

STATE OF WISCONSIN
TAX APPEALS COMMISSION

SELKEY, LLC,

Petitioner,

DOCKET NOS. 11-M-322,
12-M-175, 12-M-176, 12-M-177,
12-M-178, 12-M-179, 12-M-219,
13-M-31, 13-M-032, 13-M-33,
13-M-34, AND 13-M-35

vs.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

RULING AND ORDER

LORNA HEMP BOLL, CHAIR:

This matter comes before the Commission on the Cross-Motions for Partial Summary Judgment. This case involves classification of Petitioner's activities and the standard for determining the classification of those activities. The parties are faced with confidentiality issues involving Petitioner's processes. Once the standard is clarified, the discovery issues may be narrowed.

In its order of February 2, 2013, the Commission requested each of the parties to brief the issue, setting forth its proposed standard and its reasons therefor. Classification is determinative of the tax status of Petitioner's real and personal property for the tax years 2011 and 2012.

The Petitioner is represented by Attorney Patrick Dewane, Jr., Manitowoc, Wisconsin. The Department is represented by Attorney La Keisha Wright Butler. Both parties have submitted briefs and supplemental affidavits and information. Both have objected to each other's filings as well as each other's conclusions.

FACTS

Petitioner is involved in the cheese-making process. There may be an issue for trial as to whether cheese-aging is Petitioner's primary business activity, but, for simplicity for the sake of this motion, we will assume the Petitioner is in the business of aging cheese for other cheese-making companies. Petitioner has objected to certain discovery by the Department. In order to determine what discovery is in fact relevant to the resolution of this case, we need to determine what standard will be applied to the evidence to determine the classification of Petitioner's activities.

APPLICABLE LAW

Wis. Stat. § 70.995(1)(a): In this section "manufacturing property" includes all lands, buildings, structures and other real property used in manufacturing, assembling, processing, fabricating, making or milling tangible personal property for profit. Manufacturing property also includes warehouses, storage facilities and office structures when the predominant use of the warehouses, storage facilities or offices in support of the manufacturing property, and all personal property owned or used by a person engaged in this state in any of the activities mentioned, and used in the activity, including raw materials, supplies, machinery, equipment, work in process and finished inventory when located at the site of the activity.

Wis. Stat. § 70.995(2): In addition to the criteria set for in sub. (1), property shall be deemed prima facie manufacturing property and eligible for assessment under

this section if it is included in one of the following major group classifications set forth in the standard industrial classification manual, 1987 edition, published by the U.S. office of management and budget.

...

(c) 20 -- Food and kindred products.

SIC 2022 Code -- Cheese; Natural and Processed.

Establishments primarily engaged in manufacturing natural cheese (except cottage cheese), processed cheese, cheese foods, cheese spreads, and cheese analogs (imitations and substitutes). These establishments also produce by-products, such as raw liquid whey. Establishments primarily engaged in manufacturing cottage cheese are classified in Industry 2026, and those manufacturing cheese-based salad dressings are classified in Industry 2035.

SIC 4022 Code -- Refrigerated Warehousing and Storage.

This category includes establishments primarily engaged in the warehousing and storage of perishable goods under refrigeration. The establishments may also rent locker space for the storage of food products for individual households and provide incidental services for processing, preparing, or packaging such food for storage. Establishments primarily selling frozen foods for home freezers (freezer and locker meat provisioners) are classified in SIC 5421: Meat and Fish (Seafood) Markets, Including Freezer Provisioners.

Manufacturers, Wisconsin Department of Revenue,

¶401-581, Publication No. 203, May 2012.

**SCOPE OF MANUFACTURING
IN SPECIFIC SITUATIONS**

1. CHEESE PLANT

The **manufacturing process** in a cheese plant where raw milk is converted into cheese **includes the aging** of and the cutting and wrapping of the cheese it manufactures. Machines and processing equipment used exclusively and directly in either of these processes are exempt under sec. 77.54(6)(a), Wis. Stats.

ISSUE

The parties have proposed vastly different standards for determining

whether the business activities of the Petitioner should be classified as manufacturing, which would in turn result in tax exemptions for the real and personal property. The law is clear and the parties agree that aging is part of the manufacturing process. The question is: When does aging end and storage begin?

The Department's Proposed Standard

The Department asserts a standard based upon the federal labeling regulations which indicate that each type of cheese must be aged at least a minimum amount of time in order to be qualified to be labeled as such. Once the product has aged that minimum amount of time, the Department argues that the aging process, for the purposes of classification, and therefore taxation, ends and storage begins.

The Petitioner's Proposed Standard

The Petitioner asserts that the standard should be based upon the totality of the facts regarding Petitioner's activities at its various locations. These aspects include such details as the conditions under which the cheese is kept, the degree of direction and control exercised by the cheese owner, and the general basis upon which the cheese owner is charged for Petitioner's services.

RULING

The Commission does not adopt the idea that aging stops at the moment the cheese reaches some minimum standard after which it can legally be labeled a particular type of cheese. The Commission will instead apply a standard which evaluates Petitioner's activities over the time they possess the cheese to determine whether the cheese in question is being aged or stored. In addition, of course, the Commission will

evaluate the extent to which the Petitioner engages in other activities when it determines whether cheese aging is the Petitioner's primary activity.

In this state, referred to as America's Dairyland, there is surprisingly little guidance available on this issue either in the statutes or in our prior decisions. Both parties have pointed toward the Standard Industrial Classification (SIC) Manual. Correctly, they note that companies engaged in the manufacture of cheese fall under SIC Code section 2022. The Department has for the most part conceded, and rightly so, that aging is part of the manufacturing process. Property and equipment used in the manufacturing process is exempt from taxation.

The parties also note that SIC Code 4222 governs refrigerated warehousing and storage. These activities are not considered as part of the manufacturing process and therefore the property and equipment involved would not be exempt from taxation.

The case before us turns on identifying the point at which, if at all, Petitioner's activities move from SIC Code 2022 to SIC Code 4222. The Petitioner contends it is not involved in warehousing or storage because it ships the cheese out within 3 days of notice by the cheese manufacturer that aging is complete. Petitioner contends that the manufacturer participates in, oversees, and directs much of what Petitioner does with the cheese it is handling. These facts would need of course to be proven at trial, but, for the sake of this motion, we will take that assertion as true. So, does the owner/manufacturer get to decide when the cheese has finished aging or does the process stop for tax purposes at the earliest legal point for the cheese to be able to be labeled a particular type of cheese? We hold that the use of the labeling guidelines is inappropriate for several reasons.

First, like wine or bourbon or tobacco or meats, a manufacturer is selling a specialized good, one aspect of which is flavor. Flavor in turn is a function of the manufacturer's decisions on such variables as aging. Although cheese may, for example, be capable of being labeled parmesan after six months, Kraft may have certain quality/flavor parameters which Kraft believes are improved with aging in a certain manner such that Kraft would not sell that cheese until a pre-determined amount of additional aging occurs. (Again, these are issues to be proven at trial.) Thus, even though the product can be labeled in a certain way on a certain date, the manufacturing process is not complete.

Second, if the manufacturing process also includes the slicing and packaging of the cheese for retail, then the Department's argument that the bulk cheese is ready because it is "salable" at retail must fail.

Third, we look to IRS for insight. The IRS has pronounced guidelines for the categorization of steps in the wine-making process to determine how different tax rules apply. See *The Wine Industry Audit Technique Guide*, 2011 ARD 094-12 (May 13, 2011), IRPO ¶ 220,002 (*Audit Technique Guide for Wine Industry*, Internal Revenue Service, March 2011). In that article, the IRS analyzed the definition of the "production period" in the wine-making context:

One national accounting firm has promoted the concept that the production period should terminate at the "release date." The release date is when the wine is officially offered to the winery's distribution chain. The Service supports this determination of the end of the production period. Prior to the release date, the winery is purposely holding the wine for aging. After the release date, the wine remains unsold

only due to sales or marketing restrictions. Often, a winery will have published release dates for its wines. Barring that, the first shipping invoice for general sales may be determinative.

We liken cheese to wine. The cheese manufacturing (production) process is complete when the manufacture has produced cheese it desires to distribute/sell. If a manufacturer such as Kraft wishes to age its cheese for a certain period of time longer than the minimum required for retail labeling, that activity should not be taxed as though production is complete. Aging does not become storage until the cheese manufacturing process is complete as determined by the manufacturer. Thus, among other factors, we will evaluate the extent to which the cheese owner is involved in the Petitioner's aging process.

Fourth, we are not persuaded that a bright-line test is needed because it is easier or because the primary manufacturer has subcontracted the aging process out to the Petitioner. The type of proof required at trial is not substantially different whether the aging is done in house or by another entity.

We believe we are on the right track with our analysis when we note the legislation pending before both houses of our state legislature. In April of this year, bills were introduced before the Assembly (2013 AB 167) and the Senate (2013 SB 146). These identical bills seek to "clarif[y] that property used for aging cheese on behalf of others is manufacturing property." Under the proposed bills, "the time period for chemical change in aging cheese shall be determined by the cheese maker, owner, or processor." Again, these bills are designed to clarify aging for tax purposes. Thus,

Petitioner's proposed standard, which includes the cheese owner's declaration of the end of the aging process, is the standard we will use when evaluating the evidence in this case.

Cheese aging is part of the cheese manufacturing process. We must therefore evaluate Petitioner's activities to determine whether what Petitioner is doing is in fact aging and, if so, whether the aging activity at some point becomes simply storage and whether aging is Petitioner's primary activity so as to qualify for the manufacturing exemption. We will consider the following types of factual information in making our determination:

1. Does the Petitioner create and maintain an artificial environment? What types of variables are controlled in the artificial environment and by whom are they determined?
2. How are the cheese and its environment monitored and by whom? Is the manufacturer/owner involved?
3. Is the cheese subject to inspection and testing by the owner/manufacture's graders?
4. Who determines when the aging process is complete? If it is the owner/manufacture, how is the Petitioner notified regarding the completion of the aging process?
5. How soon after notice of the end of the aging process does the cheese leave the Petitioner's possession?
6. What are the remuneration terms the Petitioner charges the owner/manufacture for its services?

We realize that some of the details of the aging process may be proprietary aspects of the manufacturer's trade. With the guidance listed above, the parties should be able to discover/reveal significant information about the variables

involved in setting the aging conditions specific to each type of product without having to release all specific measurements and details involved in the processes.

ORDER

1. Petitioner's Motion is granted insofar as it is consistent with the analysis above as to the standard to be applied to the evidence in this case.

2. The Department's Motion is denied.

3. The Parties will appear for a status teleconference on **Monday, January 6, 2014 at 11:30 a.m.**

Dated at Madison, Wisconsin, this 5th day of December, 2013.

WISCONSIN TAX APPEALS COMMISSION



Lorna Hemp Boll, Chair
5005 University Avenue - Suite 110
Madison, Wisconsin 53705
608-266-1391

cc: Mr. Ray Selk - Selkey, LLC
Attorney Patrick A. Dewane, Jr.
Attorney LaKeisha Wright Butler