STATE OF WISCONSIN

TAX APPEALS COMMISSION

VISU-SEWER CLEAN & SEAL, INC.
W230 N4855 Betker Road
Pewaukee, WI 53072,

Petitioner,

vs.

DOCKET NO. 02-S-442

DECISION AND ORDER

WISCONSIN DEPARTMENT OF REVENUE
P.O. Box 8907
Madison, WI 53708-8907,

Respondent.

DIANE E. NORMAN, COMMISSIONER:

The above-entitled matter came before the Commission for a hearing on November 18-20, 2003. Petitioner, Visu-Sewer Clean & Seal, Inc. ("petitioner"), appeared by Attorney John R. Austin, of Reinhart Boerner Van Deuren, S.C. Respondent, Wisconsin Department of Revenue ("respondent"), appeared by Attorney Linda M. Mintener. Both parties filed post-trial briefs.

Having considered the entire record before it, the Commission finds, concludes, and orders as follows:

FINDINGS OF FACT

Jurisdictional Facts

1. As a result of a field audit, respondent issued a Notice of Amount Due for a sales/use tax assessment against petitioner on May 17, 1999, in the total amount of $221,336.36, for additional use tax, interest, and late filing fees for the tax

years 1992 through 1997 ("the period under review").

2. Petitioner filed a petition for redetermination with respondent on May 26, 1999.

3. On October 10, 2002, respondent denied the petition for redetermination.

4. On December 9, 2002, petitioner timely filed with the Commission a petition for review of respondent's denial of the petition for redetermination.

Petitioner's Business

5. Petitioner is a Wisconsin corporation engaged in various lines of business, including sewer cleaning and inspecting and re-lining underground sewer pipes that are in disrepair. At issue in this case is the process of re-lining sewer pipes with two separate products, National Liners and U-Liners.

6. Petitioner's customers are primarily government agencies, with a few industrial and private customers.

7. Petitioner did not keep an inventory of National Liners or U-Liners. Petitioner ordered custom lengths of the liners for each job and only kept small amounts of leftover liners for small repair jobs.

8. Petitioner's typical contract language for sewer re-lining and rehabilitation provided that petitioner "provide labor, equipment, and materials to complete" a specific re-lining job. Petitioner billed by the linear foot of the installed liner, a charge that included its labor, equipment, and materials to perform its work and to produce its end product. Petitioner was typically referred to as "contractor" in its contracts with customers.

9. All of petitioner's sewer re-lining work was for underground sewer pipes made of such materials as clay, reinforced concrete, non-reinforced concrete, cast iron, steel, and transite. Sewer pipes have a design life of 50 years and can last well over 100 years.

10. Both the National Liner and the U-Liners have a design life of 50 years.

11. Once the liners are installed into a sewer pipe, the liners cannot be removed without damaging the liner and the host pipe. Removal of the installed liner would only be done if it were damaged. It requires destroying the liner by cutting it up, and may require excavation to pull out the liner. If installed liner were removed after installation, it would be destroyed and could not be used again.

National Liner

12. National Liner is the name of one of the products petitioner used to re-line underground sewer pipes that were in disrepair. For each re-lining job, petitioner would order a custom amount of raw materials from Quail Pipe Corporation ("Quail").[1]

13. There were three raw materials for National Liners: a felt liner[2], resin, and a catalyst material. In order to use the raw materials for lining sewer pipes, the liquefied resin was mixed with the catalyst material. After the mixture was prepared, it had to be kept cool to prevent it from hardening prematurely. The next

[1] Quail was the seller of the raw materials to petitioner at all times during the period under review. At times, the purchases from Quail were made through a purchasing group called National EnviroTech Group.

[2] The felt liner was also called a felt bag or tube. This liner is a long tube consisting of one or more layers of flexible felt liners and a plastic coat made of material compatible with the resin/catalyst mixture.

step was injection of the resin/catalyst mixture into the felt liner in a process known as a "wet-out" process. This process was normally done at petitioner's main facility, although small jobs were occasionally done at the job site. The parties have stipulated that this process is a manufacturing process, and that the machinery and equipment used exclusively for this manufacturing process are exempt from sales and use taxation.[3]

14. After the "wet-out" process is complete and the felt liner is saturated with the resin/catalyst mixture, the liner is moved into a refrigerated truck with ice bags placed between the folds as the liner is layered into the truck. The liner must be kept at a cool temperature to prevent the liner from hardening and becoming useless. The refrigerated truck transports the liner to the job site.

15. At the customer's location, the liner is inserted into the host sewer pipe with water or air pressure by inverting the liner so that the saturated side of the liner is on the outside and the plastic coating is on the inside. After insertion, each end of the liner is capped with steam shoes to create a closed system. Steam pressure is then used to bring the temperature up inside the liner to cause the liner to expand to take the shape of the inside of the host sewer pipe. When fully expanded, the liner fits tightly into the host pipe and oozes into any crevices or grooves, making a "mechanical lock" that prevents the liner from moving away from the host pipe. The temperature of the liner is monitored through the use of heat probes. After this "curing" process of 3 to 4 hours is complete, the liner is gradually cooled down. Next,

[3] A dispute remains as to whether or not the raw materials used in this manufacturing process are subject to sales/use taxation.

the liner is inspected with a video camera pulled through the liner to see if any repairs are required. Finally, openings are cut or milled in the liner to match up with existing openings in the host sewer pipe.

U-Liner

16. U-liner is the name of the other product used by petitioner to re-line sewer pipes in need of repair. For this product, the only item purchased from the seller, Quail, was the lengths of U-Liner[4]. U-Liner is a liner made of high-density polyethylene. Prior to installation in sewer pipes, the diameter of the U-Liner is not circular, but is shaped in a "U". The U-Liner was purchased in custom lengths for each of petitioner's jobs.

17. There is no process performed on the U-Liner at petitioner's facility. It is taken directly to the customer's job site.

18. Once the U-Liner is delivered to the job site, it is inserted into the host sewer pipe. After insertion, the ends are capped off and the inside is heated with steam in a manner similar to the National Liner. The U-liner is heated to a certain temperature to change its shape to mold to the inside of the host sewer pipe. As with the National Liner, when the U-Liner is fully expanded, the liner fits tightly into the host pipe and oozes into any crevices or grooves, making a "mechanical lock" that prevents the liner from moving away from the host pipe. The liner is then cooled and inspected in a manner similar to the National Liner. Finally, cuts are made in the liner to match up with the openings in the host sewer pipe, just as is done with the National Liner.

[4] The U-Liner is also known as fold and form or deformed/reformed pipe.

Installation Royalty Payments

19. In addition to the purchase price of the U-Liner, petitioner paid to Midwest Pipeliners a flat license fee each year for the territorial rights to use this product.[5] The parties have stipulated that this license fee is a purchase of intangible property and is not subject to sales or use tax.

20. A separate, additional cost in the purchase of the U-Liner was an installation royalty fee. This fee was paid on a per-foot basis at different rates based upon the size of the diameter of the U-liner.

21. The installation royalty fee was paid to Pipe Liners or Midwest Pipeliners. The purchase of the U-Liner itself was made by petitioner from parties other than Pipe Liners or Midwest Pipeliners, pursuant to the agreements in effect during the period under review. The payments for the installation royalties and the purchase of the U-Liners were made at the same time, and both payments were recorded on petitioner's bookkeeping records as the cost of the U-Liners.

APPLICABLE WISCONSIN STATUTES

§ 77.51 Definitions.

* * *

> **(2)** "Contractors" and "subcontractors" are the consumers of tangible personal property used by them in real property construction activities and the sales and use tax applies to the sale of tangible personal property to them. A contractor engaged primarily in real property construction activities may use resale certificates only with respect to purchases of property 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 property. In this subsection, "real property construction activities" means activities

[5] There were no license or royalty fees required for the National Liner.

that occur at a site where tangible personal property that is applied or adapted to the use or purpose to which real property is devoted is affixed to that real property, if the intent of the person who affixes that property is to make a permanent accession to the real property. In this subsection, "real property construction activities" do not include affixing to real property tangible personal property that remains tangible personal property after it is affixed.

* * *

(14) "Sale", "sale, lease or rental", "retail sale", "sale at retail", or equivalent terms include any one or all of the following: the transfer of the ownership of, title to, possession of, or enjoyment of tangible personal property or services for use or consumption but not for resale as tangible personal property or services and includes:

* * *

(i) Sales of building materials, supplies and equipment to owners, contractors, subcontractors or builders for the erection of buildings or structures or the alteration, repair or improvement of real property. Such transactions are deemed retail sales in whatsoever quantity sold.

* * *

(15) a) . . . "sales price" means the total amount for which tangible personal property is sold, leased or rented, valued in money, whether paid in money or otherwise, without any deduction on account of any of the following:

1. The cost of the property sold.

2. The cost of the materials used, labor or service cost, losses or any other expenses.

3. The cost of transportation of the property prior to its purchase.

4. Any tax included in or added to the purchase price . . . .

(b) "Sales price" shall not include any of the following:

1. Cash discounts allowed and taken on sales.

2. The amount charged for property returned by customers when that entire amount is refunded either in cash or in credit.

3. Transportation charges separately stated, if the transportation occurs after the purchase of the property is made.

4. In all transactions, except those to which subd. 6 applies, in which an article of tangible personal property is traded toward the purchase of an article of greater value, the sales price shall be only that portion of the purchase price represented by the difference between the full purchase price of the article of greater value and the amount allowed for the article traded.

* * *

(20) "Tangible personal property" means all tangible personal property of every kind and description and includes electricity, natural gas, steam and water and also leased property affixed to realty if the lessor has the right to remove the property upon breach or termination of the lease agreement, unless the lessor of the property is also the lessor of the realty to which the property is affixed. . . .

* * *

§ 77.52 Imposition of retail sales tax.

(1) For the privilege of selling, leasing or renting tangible personal property, including accessories, components, attachments, parts, supplies and materials, at retail a tax is imposed upon all retailers at the rate of 5% of the gross receipts from the sale, lease or rental of tangible personal property, including accessories, components, attachments, parts, supplies and materials, sold, leased or rented at retail in this state.

* * *

(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 . . . .

* * *

§ 77.53 Imposition of use tax.

(1) . . . an excise tax is levied and imposed on the use or consumption in this state of taxable services under § 77.52 purchased from any retailer, at the rate of 5% of the sales price of those services; on the storage, use or other consumption in this state of tangible personal property purchased from any retailer, at the rate of 5% of the sales price of that property; and on the storage, use or other consumption of tangible personal property manufactured, processed or otherwise altered, in or outside this state, by the person who stores, uses or consumes it, from material purchased from any retailer, at the rate of 5% of the sales price of that material.

(2) Every person storing, using or otherwise consuming in this state tangible personal property or taxable services purchased from a retailer is liable for the tax imposed by this section. The person's liability is not extinguished until the tax has been paid to this state . . . .

* * *

§ 77.54 General Exemptions. There are exempted from the taxes imposed by this subchapter:

* * *

(2) The gross receipts from sales of and the storage, use or other consumption of tangible personal property becoming an ingredient or component part of an article of tangible personal property or which is consumed or destroyed or loses its identity in the manufacture of tangible personal property in any form destined for sale . . . .

* * *

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

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

* * *

(6m) For purposes of sub. (6)(a) "manufacturing" is the production by machinery of a new article with a different form,

use and name from existing materials by a process popularly regarded as manufacturing . . . .

* * *

(6r) The exemption under sub. (6) shall be strictly construed.

* * *

APPLICABLE WISCONSIN ADMINISTRATIVE CODE

§ Tax 11.39 Manufacturing.

* * *

(4) NONMANUFACTURERS. Nonmanufacturers include the following:

(a) Contractors, when engaged in real property construction activities . . . .

* * *

§ Tax 11.68 Construction contractors.

(1) DEFINITION. In this section, "real property construction activities" means activities that occur at a site where tangible personal property that is applied or adapted to the use or purpose to which real property is devoted is affixed to that real property, if the intent of the person who affixes that property is to make a permanent accession to the real property. "Real property construction activities" do not include affixing to real property tangible personal property that remains tangible personal property after it is affixed

* * *

(3) REAL PROPERTY CONSTRUCTION CONTRACTORS.

(a) Generally, real property construction contractors are persons who perform real property construction activities and include persons engaged in activities such as building, electrical work, plumbing, heating, painting, steel work, ventilating, paper hanging, sheet metal work, bridge or road construction, well drilling, excavating, wrecking, house moving, landscaping, roofing, carpentry, masonry and cement work, plastering and tile and terrazzo work.

(b) A retailer may also be a real property contractor, such as a department store which sells and installs tangible personal property which becomes a part of real property after installation.

Example: A hot water heater or water softener sold and installed in a purchaser's residence by a retailer becomes real property after installation. The retailer is considered to be a real property contractor.

(4) PURCHASES BY CONTRACTORS.

(a) Under § 77.51(2), Stats., contractors who perform real property construction activities are the consumers of building materials which they use in altering, repairing or improving real property. Therefore, suppliers' sales of building materials to contractors who incorporate the materials into real property in performing construction activities are subject to the tax. This includes raw materials purchased outside Wisconsin that are used by a contractor in manufacturing tangible personal property outside Wisconsin, or that are fabricated or altered outside Wisconsin by a contractor so as to become different or distinct items of tangible personal property from the constituent raw materials, and are subsequently stored, used or consumed in Wisconsin by that contractor.

* * *

(c) Machinery and equipment, including road building equipment, tunnel shields, construction machines, and cement mixers, tools, including power saws and hand tools, and supplies, including machine lubricating and fuel oils, form lumber and industrial gases, purchased by a construction contractor for the contractor's use are generally either consumed in the process of construction or are removed when the project is completed. The contractor is the consumer of the personal property and shall pay the tax on its purchases of the property. However, an exemption is provided in § 77.54(5)(d), Stats., for mobile cement mixers used for mixing and processing and the motor vehicle or trailer on which a mobile mixing unit is mounted, including accessories, attachments, parts, supplies and materials for the vehicles, trailers and units.

* * *

(5) CLASSIFICATION OF PROPERTY AFTER INSTALLATION.

(a) Contractors shall determine whether a particular contract or transaction results in an improvement to real property or in the sale and installation of personal property. In determining whether personal property becomes a part of real property, the following criteria shall be considered:

1. Actual physical annexation to the real property.

2. Application or adaptation to the use or purpose to which the real property is devoted.

3. An intention on the part of the person making the annexation to make a permanent accession to the real property.

Note: See *Dept. of Revenue vs. A. O. Smith Harvestore Products, Inc.*(1976), 72 Wis. 2d 60, regarding determining whether personal property becomes a part of real property.

* * *

(6) PERSONAL PROPERTY WHICH BECOMES A PART OF REALTY. . . . Personal property which becomes a part of real property includes the following:

* * *

(f) Improvements to land, including . . . drainage, storm and sanitary sewers, and water supply lines for drinking water, sanitary purposes . . . .

CONCLUSIONS OF LAW

1. The installation of sewer liners by petitioner was real property construction, and the materials, machinery, and equipment used to install the sewer liners were not exempt from Wisconsin use taxation under Wis. Stat. § 77.53.[6]

2. Installation royalties paid per foot based upon the size of the sewer liner were part of the purchase price of the sewer liner and subject to use taxation under Wis. Stat. § 77.53.

[6] Since the Commission has found that petitioner is a nonmanufacturer and, therefore, not eligible for the manufacturing exemptions under Wis. Stat. §§ 77.54(2) and (6)(a), we do not address respondent's argument that it was improperly denied the opportunity to present expert testimony that petitioner's installation activities were "popularly regarded as manufacturing," nor do we address respondent's other claims of error which are not necessary to the Commission's decision.

OPINION

Petitioner argues that its installation of the National Liners and U-Liners into a customer's host sewer pipes is a manufacturing process, and that the raw materials, equipment, and equipment repair and maintenance were exempt from sales and use taxation under Wis. Stat. §§ 77.54(2) and (6)(a).

Petitioner also argues that the installation royalty payments paid with U-Liner purchases are exempt from sales and use taxation because they are not tangible personal property.

Standard of Review

Tax exemptions are a matter of legislative grace and not of right. *Fall River Canning Co. v. Dep't of Taxation*, 3 Wis. 2d 632, 637, 89 N.W.2d 203 (1958); *Janesville Community Day Care v. Spoden*, 126 Wis. 2d 231, 233, 376 N.W.2d 78 (Ct. App. 1985). Because taxation is the rule and exemption is the exception, tax exemption statutes are to be strictly construed against granting an exemption. *Pabst Brewing Co. v. Milwaukee*, 125 Wis. 2d 437, 445, 373 N.W.2d 680, 684 (Ct. App. 1985). "An exemption from taxation must be clear and express. All presumptions are against it, and it should not be extended by implication." *Wrase v. City of Neenah*, 220 Wis. 2d 166, 171-172, 582 N.W. 2d 457 (Ct. App. 1998).

Sales and Use Tax: Generally

Under Wisconsin law, it is presumed that all sales of tangible personal property are subject to sales or use tax until the contrary is established. Wis. Stat. §§ 77.52(1) and (3) and 77.53(1*); H. Samuels Co. v. Dep't of Revenue*, 70 Wis. 2d 1076 at 1077-1078, 236 N.W.2d 250 (1975). In this case, petitioner has been assessed use taxes by

respondent for its purchases of machinery, equipment, and materials used in its installation of sewer pipe liners known as National Liners and U-Liners.

Petitioner is a real property construction contractor.

Under Wis. Stat. § 77.51(2), real property construction contractors are considered ultimate consumers of the goods that they use in real property construction, thus making the sales and use tax applicable to sales of goods to them.

The primary issue in this case is whether or not petitioner is a real property construction contractor when installing both the National Liner and U-Liner sewer liners. Petitioner argues that the installation of sewer liners is not real property construction because the liners remain personal property even after they are installed into the host sewer pipes.

The case of *Dep't of Revenue v. Smith Harvestore Products*, 72 Wis. 2d 60, 67-68, 240 N.W. 2d 357 (1976), sets forth the three-part test to determine if something is a fixture and, therefore, part of the realty, or remains personal property. This three-part test, codified into Wis. Stat. § 77.51(2) and Wis. Admin. Code § Tax 11.68(1), provides that a fixture has three required elements:

1. Actual physical annexation to the real estate;
2. Application or adaptation to the use or purpose to which the realty is devoted; and
3. An intention on the part of the person making the annexation to make a permanent accession to the freehold.

Physical Annexation

The sewer liners are actually physically annexed to the real estate when they are installed into the host sewer pipes. According to Wis. Admin. Code § Tax 11.68(6)(f), drainage, storm, and sanitary sewers are real property. The sewer liners installed by petitioner are not simply put or placed into sewer pipes, but are heated in place in order to "mechanically lock" into the host pipe by oozing into crevices and grooves of the host pipe before the liners are cooled and hardened. Although the liners are not glued or bolted to real property, they are physically attached in a very secure manner. The only way the sewer liners can be taken out of the host pipe is by demolishing and destroying the liners. This will also likely destroy the host pipe and require excavation for removal of the liners.

Adaptation

Because the liners were installed to repair the sewer host pipes, they are clearly adapted to the use of those pipes. The host sewer pipes are fixtures and treated as part of the real estate under Wis. Admin. Code § Tax 11.68(6)(f). Since the liners are installed to repair damaged host sewer pipes or real estate fixtures, those liners are adapted to the use of the host sewer pipes or real estate.

Intention

Finally, the sewer liners are real property if it is the intent of the petitioner "to make [the annexation] a permanent accession to the freehold." *Harvestore*, 72 Wis. 2d at 67-68. This intent is:

> . . . not the actual subjective intent of the landowner making the annexation, but an objective and presumed intention of that

> hypothetical ordinary reasonable person, to be ascertained in the light of the nature of the article, the degree of annexation, and the appropriateness of the article to the use to which the realty is put.

Harvestore, 72 Wis. 2d at 69.

From the standpoint of the ordinary reasonable person, the sewer pipe liners are intended to be a permanent accession to the realty. Sewer pipe lines, which are real property fixtures, are installed underground and have an estimated design life of 50 to 100 years. The liners also have an estimated design life of at least 50 years, and cannot be removed without demolition of the liners and excavation to remove the liners. They are permanently annexed to the host pipe.

Petitioner argues that the sewer liners are comparable to the communication towers found to be personal property in *All City Communications Co. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-677 (WTAC 2003). In *All City*, the Commission found that there was no intent for the communication towers to be a permanent part of the real property. The intent in *All City* can be distinguished from the present case. The communication towers in *All City* could be dismantled and moved to another location, and the Commission found that a market existed for the sale and purchase of used towers.

Petitioner also argues that "municipalities have the right to remove, relocate, replace, and remove, . . . highways and streets as part of [their] duty to ensure adequate water, sewerage, and other public requirements." While it is true that sewer lines can be moved, that does not make them personal property. Almost anything can be moved or removed - houses, buildings, bridges, and even mountains - and when moved can retain their identity as real property. *Affiliated Bank of Middleton v. Dep't of*

Revenue, 11 WTAC 34 (1979). Thus, the fact that an object can be moved or removed does not make it tangible personal property. Moreover, the liners can only be removed by demolition. Once removed, the liners would be worthless and could not be resold. Since the degree of annexation is such that removal requires demolition of the liners, the clear and objective intent of a reasonable ordinary person would be that the liners are intended to be a permanent accession to the real property.

Petitioner was a contractor when providing to its customers the real property improvement service of repairing sewer pipes by relining them. A "contractor" is defined as:

> One who agrees to furnish materials or perform services at a specified price, esp. for construction.

Webster's II New College Dictionary, at 245 (2001).

Petitioner contracted with its customers to provide materials and perform the service of repairing sewer pipes. The service petitioner agreed to perform is described in petitioner's typical contracts in terms such as to "provide labor, equipment, and materials to complete" a specific relining job. Petitioner billed by the linear foot of the installed liner, a charge that included its labor, equipment, and materials to perform its work and to produce its end product. Petitioner is a contractor.

Petitioner used and furnished building materials, supplies and equipment in its installation of sewer liners. Petitioner provided the liners for sewer pipes and customized those liners to the specifications of each of its jobs by purchasing the precise amount, size, and type of liner that it needed for each individual job and

further customized the liners by cutting them into specific lengths to fit the host pipe. According to Wis. Stat. § 77.51(14)(i), the sale of building materials, supplies and equipment to a contractor is a retail sale subject to sales or use taxation.

Petitioner is not entitled to the manufacturing exemption for materials consumed under Wis. Stat. § 77.54(2).

As a contractor, petitioner was the ultimate consumer of the goods used in real property construction under Wis. Stat. § 77.51(2), and the exemption under Wis. Stat. § 77.54(2) is inapplicable because the installed sewer liners did not remain "tangible personal property" nor were they "destined for sale."

Petitioner in this case claims it is entitled to a sales and use tax exemption pursuant to Wis. Stat. § 77.54(2) for its purchases of materials that became ingredients or component parts or lost their identity in the production of tangible personal property.

The parties have stipulated that the process completed at petitioner's headquarters known as the "wet-out" process is a manufacturing process. The machinery and equipment used exclusively in this manufacturing process are exempt from sales and use taxation. Wis. Stat. § 77.54(6)(a). However, this only applies to the machinery and equipment used exclusively in the manufacturing process at petitioner's headquarters. This exemption does not apply to the materials used or consumed in the wet-out plant or at the installation site for the sewer liners. The end product of sewer liners is not sold to another consumer, but is used in petitioner's performance of real property construction activities. Thus, the manufacturing exemption is not available for the materials used in the wet-out plant or in the installation of the sewer liners. *Dep't of Revenue v. Johnson & Johnson*, 130 Wis. 2d 187, 188, 387 N.W.2d 91 (Ct. App. 1986).

Under the plain language of § 77.51(2), contractors are the ultimate consumers or end-users of tangible personal property which they purchase and which is subsequently incorporated into their real property construction activities. Accordingly, contractors are liable for sales or use tax on the purchase or use of these materials in real property construction activities. *Johnson & Johnson, supra.*; *Rice Insulation, Inc. v. Dep't of Revenue,* 115 Wis. 2d 513, 340 N.W.2d 556 (Ct. App. 1983); *Dep't of Revenue v. Sterling Custom Homes,* 91 Wis. 2d 675, 283 N.W.2d 573 (1979).

It would be a different result if petitioner were not actually installing the liners at the site of the real property construction. In *Advance Pipe & Supply v. Dep't of Revenue*, 128 Wis. 2d 431, 383 N.W.2d 502 (Ct. App. 1986), the Court found that a manufacturer of manhole covers was allowed to claim the exemption for manufacturers. The reasoning was that Advance Pipe was not "significantly involved" in real property construction. *Advance Pipe,* 128 Wis. 2d at 438. Advance Pipe manufactured the components of manhole covers at its facility and delivered them to the job site for installation by the ultimate purchaser. Its drivers routinely left the sites immediately after unloading the components. Petitioner did not simply leave its sewer liners at the job site. Petitioner was significantly involved in the installation of the sewer liners into the real property sewer pipes.

The present case is similar to *Johnson & Johnson,* wherein the Court found that the petitioner was "significantly involved" in the construction process and that its operation was a fully "integrated" part of the on-site construction process. *Johnson & Johnson,* 130 Wis. 2d at 193. In that case, the Court found that the petitioner purchased raw materials from suppliers for use in the manufacture of asphalt products and that

those products were sold primarily to government entities for building roads. Johnson & Johnson did not simply sell its asphalt products to its customers, but was significantly involved in the construction of the roads. It used its own distribution equipment, expertise, and personnel to apply the asphalt. It ensured that the asphalt met specific tolerances for purity, temperature, and composition in conformance with the purchaser's requirements. When applying the asphalt, Johnson & Johnson used its own transport trucks, which were fitted with spray bars and nozzles to insure uniformity of application, and it employed calibrated pressure gauges, meters, and controls on the equipment so that the angle of the spray nozzle and the height of the spray bar were properly adjusted. It also maintained appropriate temperatures for various types and grades of asphalt, and, in general, monitored and controlled the spraying to meet the purchaser's specifications. The Court described the relationship of the special rule applicable to contractors to the exemption statutes involved in the case:

> [Petitioner] purchases raw materials from suppliers for use in the manufacture of emulsified asphalt products. The end product is sold to local units of government for road repair and construction. Generally, under secs. 77.52(13) and (14), [petitioner's] purchases would be exempt from the sales tax if the materials were simply resold to the ultimate consumers. If, however, [petitioner] is a "contractor" as that term is defined in [Wis. Stat. § 77.51(2)] — if it is a "consumer" of the purchased materials in that its resale to the ultimate customer involves the "performance of real property construction activities" by [petitioner] — the exemption is unavailable. . . .

Johnson & Johnson, 130 Wis. 2d at 188.

Petitioner's case is also very similar to the facts of *Zignego Co., Inc. v. Dep't of Revenue*, 211 Wis. 2d 819, 565 N.W.2d 590 (Ct. App. 1997), in which the

purchaser of materials which ultimately became concrete roadways and curb and gutter was found to be a real property construction contractor and not entitled to the exemption for materials consumed in manufacturing under Wis. Stat. § 77.54(2). Zignego manufactured ready-mixed concrete which it incorporated into its paving projects. Ready-mixed concrete is manufactured by mixing together cement, aggregate, water, and other ingredients either in a machine known as a "batch plant" or in specially designed trucks. After the mixing process, the ready-mixed concrete was in a semi-liquid state and was transported in special trucks to Zignego's construction sites, where it was poured into forms, finished by Zignego's employees, and then dried and hardened, forming concrete road surfaces or curbs and gutters. The court found Zignego to be a contractor under Wis. Stat. § 77.51(2), and therefore the sales and use tax was applicable to the materials used in Zignego's road building projects.

Petitioner is a real property construction contractor, and the activities in question are real property construction activities. Thus, petitioner's activities are not eligible for the manufacturing exemption. The Commission has held that when a taxpayer purchases raw materials that are consumed by the taxpayer in creating a product that the taxpayer uses in real property construction, the exemption under Wis. Stat. § 77.54(2) does not apply. *Precision Metals, Inc. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-337 (WTAC 1998); *Oscar J. Druml v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-073 (WTAC 1994). The manufacturing exemption, therefore, does not apply to petitioner in this case.

Petitioner argues that there have been other cases wherein taxpayers

were found to be entitled to the manufacturer's exemptions that petitioner contends apply in this case. In the cases cited by petitioner, the taxpayer was not found to be a real property construction contractor. There was either no discussion regarding real property construction or the case explicitly found that the product manufactured was personal property and not real property construction.[7]

Petitioner is a real property construction contractor and, therefore, a nonmanufacturer under Wis. Admin. Code § Tax 11.39(4)(a).

As a real property construction contractor, petitioner is defined as a "nonmanufacturer" under Wis. Admin. Code § Tax 11.39(4)(a). This Administrative Code provision follows the well-established application of Wis. Stat. §§ 77.51(2) and 77.54(2) and (6) for construction contractors versus manufacturers.

Wisconsin Statutes § 227.11(2)(a) permits an agency to "promulgate rules interpreting the provisions of any statute enforced or administered by it, if the agency considers it necessary to effectuate the purpose of the statute." Administrative rules enacted pursuant to statutory rule-making authority have the force and effect of law. *Kranzush v. Badger State Mut. Cas. Co.*, 103 Wis. 2d 56, 307 N.W.2d 256 (1981). Wis. Admin. Code § Tax 11.39(4)(a), which is consistent with Wisconsin statutes, has the force and effect of law, and we are bound to follow it.[8]

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[7] *Cherney Microbiological Services, Ltd. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 400-215 (WTAC 1996) (microbiological testing service); *Fort Howard Corp. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 203-218 (WTAC 1991) (manufacturer of paper products); *Valley Ready Mixed Concrete Co., Inc. v. Dep't of Revenue*, 11 WTAC 602 (1984) (manufacturer of concrete in mobile mixing units); *Feedmobile, Inc. v. Dep't of Revenue*, 11 WTAC 239 (1982) (manufacturer of mobile feed units for livestock); *Dep't of Revenue v. Bailey-Bohrman Steel Corp.*, 93 Wis. 2d 602, 287 N.W.2d 715 (1980) (manufacturer of custom-sized coiled steel).

[8] Indeed, the Commission has relied on this provision in prior cases. *See e.g., Astra Plating, Inc. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶ 203-134, at n. 48 (WTAC 1990) ("[B]ecause the department now regards retreaders as manufacturers [in Tax 11.39], we conclude that this view represents department's conclusion or acceptance of the proposition that tire retreaders are manufacturers and that the prior classification of them as non-manufacturers was incorrect."), citing *Astra Plating, Inc. v. Dep't of Revenue*, Case No. 80-CV-4446, Wis. Tax Rptr. (CCH) ¶ 201-947 (Dane Co. Cir. Ct. 1981) ("Further support for this

Petitioner is not entitled to the manufacturing exemption for machinery and equipment under Wis. Stat. § 77.54(6)(a) because, as a real property construction contractor, it is the end consumer of personal property under Wis. Admin. Code § Tax 11.68(4)(c) and not a manufacturer under Wis. Admin. Code § Tax 11.39(4)(a).

Petitioner claims an exemption for the machinery, equipment, and maintenance of such that are used in the installation of the liners as part of a manufacturing process under Wis. Stat. § 77.54(6)(a).

The exemption under § 77.54(6)(a) does not apply to the machinery and equipment used by petitioner in the installation of the sewer liners. The machinery and equipment used in the real property construction activities of installation of the sewer liners are personal property purchases that are also subject to sales and use taxation. According to Wis. Admin. Code § Tax 11.68(4)(c), machinery and equipment purchased by construction contractors are subject to sales and use tax because they are the consumers of that personal property. Moreover, as set forth in the preceding section, because petitioner is a contractor, it is not a manufacturer pursuant to Wis. Admin. Code § Tax 11.39(4)(a).

Installation royalties are subject to sales and use taxation.

Petitioner argues that sales and use tax does not apply to the installation royalties it paid for U-Liners because the royalties were a payment for the right to use the liners and not part of the purchase price of the liners.

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conclusion is found in Wis. Adm. Code, secs. Tax 11.39(3) and (4), which provide examples of manufacturers and non-manufacturers. Listed as an example of non-manufacturer in sec. (4)(a) is the entry: 'automobile and auto parts rebuilders.' . . I consider Astra to be a rebuilder, not a manufacturer, of automobile parts."); *Metalplate and Products, Inc. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 201-709 (WTAC 1980) ("Additionally, administrative rule Tax 11.39 reflects that the petitioner's activities are comparable to businesses which that rule classifies as manufacturers and are not comparable to businesses which that rule classifies as nonmanufacturers. See subsections (1), (3) and (4) of administrative rule Tax 11.39. . .").

The installation royalties are subject to sales and use taxation because they are part of the purchase price of the U-Liners. The installation royalty was charged only for the U-Liners, and the charges were based upon the diameter and length of the U-Liners that were purchased by petitioner. Although the installation royalty was payable to one party and the purchase price of the U-Liner itself was payable to another party, the payments for both the installation royalty and the purchase price were paid at the same time and recorded on petitioner's bookkeeping records as the cost of the U-Liners.

In contrast, petitioner paid one lump sum license payment for the right to use the National Liners and U-Liners in a specific territorial district, and no sales or use tax was assessed on this lump sum payment. As discussed above, the installation royalty is very different.

The installation royalty must be subject to the sales and use tax because it was part of the sales price of the National Liners and U-Liners. According to Wis. Stat. § 77.51(15)(a), the sales price of an item is defined as the "total cost" of the property sold and includes the "cost of the materials used, labor or service cost, losses or any other expenses." It is a reasonable interpretation of this statute to find that the installation royalty was part of the "total cost" of the U-Liners.

Since the interpretation of the statute by respondent is a reasonable interpretation and not in error, it must be upheld. Assessments made by the respondent are presumed to be correct, and the burden is upon the petitioner to prove by clear and satisfactory evidence in what respects the respondent erred in its determination. *Edwin J. Puissant, Jr. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶202-401

(WTAC 1984). Since there is no showing by petitioner that respondent erred in its interpretation, the Commission finds that the installation royalties are subject to sales and use taxation as part of the "total cost" of the U-Liners.

In view of the foregoing, petitioner has failed to rebut the presumption of correctness associated with the assessment in this case and has failed to establish that the materials, machinery, and equipment used and consumed in the installation of the National Liners and U-Liners were clearly and expressly exempt under Wis. Stat. §§ 77.54(2) and (6)(a). *Wrase*, 220 Wis. 2d at 171.

Petitioner has also failed to establish that the installation royalty payments for the National Liners and U-Liners were not part of the sales price for those liners. Accordingly, those royalty payments are subject to Wisconsin sales and use taxation.

Therefore,

IT IS ORDERED

That respondent's action on petitioner's petition for redetermination is affirmed.

Dated at Madison, Wisconsin, this 6th day of October, 2005.

WISCONSIN TAX APPEALS COMMISSION

_____
Jennifer E. Nashold, Chairperson

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Diane E. Norman, Commissioner

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David C. Swanson, Commissioner

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