by Petitioner for Judicial Review of Decision by the Internal Revenue Commission [sic], June 17, 1998); *aff'd on other grounds*, 230 Wis.2d 746, 604 N.W.2d 33 (Ct. App. 1999) (unpublished opinion) ("*MG&E*"). This is a heavy load to put on the scant analysis provided in the Circuit Court's bench opinion in *MG&E*,

which, in the end, simply cannot support Badger State's claims.

As a preliminary matter, it is by no means clear that the Circuit Court's bench opinion in *MG&E* has much precedential authority. Because the Court of Appeals affirmed the Circuit Court in an unpublished opinion, the Court of Appeals opinion cannot be cited as precedent. In its unpublished opinion, the Court of Appeals did not discuss the Circuit Court's bench opinion, but rather applied the standard rule and analyzed only the Commission's opinion. See, *Advance Pipe & Supply Co., Inc. v. Wis. Dep't of Revenue*, 128 Wis.2d 431, 434, 383 N.W.2d 502, 503 (Ct. App. 1986). Furthermore, the Court of Appeals did not even reach the issue of offsets that is at the heart of Badger State's claim.

In addition to its questionable precedential value, *MG&E* is readily distinguishable on its facts from these cases. In *MG&E*, the taxpayer utility suffered a loss when a 63-mile transmission line was destroyed. The taxpayer claimed the loss as a corporate franchise (income) tax deduction over three years (1975-1977). The Department denied the deduction for the years claimed because the taxpayer eventually received a settlement from a third party for the loss, arguing that the loss was offset by the recovery in its year of receipt (1978). For the four-year audit period that was at issue in *MG&E*, the Department assessed underpayments for three years (1976, 1977 and 1979) and found an overpayment in the other year (1978). All four years were covered in the Department's original audit assessment and were the subject of the taxpayer's petition for redetermination and petition for review before the Commission. The dispute between the parties focused on the timing and the amount of the offset of the underpayments and associated interest by the overpayment and its related interest.

The Commission ruled for the Department on the issue of the loss deduction, and further held that the calculation of interest on amounts overpaid and amounts underpaid was within the Department's discretion under Wis. Stat. § 71.09(10) (1981-82). The Circuit Court reversed the Commission's ruling on both issues and held that the Department's timing of the calculation of interest offsets was not discretionary, essentially adopting the taxpayer's position that the Department should have credited the 1978 overpayment as of the date paid against the 1976 and 1977 underpayments and interest accrued to the date of that overpayment, and then calculated twelve percent interest on only the net amount of taxes remaining. The Court of Appeals affirmed the Circuit Court, but provided a legal analysis of only the issue of the loss deduction in its unpublished opinion.

In Badger State's cases, the Department does not concede that there has been any overpayment and has denied Badger State's 2005 Refund Claim. In addition, there is no dispute regarding the amounts of the underpayments at issue, which Badger State reported on its 2004 Returns. Also unlike *MG&E*, the amounts at issue in these cases did not result from a single audit and assessment, but rather are the subjects of separate actions for different tax years. Finally, the 2005 Refund Claim involves a completely different set of facts that implicate the statutes governing sales tax exemptions, which are not at issue in the 2004 Returns.

The legal issues are similarly distinguishable. As the Department correctly points out, *MG&E* involved a franchise/income tax matter that arose under Wis. Stat. § 71.82(1)(b), which does not apply to sales and use tax. Section 71.82(1)(b) generally involves the timing of interest paid on income tax refunds, and does not state

that the method used to credit such interest is within the Department's discretion. In contrast, Wis. Stat. § 77.59(5) specifically provides that decisions regarding offsets of use tax refunds and related interest are within the Department's discretion.

Badger State's main concern appears to be the difference in the interest rates applied to the claims at issue. Interest is accumulating on the deficiency assessed on the 2004 Returns at a rate of 18%, while interest on the 2005 Refund Claim runs at just 9%. Badger State argues that it is being "whipsawed" by the differential in these rates, which excessively favor the Department. (Pet. Brief at 8, n. 11.) However, Badger State agreed to pay interest at the 18% rate and waived its right to appeal that interest pursuant to the Agreement. Second, Badger State could have stopped the accumulation of interest on the deficiency at the 18% rate by paying the amount due while pursuing the 2005 Refund Claim before the Commission. Third, the 2005 Refund Claim remains pending before the Commission. Badger State will only be paid interest on that claim if its appeal succeeds, which may or may not occur. Finally, the interest rates applied to sales and use tax deficiencies and refund claims have been set by statute by the Legislature. *See*, Wis. Stat. § 77.60. The Commission has neither the power nor the authority to alter them or their application.

As noted above, the Commission's jurisdiction is limited to questions of law and fact arising under the statutes enumerated in Wis. Stat. § 73.01(4)(a), which do not include Wis. Stat. § 77.59(5). Instead, Section 77.59(5) states that the determination of offsets of any amounts of sales and use tax assessments, interest and penalties against refund claims is within the discretion of the Department. Badger State has not made a

credible allegation that the Department has abused its discretion under Section 77.59(5); indeed, the Department's decisions in these cases appear to be entirely reasonable. Therefore, we hold that the Commission does not have jurisdiction to hear the petitions filed by Badger State in Docket Numbers 06-S-199 through 06-S-202.²

Finally, as an alternative position, Badger State suggests that the Commission stay Docket Numbers 06-S-199 through 06-S-202 until it issues a final ruling in Docket Number 07-S-45, which the Commission construes as a motion to stay. Such a stay would serve no purpose other than to delay the resolution of Docket Numbers 06-S-199 through 06-S-202, because the Commission has determined that it has no jurisdiction in those matters. If Badger State's 2005 Refund Claim fails, then Badger State will owe the same amount currently assessed on the 2004 Returns. If its 2005 Refund Claim succeeds, in whole or in part, then the Department will have the discretion under Wis. Stat. § 77.59(5) to offset with the refund other amounts owed by Badger State, if any, or pay the refund directly to Badger State.

² The Department offers a number of additional theories in support of its argument that the Commission lacks jurisdiction over Docket Numbers 06-S-199 through 06-S-202. For the reasons discussed herein, we agree that the Commission lacks jurisdiction over Docket Numbers 06-S-199 through 06-S-202 and thus do not reach the Department's additional arguments.

3. Badger State's Motion to Consolidate

On March 19, 2007, Badger State filed the petition for review of the Department's action on Badger State's petition for redetermination of the Department's denial of Badger State's 2005 Claim for Refund, which was assigned Commission Docket Number 07-S-45. On March 27, 2007, Badger State filed a motion to consolidate Docket Number 07-S-45 with Docket Numbers 06-S-199 through 06-S-202, and the Department filed its objection to that motion on April 2, 2007. As discussed above, the Commission finds that these matters concern very different issues of fact and law, and that consolidation thus is not appropriate.

Based on the findings of fact and law described above,

IT IS ORDERED

1. Badger State's motion for leave to file a supplemental memorandum of law in response to the Department's motion to dismiss is granted, and its supplemental memorandum of law is accepted and made a part of the record in Docket Numbers 06-S-199, 06-S-200, 06-S-201 and 06-S-202.

2. The Department's memorandum of law included in its objection to Badger State's motion for leave to file a supplemental memorandum of law in response to the Department's motion to dismiss is also accepted and made a part of the record in Docket Numbers 06-S-199, 06-S-200, 06-S-201 and 06-S-202.

3. Badger State's motion to stay Docket Numbers 06-S-199, 06-S-200, 06-S-201 and 06-S-202 until the Commission issues a final ruling in Docket Number 07-S-45 is denied.

4. The Department's motion to dismiss Badger State's petitions for review in Docket Numbers 06-S-199, 06-S-200, 06-S-201 and 06-S-202 is granted.

5. Badger State's motion to consolidate Docket Number 07-S-45 with Docket Numbers 06-S-199 through 06-S-202 is denied. The Commission will contact the parties to arrange a status conference to discuss further proceedings in Docket Number 07-S-45.

Dated at Madison, Wisconsin, this 26th day of September, 2007.

WISCONSIN TAX APPEALS COMMISSION

Diane E. Norman, Acting Chairperson

David C. Swanson, Commissioner

ATTACHMENT: "NOTICE OF APPEAL INFORMATION"