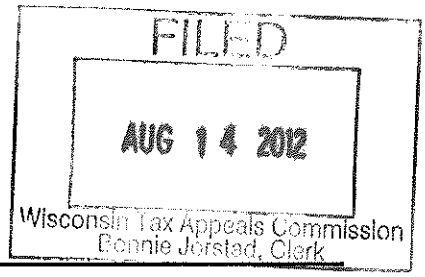
STATE OF WISCONSIN

TAX APPEALS COMMISSION



SULLIVAN BROTHERS, INC., **DOCKET NO. 09-S-242**

Petitioner,

vs. **RULING AND ORDER**

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

THOMAS J. McADAMS, COMMISSIONER:

This case is before the Commission for decision because the parties have filed Motions for Summary Judgment. The Petitioner is represented by Attorney Joseph A. Pickart and David C. Swanson of the law firm of Whyte Hirschboeck Dudek, S.C., located in Milwaukee, Wisconsin. The Respondent in this matter, the Wisconsin Department of Revenue ("the Department"), is represented by Attorney John R. Evans. Both sides have filed briefs with supporting affidavits.

This is a case of "substance v. form." In brief, the Petitioner in this case sells and installs construction materials to non-profit organizations. In order to avoid the sales tax,[1] the Petitioner set up a wholly owned subsidiary to act as a "middleman."

[1] The Department's assessment on Sullivan Brothers is technically for "use tax." However, we will sometimes in this opinion generically use the term "sales tax" in this opinion as the two taxes constitute a unitary system. The use tax is designed to tax sales not reached by the sales tax. *Dep't of Revenue v. Moebius Printing Co.*, 89 Wis. 2d 610, 622, 279 N.W.2d 213, 218 (1979). The two sections together create a sales and use tax plan "under which everything is taxable at the retail level unless specifically exempted." *Dep't of Revenue v. Milwaukee Refining Corp.*, 80 Wis. 2d 44, 49, 257 N.W.2d 855, 858 (1977).

The legal issue is whether this device works to avoid the Wisconsin sales and use tax. For the reasons stated below, we hold that it does not.

FACTS[2]

A. Jurisdictional Facts

1. The Petitioner is Sullivan Brothers, Inc. (usually referred to herein as "Sullivan"), a Wisconsin corporation with a principal place of business located at 2515 South Stoughton Road, Madison, Wisconsin, and was so for all times relevant to this matter. (Affidavit of Attorney Joseph A. Pickart, "Pickart Affidavit," dated Oct. 31, 2011, ¶3.)

2. Sullivan Brothers Supply, Inc. (usually referred to herein as "Supply"), is a Wisconsin corporation located at 2515 S. Stoughton Road, Madison, Wisconsin, and was so for all times relevant to the above matter. (*Id.*)

3. The period of review is January 1, 2004, through December 31, 2007. (Respondent's Brief at 4.)

4. The Department performed a field audit of Sullivan Brothers for the period under review. (*Id.*)

5. The Department issued an assessment of additional sales and use tax to Sullivan Brothers by Notice of Field Audit Action ("assessment") dated April 9, 2009, in the amount of $52,896.17 in taxes, interest in the amount of $29,920.44, and

[2] Both parties have submitted proposed jurisdictional and material facts. There are no issues as to the jurisdictional facts, and we have combined them from the respective submissions in Section A. As to the material facts, we have included almost all of the proposed material facts in Section B. Several proposed material facts were combined from the respective submissions. Of the handful or so of proposed material facts we did not include, several were perceived by the Commission to be unduly conclusionary or not highly relevant to the Commission's reasoning on the motions.

refund interest in the amount of $2,749.17, for a total amount of $80,067.44. (Affidavit of John R. Evans, "Evans Affidavit," dated Aug. 3, 2011, Exhibit 1.)

6. Sullivan Brothers filed a Petition for Redetermination dated May 19, 2009, objecting to the assessment. (Evans Affidavit, Exhibit 2.)

7. By Notice of Action dated November 12, 2009, the Department denied the Petition for Redetermination. (Evans Affidavit, Exhibit 3.)

8. On December 7, 2009, Sullivan Brothers timely filed a Petition for Review to this Commission. (Pickart Affidavit, ¶8.)

B. Material Facts

9. Sullivan Brothers is a specialty contractor engaged in real property construction activities, that is, purchasing, supplying, and installing ceiling tiles and related materials for customers who contracted with Sullivan Brothers for such construction activity. (Affidavit of Jerome M. Sullivan dated Oct. 31, 2011, ¶3; Affidavit of Eugene A. Sauer, Exhibit 6; Evans Affidavit, Exhibit 18.)

10. Sullivan Brothers is engaged in construction for customers that qualify as entities that are exempt from the payment of sales and use tax and for entities that are subject to the payment of sales and use tax, both of which are collectively referred to as the "install customers" (collectively "install customers" unless specifically referred to as either a "taxable install customer" or a "tax-exempt install customer"). (Sauer Affidavit, Exhibit 1; Evans Affidavit, Exhibit 18.)

11. Sullivan Brothers Supply, Inc., a Wisconsin corporation owned in the same proportions by the same individuals who own Sullivan, is, and was during the

audit period, engaged in the retail sale of ceiling systems and related goods. (Sullivan Affidavit, ¶5.)

12. Sullivan Brothers was engaged in the sales of materials to taxable customers who were not install customers ("over-the-counter sales customers") by transfer of materials at cost by journal entry to Sullivan Brothers Supply, who in turn would sell the materials to the over-the-counter sales customers. The sales were reported for sales tax purposes by Sullivan Brothers. The sales were recorded for income and franchise tax purposes as sales of Sullivan Brothers Supply. Pursuant to the amended returns of Sullivan Brothers and Sullivan Brothers Supply, the sales of the over-the-counter materials to the non-install taxable customers were reported on the sales and use tax returns of Sullivan Brothers Supply. (Sauer Affidavit, Exhibit 2.)

13. Sullivan Brothers collected sales tax on the sales of materials to the over-the-counter sales customers (except as may be at issue herein as part of the sales and use tax sample assessment). (*Id.*)

14. Pursuant to the construction for taxable install customers, Sullivan Brothers paid sales and use tax on all materials used or consumed in construction for the taxable install customers (except as may be at issue as part of the sales and use tax sample assessment). (*Id.*)

15. Pursuant to the construction for the tax-exempt install customers, Sullivan Brothers would transfer the materials to be used or consumed in construction to Sullivan Brothers Supply by journal entry; Sullivan Brothers Supply would transfer the materials to the tax-exempt install customers for installation by Sullivan Brothers;

Sullivan Brothers Supply would accept tax exemption certificates from the tax-exempt install customers; Sullivan Brothers Supply did not collect any sales tax on the transfer of materials to the tax-exempt install customers to be installed by Sullivan Brothers; Sullivan Brothers did not collect any sales or use tax on the materials used by Sullivan Brothers for construction for the tax-exempt install customers. (*Id.*)

16. Sullivan Brothers' transfer of materials to Sullivan Brothers Supply by journal entry was done at the end of the year for the calendar year for all transfers. (Sauer Affidavit, Exhibit 5.)

17. Sullivan Brothers and Sullivan Brothers Supply share the same location, and the materials are stored at the same location until moved to the install customers' locations or removed from the location by over-the-counter customers. (Respondent's Brief at 6.)

18. Sullivan Brothers carried all of the materials on its federal income tax returns and its Wisconsin Income or Franchise Tax returns as its inventory for balance sheet purposes; Sullivan Brothers Supply carried no materials on its federal income tax returns and its Wisconsin Income or Franchise Tax returns as inventory and declared no "beginning" inventory and no "ending" inventory on said returns. (Evans Affidavit, Exhibits 6 through 13.)

19. Sullivan Brothers reported the income from construction, which would include the sales of materials to its install customers as part of its "gross receipts" on its federal tax returns and its state franchise tax returns. (Sauer Affidavit, Exhibit 2; Evans Affidavit, Exhibits 6 through 13.)

20. Sullivan Brothers included the cost of materials used in construction to its install customers as part of its "cost of goods sold" on its federal tax returns and its state franchise tax returns. (Sauer Affidavit, Exhibit 2.)

21. After the commencement of the audit, Sullivan Brothers amended its sales and use tax returns for the period to exclude sales of materials to taxable over-the-counter sales customers; the amended returns were included in the audit. (Sauer Affidavit, Exhibit 8.)

22. After the commencement of the audit, Sullivan Brothers Supply amended its sales and use tax returns for the period to include sales of materials to taxable over-the-counter sales customers; the amended returns were included in the audit of Sullivan Brothers Supply and considered for purposes of the audit and assessment of Sullivan Brothers. (*Id.*)

23. Pursuant to the amended sales and use tax returns of Sullivan Brothers, a refund of sales and use tax was determined and included in the results of the audit of Sullivan Brothers; the amended sales and use tax returns of Sullivan Brothers are not at issue in the matter except to the extent of the additional adjustments made in the audit. (Evans Affidavit, Exhibit 1.)

24. Pursuant to the amended sales and use tax returns of Sullivan Brothers Supply, an additional assessment of sales and use tax was determined in the audit. The additional assessment of tax is not at issue as the assessment and audit are not appealed in the above matter and are final, having been withdrawn before the

Wisconsin Tax Appeals Commission on June 15, 2010. (*See Sullivan Brothers Supply, Inc. v. Dep't of Revenue*, Docket No. 9-S-241.)

25. Sullivan and Supply are separate legal entities with separate bank accounts, separate business records, and separate sales invoices. Sullivan was formed and registered with the State of Wisconsin in 1934. Supply was formed and registered with the State of Wisconsin in 1963. Supply was formed to establish the type of structure required by the Department to treat tax-exempt customers' purchases of construction materials as exempt from sales and use tax. (Sullivan Affidavit, ¶¶ 6 and 7.)

26. Both Sullivan and Supply are in good standing with the Department of Financial Institutions, file separate sales tax returns, and file separate corporate income tax returns. (Sullivan Affidavit, ¶8.)

27. When either Sullivan or Supply paid sales tax on a purchase of goods for a nontax-exempt customer, it passed this cost to its customer for reimbursement. (Sullivan Affidavit, ¶10.)

28. The supply chain for ceiling components is controlled by industry limitations. There are a limited number of ceiling system manufacturers and suppliers that provide the products that Sullivan installs. Most ceiling system manufacturers and suppliers operating in Wisconsin have exclusive distribution agreements with distributors other than Supply. (Sullivan Affidavit, ¶22.)

29. Under these distribution agreements, ceiling system manufacturers and suppliers cannot sell materials in Wisconsin to other independent distributors, like Supply. (Sullivan Affidavit, ¶23.)

30. Most authorized distributors of ceiling systems in Wisconsin are in some way affiliated or have business relationships with contractors that are Sullivan's competitors. (Sullivan Affidavit, ¶24.)

31. In order to remain competitive with other installers that have business relationships with their suppliers, Sullivan could not collect sales tax from tax-exempt customers or otherwise pass along the cost of use tax to its tax-exempt customers on supplies purchased for work done on tax-exempt customers' properties. (Sullivan Affidavit, ¶25.)

32. Because Sullivan is a specialty contractor and not a distributor, it can purchase ceiling systems from manufacturers and suppliers without violating the manufacturers' and suppliers' distribution agreements with third-party distributors in Wisconsin. (Sullivan Affidavit, ¶26.)

33. Sullivan purchases the ceiling system materials from the manufacturers and suppliers and resells the ceiling system materials to Supply, the retailing entity, which resells the ceiling systems to the ultimate consumer. (Sullivan Affidavit, ¶27.)

34. The purchases by Sullivan from the manufacturers and suppliers are not purchased for any particular project. (Sullivan Affidavit, ¶28.)

35. Supply bills the customer for the cost of the materials plus any tax that may be applicable to the sale of the materials. Supply also has over-the-counter sales, upon which Supply collects and remits sales tax where it believes appropriate. In the questioned transactions, Supply resold ceiling materials to tax-exempt organizations without tax pursuant to the issuance of a tax-exemption certificate. (Sullivan Affidavit, ¶30.)

36. In those cases in which Sullivan performed real property construction services for tax-exempt entities that were also customers of Supply, Sullivan and the tax-exempt entities negotiated and executed separate contracts between Sullivan and the tax-exempt entities. Supply was not a party to the contracts between Sullivan and the tax-exempt entities. (Sullivan Affidavit, ¶16.)

37. Supply resells materials to tax-exempt entities pursuant to valid tax-exemption certificates for use in real property construction activities. (Sullivan Affidavit, ¶19.)

38. The tax-exemption certificates provided to Supply by its tax-exempt customers includes a valid Certificate of Exempt Status number issued to the tax-exempt customer by the Department. (Sullivan Affidavit, ¶20.)

39. Sullivan separately contracts with customers that wish to have ceiling systems installed by Sullivan. Once the ceiling system is completely installed, Sullivan bills the customer for the cost of the installation service. In the questioned transactions, Sullivan performed installation services for tax-exempt entities using

materials provided by the tax-exempt entities that were purchased from Supply. (Sullivan Affidavit, ¶32.)

APPLICABLE STATUTE AND REGULATIONS

A. Wis. Stat. § 77.51(2) Definitions

***

(2) "Contractors" and "subcontractors" are the consumers of tangible personal property or items or goods under s. 77.52(1)(b) or (d) used by them in real property construction activities and the sales and use tax applies to the sale of tangible personal property or items or goods under s. 77.52(1)(b) or (d) to them. A contractor engaged primarily in real property construction activities may use resale certificates only with respect to purchases of tangible personal property or items or goods under s. 77.52(1)(b) or (d) which the contractor has sound reason to believe the contractor will sell to customers for whom the contractor will not perform real property construction activities involving the use of such tangible personal property or items or goods under s. 77.52(1)(b) or (d) . . .

B. Wis. Admin. Code § Tax 11.04 Constructing buildings for exempt entities.

§ Tax 11.04(3) PURCHASES PRESUMED TAXABLE. When a contractor and an exempt entity enter into a construction contract to improve real property, which provides that the contractor is to furnish the building materials, it is presumed until the contrary is established, that deliveries of building materials to the contractor are made pursuant to purchases made by the contractor.

§ Tax 11.04(4) SUPPLIER IS CONTRACTOR. A supplier, who is also the contractor who uses the building materials in the construction of buildings or structures, or the alteration, repair or improvement of real property for an exempt entity, is the consumer of such building materials, not the seller of personal property to the exempt entity. The sale of building materials to the consumer is subject to the tax.

> § Tax 11.04(5) EXEMPT SALES. A supplier's sales of building materials made directly to an exempt entity are not taxable, even though such tangible personal property or item, property, or good under s. 77.52(1)(b), (c), or (d), Stats., is used by the contractor in the erection of a building or structure, or in the alteration, repair or improvement of real property for the exempt entity. Suppliers of building materials may presume that a sale is made directly to an exempt entity if the supplier receives a purchase order from the exempt entity, and payment for such building materials is received directly from the exempt entity.

OPINION

The facts necessary to resolve the motions are not in dispute and we will summarize them below. The Petitioner, Sullivan Brothers, Inc., is in the business of installing ceiling tile, including the provision of the materials. During the relevant period, Sullivan Brothers did construction for tax-exempt as well as nontax-exempt entities. Prior to the audit, Sullivan Brothers owned the materials that were used by Sullivan Brothers. Those materials were set forth on the books and records of Sullivan Brothers as inventory. The inventory was accounted for as inventory of Sullivan Brothers for tax purposes, also.

In the early 1960s, Sullivan Brothers set up a wholly owned subsidiary by the name of Sullivan Brothers Supply, Inc. When Sullivan Brothers contracted to do work for tax-exempt entities, Sullivan Brothers would make a journal entry at the end of the year to transfer the inventory it had used for those entities' projects to Sullivan Brothers Supply. The tax-exempt entity would issue two purchase orders. One would be issued to Sullivan Brothers for the installation. The second would be issued to

Sullivan Brothers Supply for the materials. The materials would be installed by Sullivan Brothers. Sullivan Brothers would account for the transfer as a sale for resale and move the materials out of the inventory account by journal entry. Sullivan Brothers Supply would account for the sale as a sale to a tax-exempt entity and no sales or use tax would be reported. The Department assessed use tax on these materials because Sullivan Brothers installed them.

During the audit, Sullivan Brothers and Sullivan Brothers Supply changed the method of reporting sales. Amended returns were filed to show that all materials provided to non-installation customers, or "over-the-counter sales," were sales by Sullivan Brothers Supply. The Department accepted the amended returns. However, the amended returns did not have an impact on the assessment at issue as it was the Department's position that Sullivan Brothers owned the materials at the time of the contracting and thus knew that Sullivan Brothers would be installing those materials for the tax-exempt entities. The amended returns only moved sales from Sullivan Brothers to Sullivan Brothers Supply that had been made by Sullivan Brothers to non-installation customers that were taxable entities. The sales tax returns of Sullivan Brothers Supply had not reported any taxable sales prior to the amendment. Sullivan Brothers had reported these taxable non-installation sales prior to the amendment for sales tax purposes but Sullivan Brothers Supply had reported such sales for income tax purposes.

The first part of this opinion will set forth the law on summary judgment. The second part of this opinion will set forth the substantive law. The third part of this opinion will set forth the legal arguments. The final part of this opinion will state why we find for the Department.

A. Summary Judgment

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). Summary judgment procedure imposes on the moving party the burden of demonstrating both the absence of any genuine factual disputes and entitlement to judgment as a matter of law under the legal standards applicable to the claim. Wis. Stats. §§ 802.08(2) and (3). The purpose of summary judgment is "to avoid trials where there is nothing to try." *Transportation Ins. Co. v. Hunzinger Construction Co.*, 179 Wis. 2d 281, 507 N.W.2d 136, 139 (Ct. App. 1993). In our review of a summary judgment motion, we are prohibited from deciding issues of fact; our inquiry is limited to determining whether a material factual issue exists. *Milwaukee Deputy Sheriff's Ass'n v. City of Wauwatosa*, 2010 WI App 95, 327 Wis. 2d 206, 787 N.W.2d 438. When "both parties file counter-motions for summary judgment, and neither argues that factual disputes bar the other's motion, the

facts are deemed stipulated" and summary judgment is appropriate. *Hussey v. Outagamie County*, 201 Wis. 2d 14, 18, 548 N.W.2d 848, 850 (Ct. App. 1996).[3]

B. Applicable Law

We set forth the law and rules that guide our analysis.

First, the Department's assessment is presumed to be correct, and it is the Petitioner's burden to demonstrate that the assessment is incorrect. *See Hormel Foods Corp. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-741 (WTAC 2004), *aff'd*, Case No. 04-CV-1278 (Dane Co. Cir. Ct. 2004).[4]

Second, to be entitled to a tax exemption, the taxpayer must bring the taxpayer within the exact terms of the exemption statute. *Sisters of Saint Mary v. City of Madison*, 89 Wis. 2d 372, 379, 278 N.W.2d 814 (1979).

Third, statutes conferring tax exemptions are to be strictly construed. Wis. Stat. § 70.109; *Columbus Park Housing Corp. v. City of Kenosha*, 267 Wis. 2d 59, 671 N.W.2d 633 (2003); *Friendship Village of Greater Milwaukee, Inc. v. City of Milwaukee*, 181 Wis. 2d 207, 219, 511 N.W.2d 345, 350 (Ct. App. 1993) (*pet. den'd*). An exemption statute need not be given the narrowest possible construction. *Id.* While the statute must be given a strict construction in favor of taxation, the modern rule is that the statute must be given

---

[3]Neither party in this case contends that any material fact needs to be resolved by trial. Both state that the facts are not in dispute as to their own motions. However, the Department points out that there are "potential" issues of fact concerning the Petitioner's Motion for Summary Judgment. In brief, those two potential issues relate to contractual limitations between Sullivan and its suppliers and the effect of the Fair Dealership Act. The Petitioner, however, responds that those alleged limitations are not relevant to the motions, and we agree that we can and should go forward. The "mere existence of *some* alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment; the requirement is that there be no genuine issue of *material* fact." *Baxter v. DNR*, 165 Wis. 2d 298, 312, 477 N.W.2d 648 (Ct. App. 1991).

[4] The Petitioner's appeal to circuit court was withdrawn.

a "strict but reasonable" construction. *Wauwatosa Avenue United Methodist Church v. City of Wauwatosa*, 2009 WI App 171, 321 Wis. 2d 796, 776 N.W.2d 280.

Fourth, Wis. Stat. § 77.53 (1b) states that the consumption in this state of tangible personal property is subject to the tax, unless an exemption applies.

C. The Parties' Legal Arguments

We will summarize the arguments the parties make in support of their respective Motions for Summary Judgment.

1. The Petitioner's Arguments

The Petitioner argues that Sullivan was the contractor, not the supplier, and the sales were all exempt because the forms of the transactions must be respected. First, there was no tax avoidance scheme because no tax was due on sales for resale or on sales to tax-exempt customers. Sullivan charged its taxable customers for applicable sales tax and treated its tax-exempt customers as exempt, following the letter and intent of the statutes. Second, the sales were exempt according to the plain meaning of the statute. Third, the transactions must be respected under a "substance and realities" analysis because Sullivan had a legitimate business purpose for the form it chose and tax avoidance was not the primary purpose. Finally, precedent shows that Sullivan and Supply properly respected the exemptions granted by the Department to Sullivan's and Supply's tax-exempt customers.

2. The Department's Arguments

The Department argues that a supplier who is also the contractor owes tax on the materials. First, the books and records of Sullivan Brothers do not support the

argument that Sullivan Brothers, Inc., and Sullivan Brothers Supply, Inc., were dealing at arm's length and were separate and distinct. The transactions were at cost and the sales were not treated consistently. Second, even if the transactions are respected and the bookkeeping is ignored, Sullivan Brothers falls squarely within *Rice Insulation, Inc. v. Dep't. of Revenue,* 115 Wis. 2d 513, 540 N.W.2d 556 (Ct. App. 1983) and *Precision Metals, Inc. v. Dep't of Revenue,* Wis. Tax Rptr. ¶400-337 (WTAC 1998). Sullivan Brothers' facts are less favorable to the taxpayer than the facts in either *Rice Insulation* or *Precision Metals.* Third, the Petitioner, Sullivan Brothers, admits that it could not act as the seller in the contracts as it was not the authorized distributor designated for the territory.

D. Analysis

As mentioned above, summary judgment procedure imposes on the moving party the burden of demonstrating both the absence of any genuine factual disputes and entitlement to judgment as a matter of law under the legal standards applicable to the claim. Wis. Stats. §§ 802.08(2) and (3). Here, for summary judgment purposes, the facts are substantially undisputed. Thus, the remaining issue for us to consider is which party is entitled to judgment. The application of a statute to a set of facts is a question of law. *Dep't of Revenue v. J.C. Penney Co.,* 108 Wis. 2d 662, 666, 323 N.W.2d 168, 169 (Ct. App. 1982). Both parties agree that Wis. Stat. § 77.51(2) controls.

We find for the Department for several reasons. First, we read the statute differently than the Petitioner. Second, the transactions at issue fail Wisconsin's "substance and realities" test. Third, the case law supports the Department's analysis.

1. Statutory Construction

This case requires us to analyze Wis. Stat. § 77.51(2). The goal of statutory interpretation is to discern the intent of the legislature. *Teschendorf v. State Farm Ins. Companies,* 2006 WI 89, 293 Wis. 2d 123, 717 N.W.2d 258. Because a legislature expresses its purpose by words, our first resort in construing a statute is to look to what is written in the statute books, not to what is unwritten; our aim in doing so is to ascertain—neither to add nor to subtract, neither to delete nor to distort. *State v. Bruckner,* 151 Wis. 2d 833, 844, 447 N.W.2d 376, 381 (Ct. App. 1989) (quoting *62 Cases of Jam v. United States,* 340 U.S. 593, 596 (1951)).

We must first look to the plain language of the statute. *Hemburger v. Bitzer,* 216 Wis. 2d 509, 517, 574 N.W.2d 656 (1998). In seeking a plain meaning, a court or a commission seeks a meaning that anyone—a lawyer, a party, an administrator, or any reader—could discern simply by examining the text of the statute, perhaps with the aid of a dictionary, a book generally available to all. *County of Dane v. LIRC,* 2009 WI 9, ¶48, 315 Wis. 2d 293, 759 N.W.2d 571 (Abrahamson, J., concurring opinion). A statute, word or phrase is ambiguous, and use of the rules of construction proper, only when it is capable of being interpreted by reasonably well-informed persons in two or more senses. *See Guertin v. Harbour Assurance Co. of Bermuda, Ltd.,* 135 Wis. 2d 334, 338, 400 N.W.2d 56, 58 (Ct. App. 1986), *aff'd,* 141 Wis. 2d 622, 415 N.W.2d 831 (1987). If the language in the law is plain, the analysis stops there. If the language in the statute is ambiguous, we may rely on extrinsic aids such as legislative history, scope, purpose, subject matter and context to determine the legislature's intent. *Id.*

When the legislature imposes a tax, it must do so in clear and express language, with all ambiguity and doubt in the legislation being resolved against the one seeking to impose the tax. *Kearney & Trecker Corp. v. Dep't of Revenue,* 91 Wis. 2d 746, 753, 284 N.W.2d 61 (1979). However, although the benefit of doubt is to be given to the taxpayer in cases where the language imposing the tax is ambiguous, a court or a commission has no duty to search for doubt in an effort to defeat an obvious legislative intention. *Transamerica Financial Corp. v. Dep't of Revenue,* 56 Wis. 2d 57, 65, 201 N.W.2d 552 (1972); *Kearney & Trecker,* 91 Wis. 2d at 753.

Once it is clear that a tax has been imposed, the burden shifts to the taxpayer to show that the transactions at issue have been exempted. Tax exemptions, deductions, and privileges are purely matters of legislative grace; and tax statutes are to be strictly construed against the granting of same. A taxpayer claiming an exemption must point to an express provision granting an exemption by language which clearly specifies the exemption. The taxpayer must bring itself clearly within the terms of the exemption. *Comet Co. v. Dep't of Taxation,* 243 Wis. 117, 123, 9 N.W.2d 620 (1943); *Fall River Canning Co. v. Dep't of Taxation,* 3 Wis. 2d 632, 637, 89 N.W.2d 203 (1958); *Ramrod, Inc. v. Dep't of Revenue,* 64 Wis. 2d 499, 504, 219 N.W.2d 604 (1974); *Dep't of Revenue v. Greiling,* 112 Wis. 2d 602, 605, 334 N.W.2d 118 (1983).

This methodology has been used by the courts and the Commission to construe the sales tax statute on many occasions. *See, e.g., All City Communication Co., Inc. v. Dep't of Revenue,* 2003 WI App 77, 263 Wis. 2d 394, 661 N.W.2d 845 (finding sales tax statute is ambiguous because reasonable minds could differ as to whether a

communications tower is "personal property"); *National Amusement Co. v. Dep't. of Taxation,* 41 Wis. 2d 261, 163 N.W.2d 625 (1969) (holding sales tax statute is not ambiguous as to sale of popcorn and soft drinks prepared and sold at motion picture theater refreshment stands); *Luetzow Industries v. Dep't of Revenue,* 197 Wis. 2d 916, 541 N.W.2d 810 (1995) (finding statutory sales tax exemption concerning packing and shipping materials used in transfer of "merchandise" to customers is ambiguous); *Kastengren v. Dep't of Revenue,* 179 Wis. 2d 587, 594, 508 N.W.2d 431 (1993) (explaining that the term "predecessor" is ambiguous); *SSM Health Care v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶400-593 (WTAC 2002) (holding that emergency phone system statute is not ambiguous); *Pet Vacations, Ltd. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶400-002 (WTAC 1993) (explaining that the term "maintenance" in Wis. Stat. § 77.52(2)(a) is ambiguous).

Both the Petitioner and Department argue that Wis. Stat. § 77.51(2) is not ambiguous and we agree. The Petitioner argues that Sullivan did not perform real property construction activities for Supply. Therefore, the sales at issue were sales for resale or sales to exempt organizations and no tax is due. The Department maintains that the Petitioner is liable under the statute for the sales and use tax as the Petitioner owned the materials at the time of the contracting and thus knew it would be the consumer of those same materials. We agree with the parties that Wis. Stat. § 77.51(2) has a "plain meaning" in this case.

We find for the Department for several reasons. First, there is the "obvious legislative intention" expressed in the first sentence of the statute which states

that a contractor is the consumer of building materials and, therefore, pays the tax. In our view, in order to resolve the question here, one must read both sentences together. As relevant to this particular case, Wis. Stat. § 77.51(2) states the following:

> "Contractors" and "subcontractors" are the consumers of tangible personal property or items or goods under s. 77.52(1)(b) or (d) used by them in real property construction activities and the sales and use tax applies to the sale of tangible personal property or items or goods under s. 77.52(1)(b) or (d) to them.
>
> [and]
>
> A contractor engaged primarily in real property construction activities may use resale certificates only with respect to purchases of tangible personal property or items or goods under s. 77.52(1)(b) or (d) which the contractor has sound reason to believe the contractor will sell to customers for whom the contractor will not perform real property construction activities involving the use of such tangible personal property or items or goods under s. 77.52(1)(b) or (d).

A plain reading of the statute is that the first sentence creates the rule that the sales at issue here are taxable and the second sentence describes situations where the contractor would not be taxed. Thus, as described above, we start with the presumption of taxability as the Petitioner is clearly a "contractor" and to prevail here the Petitioner attempts to bring itself within the terms of the second sentence. The Petitioner's claim here is that what it "knew" was that it would be selling the materials to its Supply Corporation and that it "knew" it would not be doing construction activities for the Supply Corporation. Thus, the transactions do not fit within the second sentence above.

There are at least three problems with the Petitioner's construction and application of this statute. First, courts and commissions must look to the common sense meaning of a statute to avoid unreasonable and absurd results. *Kania v. Airborne Freight Corp.*, 99 Wis. 2d 746, 766, 300 N.W.2d 63, 71 (1981). "Customers" doesn't in common parlance or in law typically mean a wholly owned subsidiary; it means consumers or the general public. Words and phrases of statutes "shall be construed according to common and approved usage." Wis. Stat. § 990.01(1). The simple fact is that a wholly owned corporate subsidiary is not commonly understood to be a "customer." In our view, the Petitioner's construction of "customers" as its wholly owned subsidiary is a rather strained and questionable understanding of that term. Further, it does not make sense to construe a sentence *limiting* the use of resale certificates in such a way that "consumers" would mean a wholly owned subsidiary set up to avoid the tax the previous sentence clearly imposes on a contractor. The Petitioner's construction emphasizes the second sentence, while our construction reads both sentences together.

The Petitioner argues that the corporate form it chose to interpose here must be respected. While we recognize that Wisconsin is generally an entity theory state,[5] there are situations where courts and commissions have held that such corporate forms are not absolute or determinative for sales tax purposes. *See, e.g., Dep't. of Revenue v. River City Refuse Removal, Inc.*, 2007 WI 27, 299 Wis. 2d 561, 729 N.W.2d 396. In that case, the Department sought judicial review of a Commission ruling that the taxpayer was not liable for use tax on transfers of fixed assets between wholly owned subsidiaries. The Wisconsin Supreme Court held that despite being separate entities corporate subsidiaries that transferred fixed assets were not "retailers," as was required to impose use tax on the value of assets. In making that determination, the court used a dictionary definition to determine that "retail" means the sale of goods or commodities in small quantities to consumers. The court further stated that merely passing along an isolated asset in a transaction is not enough to constitute "retail." When we perform the same kind of analysis the court performed in *River City*, we think that a plain and

[5] Wisconsin historically follows the legal entity theory. *Interstate Finance Corp v. Dep't of Taxation*, 28 Wis. 2d 262, 137 N.W.2d 38 (1965). The legal-entity theory refers to the fact that each separate legal entity is required to file its own separate return. The Commission and the courts have considered transactions between related entities on several occasions. For example, in *Dep't of Revenue v. Sentry Financial Services Corp.*, 161 Wis. 2d 902, 914, 469 N.W.2d 235 (Ct. App. 1991), the Court of Appeals dealt with the Department's challenge of a taxpayer's claimed non-recognition of gain on a sale between related entities. The Court held that non-recognition would apply "as long as the transfer serves a valid business purpose and was not done to avoid or evade taxation." In *Wall v. Dep't of Revenue*, 157 Wis. 2d 1, 458 N.W.2d 814 (Ct. App. 1990), the Court of Appeals addressed allocations of a partner's share of profits and loss under a partnership agreement. The court stated that such allocations must serve a bona fide business purpose and would be disregarded if they lack substantial economic effect. In *Kimberly-Clark Corp. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-056 (WTAC 1994), the Commission noted that a corporate entity is "not to be lightly disregarded."

common sense reading of Wis. Stat. § 77.51(2) compels the conclusion that a wholly owned subsidiary set up to avoid the tax is not a "customer."

An additional problem with the Petitioner's reading of this statute is that the second sentence requires that the contractor demonstrate "sound reason" to believe the contractor will sell the materials to customers for whom the contractor will not perform real property construction activities. We believe this standard set forth by the legislature to be an objective one, subject to analysis by the Commission and the courts. We note the legislative choice to employ the term "sound reason," and presumably the legislature added the term "sound" for meaning and emphasis and not to create a tautology. In this context, we equate this standard with the common concept of reasonableness, and the taxpayer's willful imposition of a wholly owned intermediary to create a "customer" to avoid the sales tax is not, in our view, "sound reason."

A third issue is the existence of Wis. Tax Admin Code § 11.04(5). That section states as follows:

> § Tax 11.04(5) EXEMPT SALES. A supplier's sales of building materials made **directly** to an exempt entity are not taxable, even though such tangible personal property or item, property, or good under s. 77.52(1)(b), (c), or (d), Stats., is used by the contractor in the erection of a building or structure, or in the alteration, repair or improvement of real property for the exempt entity. Suppliers of building materials may presume that a sale is made directly to an exempt entity **if the supplier receives a purchase order from the exempt entity, and payment for such building materials is received directly from the exempt entity.**

[emphasis added.]

In essence, this section can be viewed as setting forth to contractors a "safe harbor" on how to accomplish the result the Petitioner intends here. Part of our task here is to harmonize the various statutory and regulatory provisions, and we think Wis. Stat. § 77.51(2) has to be read with § Tax 11.04(5). Administrative rules enacted pursuant to statutory rulemaking authority have the force and effect of law in Wisconsin. *Staples v. DHSS,* 115 Wis. 2d 363, 367, 340 N.W.2d 194 (1983). Admittedly, § Tax 11.04, which appears to have been enacted in 1979, does not say that it is the *exclusive* way for the sales tax not to apply, but we do not think that for statutory construction purposes a section entitled "exempt sales" can be entirely overlooked in a case involving allegedly exempt sales. We read § Tax 11.04(5) as the way the legislature intended that a contractor accomplish the result the Petitioner attempted here. Given the entirety of the statutory scheme before us, the Petitioner simply has not shown us anything that overcomes the presumption of taxability for these transactions.

The Petitioner argues in the alternative that it should prevail on its motion even if the statute is ambiguous. The argument is that, if the statute is ambiguous, then no tax can be imposed under long standing principles of law. While we agree with that part of the Petitioner's argument, we believe the law here is, in fact, clear. But even if it were not, our review of the circumstances surrounding the adoption and retention of this provision tends to indicate that the legislature means for the construction we take here.[6] Assembly Bill 471, which was introduced August 14, 1997, proposed amending

[6] We may consult legislative history to support our reading of the plain meaning of the statute. *Columbus Park Housing Corp. v. City of Kenosha,* 2003 WI 143, 267 Wis. 2d 59, 671 N.W.2d 633.

Wis. Stat. § 77.52(13) as it relates to construction contracts with entities that are tax-exempt. A public hearing was held on November 12, 1997, but the bill failed to pass on April 2, 1998.[7] If it had been passed, the proposed law would have allowed building contractors to use the sales tax exemption certificate of an exempt entity when purchasing goods or services exclusively for construction for the tax exempt entity. The text of the bill read as follows:

> **Section 1.** 77.52(13) of the statutes is amended to read:
>
> 77.52**(13)** For the purpose of the proper administration of this section and to prevent evasion of the sales tax it shall be presumed that all receipts are subject to the tax until the contrary is established. The burden of proving that a sale of tangible personal property or services is not a taxable sale at retail is upon the person who makes the sale unless that person takes from the purchaser a certificate to the effect that the property or service is purchased for resale or is otherwise exempt. *A building contractor who purchases goods or services exclusively for use in construction for an entity sales to which are exempt under this subchapter may use an exemption certificate of the exempt entity if the building contractor also presents a statement from the exempt entity that the goods or services are to be used exclusively for construction for the exempt entity.*

[emphasis added to the original]

This proposed legislation leads us to several conclusions. First, the very existence of the proposed legislation leads us to believe that our construction is the correct view of existing law that the contractor pays the tax. In fact, the proposed legislation would have been superfluous if our view of the statute were not the correct one. It is a basic

---

[7] The legislative record for AB471 is available at https://docs.legis.wisconsin.gov/1997/related/proposals/ab471 (last visited on May 17, 2012). The bill was sponsored by 23 representatives and 4 senators.

precept of statutory construction that the legislature is presumed to act with full knowledge of existing laws. *State v. Gordon*, 111 Wis. 2d 133, 145, 330 N.W.2d 564, 569 (1983). Further, by analyzing the changes the legislature might have made over the course of several years, we may be assisted in arriving at the meaning of a statute. *County of Dane v. Labor and Industry Review Com'n*, 2009 WI 9, 315 Wis. 2d 293, 759 N.W.2d 571. Second, we may also infer that by not passing the legislation that the legislature still means the tax should be imposed. Under proper circumstances, inaction by the legislature may be evidence of legislative intent. *Schill v. Wisconsin Rapids School Dist.*, 2010 WI 86, 327 Wis. 2d 572, 786 N.W.2d 177. Assembly Bill 471 followed the appellate court's decision in *Rice* finding an arguably similar transaction taxable,[8] so the legislature presumably was aware of the *Rice* decision and can be viewed as acquiescing in the Wisconsin Court of Appeals' construction. Thus, while we believe the statute in question is clear, even if it were not, our review of the available legislative materials[9] tends to indicate that our view of Wis. Stat. § 77.51(2) is correct.

In sum, as we pointed out above, the presumption under Wis. Stat. § 77.53(1b) is that these transactions are taxable. The statute here clearly imposes the tax on the contractor. The Petitioner has not overcome this presumption.

---

[8] The *Rice* case is discussed in section 3 below.

[9] The second sentence of the current version of Wis. Stat. § 77.51(2) was added to the law in 1969 and the section was renumbered. Previously, the first sentence of the current Wis. Stat. § 77.51(2) was a part of Wis. Stat. § 77.51(18). Examination of the drafting records on microfiche for section 237 of c. 154 of the 1969 change did not reveal any probative history for the question here.

2. The Substance and Realities Test

As described in the previous section, the Petitioner argues in its brief that Wisconsin law does not impose a sales or use tax on these transactions. Further, the Petitioner argues that the corporate structure it used has a business purpose and discusses the application of the various "substance v. form" tests. In brief, the Petitioner argues that the transactions must be respected under a "substance and realities" analysis because Sullivan had a legitimate business purpose for the form it chose and tax avoidance was not the primary purpose. The Department responds in its Reply Brief that this argument is irrelevant at best and Wisconsin law imposes the use tax on Sullivan Brothers as the consumer of the materials it installs. Having reviewed the facts here and the law, we cannot agree with the Petitioner; thus, an alternative basis for our ruling is that the structure the Petitioner uses fails the "substance and realities" test. First, we will summarize the law regarding substance v. form. Then, we will set forth the reasons the questioned transactions fail Wisconsin's "substance and realities" test.

a. Substance v. Realities

Wisconsin courts have long looked to substance in taxation matters. *Cliff's Chemical Co. v. Wisconsin Tax Commission,* 193 Wis. 295, 214 N.W. 447 (1927); *Miller v. Wisconsin Tax Commission,* 195 Wis. 219, 221, 217 N.W. 568 (1928). The Wisconsin Supreme Court has stated that it will make determinations of taxability based on the facts viewed as a whole and that it is the "substance and realities" of a taxpayer's activities that are determinative of the Department's power to tax. *Dep't of Revenue v.*

Sterling Custom Homes Corp., 91 Wis. 2d 675, 679, 283 N.W.2d 573, 575 (1979). In *Sterling Custom Homes*, the issue was the taxability of the taxpayer's real construction activities and the court examined the taxpayer's everyday work activities to determine that its actual activities were entitled to the real property exemption to the sales and use tax. In *Madison Newspapers, Inc. v. Dep't of Revenue*, 228 Wis. 2d 745, 599 N.W.2d 51 (Ct. App. 1999), the court looked to the substance of the taxpayer's relationship with its carriers to determine if certain materials were exempt from the sales and use tax. In *Dep't of Revenue v. River City Refuse Removal, Inc.*, 289 Wis. 2d 628, 712 N.W.2d 351 (Ct. App. 2006),[10] the Wisconsin Court of Appeals noted the Department's reliance on the longstanding principle that the taxability of a given transaction is determined, not by how a taxpayer characterizes it for accounting purposes, but by the substance of the transaction itself. This Commission has previously used this test as well. *Manpower Inc. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶401-223 (WTAC 2009). In *Manpower*, the Commission determined that in substance and reality temporary services were not the same thing as the services the Wisconsin Statutes specifically tax, and thus were not subject to the sales tax on services.

Wisconsin generally follows federal law at least as to income taxation, and the federal courts have developed a number of closely related and sometimes overlapping doctrines that can be applied to negate claimed tax benefits. *Hormel.*

[10] The appellate court's decision cited above was affirmed by the Wisconsin Supreme Court in *Dep't of Revenue v. River City Refuse Removal, Inc.*, 2007 WI 27, 299 Wis. 2d 561, 729 N.W.2d 396.

Sometimes the doctrine is referred to as the "economic substance doctrine,"[11] sometimes it is referred to as the "sham transaction doctrine," and sometimes it is referred to as the "step transaction doctrine." *Id.* For our purposes here in this case, we assume these doctrines are largely one and the same. *See generally* Joseph Bankman, *The Economic Substance Doctrine,* 74 S. Cal. L. Rev. 5 (2000) (discussing origins and difficulties of substance-over-form doctrines, including the step transaction doctrine). As the Commission noted in *Hormel,* the language used in these opinions is often inscrutable.[12] The proper result in this case is clear, however.

The economic substance doctrine has a long history in federal case law. The origin of this doctrine is the United States Supreme Court's decision in *Gregory v. Helvering,* 293 U.S. 465 (1935). The taxpayer in *Gregory* desired to sell stock shares held by a subsidiary. In order to minimize her tax liability, the taxpayer had the stock that was to be sold transferred to her by way of a tax-free reorganization using a newly created and separate corporate entity. After using the separate corporate entity in this manner, the taxpayer quickly dissolved it. Once the taxpayer owned the stock directly,

---

[11] Section 1409 of the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, added section 7701(o) to codify the economic substance doctrine for transactions entered into on or after March 31, 2010. In 2009, the Wisconsin Legislature amended Wis. Stat. § 71.10(1m), placing the burden on taxpayers in certain circumstances to show that certain disallowed transactions clearly and convincingly had economic substance.

[12] In this case, we will attempt to use the terms "substance v. reality" or the "economic substance doctrine." We will, however, avoid the use of the term "sham transaction" because we do not believe that the use of the term "sham" is appropriate here. First, one of the taxpayer's goals in this case is to avoid non-profits and charities paying the sales tax, a goal which the legislature has recognized by granting exemptions to these organizations in the first place. Second, the taxpayer paid the tax as to non-exempt entities. Third, a bill to accomplish this result was introduced by 27 Wisconsin legislators in 1997. Fourth, the Department has issued publications giving guidance as to how taxpayers can achieve the result intended here.

she sold the shares, resulting in a substantially lower income tax assessment than if the original corporation had sold the shares directly to her.

The Supreme Court dismissed the transaction as "an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else," noting that the entity was disbanded immediately following the sale of the stock. *Id.* at 470. Although the use of the new entity followed the letter of the federal statute, which allowed for tax-free corporate reorganizations, the transaction was rejected as a "sham" because it had no relationship to the legislative intent. The federal statute was passed to allow corporations to transfer assets "in pursuance of a plan of reorganization," not to facilitate tax avoidance. *Id.* at 469. The Court stated that, while taxpayers have a legal right to act in a way that will diminish their tax burden, they may not do so by creating a business entity with no other business or corporate purpose, but whose "sole object and accomplishment [is] . . . the consummation of a preconceived plan" to avoid taxation. *Id.*

The Commission most recently considered substance v. form in *Hormel.* In that case, the taxpayer claimed deductions for royalties paid to an affiliate for the use of intellectual property. The Department had disallowed the deductions because the underlying transactions lacked economic substance and a valid business purpose and were entered into primarily for the purpose of tax avoidance. In sustaining the Department's action, the Commission noted that Wisconsin courts have generally recognized transactions for tax purposes only if they have economic substance and a valid business purpose other than avoiding taxes.

The corporation argued at trial that the business purpose for forming the Delaware affiliate was to protect and promote the corporation's intellectual property, but the evidence overwhelmingly established that the primary purpose for the creation of the Delaware affiliate and the payment of royalties was tax avoidance. The idea for the restructuring originated as a plan to reduce the corporation's Wisconsin income taxes, and the new structure created a circular flow of funds. The corporation transferred its intellectual property to the affiliate, licensed the property back, paid royalties to the Delaware affiliate, and then deducted the royalties as business expenses on its Wisconsin returns. The funds then wound their way back to the corporation through a series of additional transactions with other related entities.

Although reducing taxes is a perfectly legitimate business goal, as long as it is not the primary purpose for a transaction, the evidence in the *Hormel* case showed that the corporation's other alleged purposes for engaging in the challenged transactions were a mere cover for the real purpose, which was tax avoidance. The corporation largely retained control over all decisions related to the intellectual property while it was held by the affiliate. In addition, the affiliate never licensed the property to any unrelated third-party and never had any income from a license to a third-party. These facts strongly indicated that the challenged royalties had no economic substance or business purpose.

The corporation also argued that the transfer of its engineering and research and development divisions and operations to the affiliate showed that the arrangement had economic substance and a business purpose. However, the evidence

showed that this transfer was accomplished primarily to give economic substance to the affiliate in order to protect the tax planning behind its creation. Moreover, the evidence showed that the transferred divisions and personnel did not alter their operations after the transfer, indicating that the restructuring was not undertaken for business purposes.

b. Application of *Hormel*

As *Hormel* involved the formation of related corporate entities to achieve a desired tax result, there are some similarities to the fact situation here. Thus, consistent with *Hormel*, we analyze the "substance and realities" of the transactions by focusing on economic substance, business purpose, and a showing that the transaction was not shaped solely by tax-avoidance features, an approach with which the Commission has long experience. We emphasize, as a start to our substance over form analysis, "[t]he legal right of a taxpayer to decrease the amount of what otherwise would be his [or her] taxes, or altogether avoid them, by means which the law permits." *Gregory v. Helvering*, 293 U.S. 465, 469 (1935). A tax minimization motive for structuring a transaction in a particular way is not inherently fatal, and nothing in this opinion is intended to invalidate otherwise legitimate tax planning strategies. This case thus requires us to strike a balance between legitimate tax planning considerations and the clear mandate of the law.

Several problems here lead us to hold that these transactions fail the "substance and realities" test. First, there is little or no independent substance to the Supply Corporation. The ownership, location, and employees are identical, and the Petitioner admits that Supply was set up as a device to avoid having to charge tax-

exempt customers the sales and use tax. We are not aware of any significant business that Supply conducted on its own unrelated to these transactions. In fact, there is substantially less substance to this relationship than there was in *Hormel* between the parent company and its subsidiary, which had at least one valuable asset, a separate location, and a research and development division. Second, the transactions between Sullivan and Supply are at cost, which tends to indicate the pass-through nature of the transactions. Third, there are indications that the necessary entries between the two corporations were done at the end of the year, and not contemporaneously with the alleged transactions between the two. Fourth, amended returns were filed after the audit began, arguably to support the Petitioner's view of these transactions. The relevant sales were originally reported for sales tax purposes by Sullivan, not Supply. Sullivan carried all of the materials on its returns as its inventory for balance sheet purposes. Fifth, the questioned transactions can be described as indirect. In general, a taxpayer may not secure, by a series of contrived steps, different tax treatment for a transaction than if he or she had carried out the transaction directly. *See Crenshaw v. U.S.*, 450 F.2d 472 (5th Cir. 1971). Sullivan attempts to change what would have been the natural result of a direct purchase of the ceiling tiles by engaging in a second step designed from the outset to circumvent the intent of the tax code. Fundamental principles of taxation, however, dictate that a given result at the end of a straight path is not made a different result because reached by following an indirect path. *Minnesota Tea Co. v. Helvering*, 302 U.S. 609, 613 (1938).

The Petitioner argues that there were two business purposes for the structure it chose for these transactions. First, Sullivan needed to honor its tax-exempt customers' legitimate exemptions from sales tax to remain competitive. Part of the concern is equity with direct sales from the supplier to the tax-exempt organization and the other part is that similarly situated taxpayers should be treated similarly. Indeed, these concerns led the Department as far back as March of 1973 to issue published guidance on these transactions in a Tax Report which is a part of the record for this case. Second, the Petitioner argues that the structure was made necessary because of industry limitations on distributorships, as many of Sullivan's suppliers because of distributorship agreements could not sell their products directly to Supply. However, neither of these justifications presents us with anything truly independent of sales tax considerations. Consequently, because of the lack of economic substance and business purpose, we affirm the Department's decision to ignore the indirect route of the two individual steps, view the transactions in their entireties, and treat them as transactions between Sullivan and its tax-exempt customers.

3. The Case Law

The Commission has visited the question of the responsibility of contractors for the sales tax on sales of materials to non-profits on numerous occasions over the last 50 years. *See, e.g.,* S. *Blickman, Inc. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶200-454 (WTAC 1968); *Willard G. Gilson d.b.a. Gilson Floors v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶201-216 (WTAC 1974), *set aside and remanded* Wis. Tax Rptr. (CCH)¶201-032 (Cir. Ct. 1974), *reinstated* Wis. Tax Rptr. (CCH) ¶201-216 (WTAC 1976); *Jane H.*

Caryer, Inc. d/b/a Caryer Interiors v. Dep't of Revenue, Wis. Tax Rptr (CCH) ¶201-509 (WTAC 1978) *affirmed* Wis. Tax Rptr. (CCH) ¶201-741 (Cir. Ct. 1979); *Badger Electric Construction Co., Inc. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶202-097 (WTAC 1982). In those cases, the Commission upheld the imposition of the tax and made a distinction between the materials the sales tax law taxed and the statute which made certain organizations exempt from the tax.[13] These early cases, however, involve an earlier version of the statute without the second sentence in the current statute limiting the use of resale certificates or do not involve an intermediary, so they do not directly answer the question here.

There are, however, two cases that are more relevant here that were decided after the legislature added the second sentence to what is now Wis. Stat. § 77.51(2) in 1969. They both have similarities to the case here, but also involve significant differences from this case.[14] The parties discuss them at length in the briefs, each attempting to use the cases to support their respective positions. We have reviewed both of the cases and we have concluded that they tend to support the

---

[13] There is also a distinct line of cases where the issue was whether the taxpayer was a "contractor." *See, e.g., Johnson and Johnson, dba Asphalt Products Co. and Asphalt Products Co. Inc. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH)¶202-290 (WTAC 1983); *Advance Pipe and Supply Co., Inc., and Milwaukee Sewer Pipe & Supply Co., Inc. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶202-252 (WTAC 1983).

[14] We see several differences between this case and *Rice* and *Precision Metals* such that we cannot say that those cases are on all fours here. First, the form the Petitioners used here differs from that the taxpayer used in *Rice.* Second, those cases were decided before the Commission issued its decision in *Hormel.* Third, although not an issue in the motions before the Commission, *Rice* and *Precision Metals* were arguably decided under a different statute as 2007 Wis. Act 20 amended Wis. Stat. § 77.51(4)(c)1 effective January 1, 2006, which is in the middle of the audit period here, and renumbered it as Wis. Stat. § 77.51(14)(m). In brief, the statute used to define book transactions as "gross receipts" whereas in the present statute they are defined as a "sale."

Department's argument here. We will first summarize the cases and then explain why they support our conclusion.

The first case is the appellate court decision in *Rice Insulation*. In that case, Rice bought insulation materials from a manufacturer without paying the sales tax. It gave the manufacturer resale certificates, stating the materials were to be resold to a tax-exempt entity. Rice then contracted to sell the materials to a hospital for use in construction. No tax was paid on the resale because the hospital was tax-exempt. The hospital's general contractor subcontracted the installation of the insulation to Rice.

The Department assessed a use tax against Rice for the materials sold to the hospital. After a hearing, the Commission concluded Rice was liable for the use tax because it installed materials it had purchased without paying the sales tax. The Commission held that the differences between the Petitioner's facts and the situations in prior cases decided by the Commission were not sufficient to produce a different result. *Rice Insulation, Inc. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶201-701 (WTAC 1980). The Commission called the Petitioner's argument that it performed its construction activities "for" the general contractor rather than "for" the hospital a "technical distinction without a substantive difference." The Commission stated that there may have been a valid contract between the Petitioner and the general contractor, but the Commission would not recognize it "as a vehicle to circumvent . . . Petitioner's use tax liability." The Commission termed the Petitioner's argument a "4-step series of transactions to avoid the application of the use tax."

The circuit court affirmed the Commission, and the Wisconsin Court of Appeals agreed, stating as follows:

> Rice used the insulation it purchased in its work on St. Michael Hospital. Rice knew it would use the insulation material on the hospital project when it bought the material. Rice's vice-president, William G. Rice, testified at the Tax Appeals Commission hearing that when Rice purchased the insulation, it did so "for the St. Michael's Hospital job." Rice violated sec. 77.51(18), Stats., by failing to pay the tax and reselling the insulation to a customer for whom it would install it. That Becker Construction was an intermediary is irrelevant.

Rice Insulation at 516.

The appellate court rejected Rice's argument that it was not liable for the tax because the legislature intends charitable and religious organizations to be exempt from sales and use taxes. The appellate court cited *Servomation Corp. v. Dep't of Revenue*, 106 Wis. 2d 616, 317 N.W.2d 464 (1982) for the proposition that because a seller may pass a tax on to an exempt entity does not relieve the seller from liability for the tax.

The second decision is *Precision Metals*. Precision Metals, a manufacturer of hollow metal products, bid on a municipal contract for doors. Precision Metals entered three separate bids to supply the doors and three separate bids to install the doors. The bids were not dependent upon each other as to the doors or as to the locations. That is, if Precision was awarded the installation contract, it was not assured that it would get the supply contract or vice versa. Precision Metals, in fact, was awarded all of the contracts. It subsequently entered into six separate contracts.

In completing the contracts, Precision Metals purchased all of the materials without paying sales tax, giving exemption certificates to the suppliers. The Department filed a motion for partial summary judgment. In holding that Precision Metals was subject to the sales and use tax, the Commission held that, at the time Precision Metals acquired the materials, it knew that it was the installer. The Commission held that this case was indistinguishable from *Rice*. The separate contracts for the sales and installation were irrelevant.

Precision Metal's main argument to the Commission appears to have been that *Rice* should not apply because the municipal authority was the consumer of the materials. The Commission disagreed, stating that it was undisputed that Precision Metals did the installation. The Commission noted that, as with the subcontractor in Rice, the Petitioner knew it would install the doors when it purchased the raw materials. The Commission stated that, as Precision Metals had contracts for both the supply and installation, it was liable for the tax when the raw materials were purchased.

We agree with the Department that these cases tend to support its position here. While the Petitioner writes that it is not arguing that those cases were wrongly decided, it goes on to argue that *Servomation* supports the proposition that a seller may structure its business and transactions to give substance to a tax exemption granted by the legislature and recognized by the Department.[15] In addition to being

[15] In *Servomation*, the Commission, the circuit court, the court of appeals, and the Wisconsin Supreme Court agreed that a vending machine operator was liable for the sales tax on sales made from its vending machines located on the property of tax-exempt organizations.

distinguishable, the Petitioner argues that *Rice* and *Precision Metals* are both based on questionable interpretations of two earlier decisions of the Wisconsin Supreme Court. In our view, *Servomation* clearly does not control here, as that case does not involve Wis. Stat. § 77.51(2) or even construction materials. Instead, we draw support from *Rice* and *Precision Metals* for our holding here for two reasons. First, if an unrelated entity did not insulate the contractor in *Rice* from liability for the tax, the willful imposition of a wholly owned subsidiary like Sullivan Supply here cannot insulate Sullivan. Second, the holding by the Commission in *Precision Metals* can be read to focus the inquiry on whether or not the supplier ends up installing the materials, as it did here. If the supplier does the installation, it owes the tax regardless of any intervening entity, related or not.

In sum, our view after reviewing the arguments made by the parties here is that the case law favors the Department's interpretation of the statute.

CONCLUSION

The Department's Motion for Summary Judgment is granted for three reasons. First, the Department has the better reading of the statute. Second, the structure the Petitioners used fails the substance and realities test. Finally, our holding is supported by the *Rice* and *Precision Metals* cases.

ORDERS

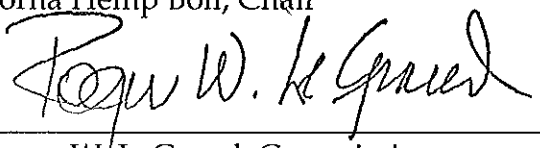
1. The Petitioner's Motion for Summary Judgment is denied.

2. The Department's Motion for Summary Judgment is granted.

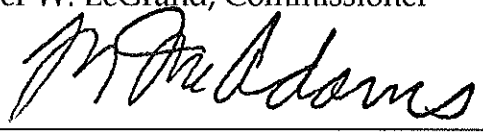
Dated at Madison, Wisconsin, this 14th day of August, 2012.

WISCONSIN TAX APPEALS COMMISSION

Lorna Hemp Boll, Chair



Roger W. LeGrand, Commissioner



Thomas J. McAdams, Commissioner

ATTACHMENT: **"NOTICE OF APPEAL INFORMATION"**

WISCONSIN TAX APPEALS COMMISSION
5005 University Avenue - Suite 110
Madison, Wisconsin - 53705

NOTICE OF APPEAL INFORMATION

NOTICE OF RIGHTS FOR REHEARING OR JUDICIAL REVIEW, THE TIMES ALLOWED FOR EACH, AND THE IDENTIFICATION OF THE PARTY TO BE NAMED AS RESPONDENT

A taxpayer has two options after receiving a Commission final decision:

Option 1: PETITION FOR REHEARING BEFORE THE COMMISSION

The taxpayer has a right to petition for a rehearing of a final decision within 20 days of the service of this decision, as provided in Wis. Stat. § 227.49. The 20-day period commences the day after personal service on the taxpayer or on the date the Commission issued its original decision to the taxpayer. The petition for rehearing should be filed with the Tax Appeals Commission and served upon the other party (which usually is the Department of Revenue). The Petition for Rehearing can be served either in-person, by USPS, or by courier; however, the filing must arrive at the Commission within the 20-day timeframe of the order to be accepted. Alternatively, the taxpayer can appeal this decision directly to circuit court through the filing of a petition for judicial review. It is not necessary to petition for a rehearing first.

AND/OR

Option 2: PETITION FOR JUDICIAL REVIEW

Wis. Stat. § 227.53 provides for judicial review of a final decision. **Several points about starting a case:**

1. **The petition must be filed in the appropriate county circuit court and served upon the Tax Appeals Commission either in-person, by certified mail, or by courier, and served upon the other party (which usually is the Department of Revenue)** within 30 days of this decision if there has been no petition for rehearing, or within 30 days of service of the order that decides a timely petition for rehearing.

2. If a party files a late petition for rehearing, the 30-day period for judicial review starts on the date the Commission issued its original decision to the taxpayer.

3. The 30-day period starts the day after personal service or the day we mail the decision.

4. **The petition for judicial review should name the other party (which is usually the Department of Revenue) as the Respondent, but not the Commission, which is not a party.**

For more information about the other requirements for commencing an appeal to the circuit court, you may wish to contact the clerk of the appropriate circuit court or the Wisconsin Statutes. The website for the courts is *http://wicourts.gov*.

This notice is part of the decision and incorporated therein.