STATE OF WISCONSIN

TAX APPEALS COMMISSION

THE WISSOTA SAND AND GRAVEL COMPANY **DOCKET NO. 00-S-23**
1119 Regis Court, Suite 250
Eau Claire, WI 54701,

Petitioner,

vs. **DECISION AND ORDER**

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

Respondent.

DON M. MILLIS, COMMISSION CHAIRPERSON:

This matter came before the Commission for trial on November 11-13, 2002, in Waukesha. Both parties have submitted post-hearing briefs. Petitioner is represented by Reinhart Boerner Van Deuren, S.C., by Attorney John R. Austin. Respondent is represented by Attorney Linda M. Mintener.

Based on the evidence received at trial, the submissions of the parties, and the entire record in this matter, the Commission finds, concludes, and orders as follows:

FINDINGS OF FACT

Petitioner's Business

1. Petitioner is a Wisconsin corporation with its principal place of business in Eau Claire, Wisconsin. Petitioner's business includes selling sand and gravel.

2. Since before the beginning of the audit period,[1] petitioner has held a sales and use tax seller's permit.

3. During the audit period, petitioner operated at five locations in Wisconsin: Richfield, Haugen, Hayward, Ashland, and Chippewa Falls. At three of these locations—Richfield, Haugen, and Hayward—petitioner operated quarries[2] that crushed, sorted, and washed aggregate products.

4. Petitioner's crushing, sorting, and washing operations at these three quarries are the sole source of issues in this case.

5. Petitioner's quarry operations produce approximately 10 products that it from time to time sells to its customers, depending on demand. These include washed sand, concrete sand, silt or bedding sand, and various sizes of rock aggregates.

Quarry Set Up

6. Setting up the quarries at issue involved multiple steps. The first step was to remove or strip the topsoil, sometimes referred to as A horizon, and the B horizon.[3] (A horizon and B horizon are also collectively referred to as overburden.) These materials were piled along the property lines in a berm. Once the quarry's useful life is over, these materials will be replaced and seeded as part of the reclamation process.

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[1] Unless otherwise specified, all facts pertain to the audit period of November 1, 1993, through October 31, 1997.

[2] In petitioner's trade, the terms quarry, mine, pit, borrow pit, open face pit, and sand and gravel operation are often used interchangeably. The Commission will refer to the operations at issue as quarries.

[3] "A horizon" is the upper portion of the topsoil that contains a higher percentage of organic material. "B horizon" is the layer of topsoil below the A horizon, and contains less organic material and more clay and other impurities.

7. The material exposed by the removal of the overburden is considered the reserve of the quarry.

8. The initial stripping of overburden typically involved only a portion of the quarry property. As the quarry's reserve is depleted, overburden is stripped from remaining portions of the quarry property, typically in the spring of each year.

9. The removal of the overburden was accomplished with the use of bulldozers and scrapers, items of equipment that are not at issue in this case.

10. Once the overburden was removed, the next step was to set up crushing, sorting, and washing equipment, connected by a series of conveyors.

11. The final step was to excavate a series of settling ponds (eight settling ponds in the case of the Richfield site) and fill them with water pumped from a well in the quarry.

Quarry Operation[4]

Bank Run

12. After the overburden was removed, the natural forces of wind and rain caused reserve material from the exposed face of the quarry wall (sometimes referred to as "the face") to slough off and fall to the ground.[5] The material that sloughs off the face is called bank run. This sloughing of the bank run occurs constantly. Other than

[4] This description primarily applies to petitioner's Richfield quarry, where all of the equipment is permanent. The Haugen and Hayward quarries used portable equipment for primary and secondary crushing. The wash plant and ponds at Haugen and Hayward are permanent.

[5] The bank run sloughs off the face because it is not solid but, rather, consists of morainic material.

removal of the overburden, petitioner undertakes no deliberate action to cause the bank run to slough off the face.

13. Depending on the time of year, time of day, and the particular operation at the quarry, bank run may remain at the base of the face for as little as ten minutes or as long as six months.

14. During the audit period, petitioner purchased two 988F wheel loaders, both of which were used exclusively[6] to lift the bank run from the quarry face and carry the bank run to and deposit it in the primary crusher (sometimes referred to as the primary jaw).

15. One of the 988F wheel loaders was used exclusively at the Richfield quarry. The other 988F wheel loader was used along with petitioner's portable crushing equipment. After trade-in allowances, petitioner's cash price for these two 988F wheel loaders was $376,133.

Primary Crusher

16. There are no intermediate steps or storage of bank run between the lifting of the bank run from the base of the face and its deposit into the primary crusher.

17. The primary crusher reduces the size of the largest rocks in the bank run to no larger than three inches in diameter.

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[6] On the day respondent's counsel, other representatives of respondent, and petitioner's counsel visited and filmed the operation at the Richfield quarry in anticipation of trial, one of the 988F wheel loaders was carrying water around the quarry in an attempt to reduce the amount of dust at the quarry. Ordinarily, a water tanker is used to spray water on the quarry to reduce the amount of dust. Petitioner's president had instructed the Richfield quarry foreman to make sure

18. Once the bank run has gone through the primary crusher, it is called breaker run, and includes sand and rocks up to three inches in diameter.

Secondary Crusher

19. From the primary crusher, the breaker run moves via conveyor to a surge pile. From the surge pile, the breaker run moves via conveyor to the secondary crushing spread.

20. The first portion of the secondary crushing spread is the screening plant, which consists of a series of woven wire screens that segregate the breaker run into three sizes: (1) material with a diameter of 1½ to 3 inches; (2) material with a diameter of 7/8 to 1½ inches; and (3) material with a diameter of less than 7/8 inch.

21. Material with a diameter of 1½ to 3 inches goes to a cone crusher that is designed to reduce the material to a maximum diameter of 1½ inches, and then it returns to the screening plant.

22. Material with a diameter of 7/8 to 1½ inches goes to another cone crusher that is designed to reduce the size of the material to a maximum of 7/8 inch in diameter. About 40 percent of the material in the two larger categories will go through the crushers at least twice in order to achieve a diameter of 7/8 inch.

23. Generally, the material leaving the secondary crushing spread is reduced to a diameter of 7/8 inch or less. The size of the screens at the screening plant

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to eliminate dust, given the planned visit. Other than this incident, the 988F wheel loader was used only as described in the text.

can be adjusted to allow a different size rock to emerge from the secondary crushing spread.

Wash Plant, Sand Screws and Drying Areas

24. From the secondary crushing spread, the material moves via conveyor to another surge pile. The purpose of each surge pile is to provide a constant flow of material to the next step in the process.

25. From the second surge pile, the material moves via conveyor to the wash plant, where the material goes across a large screen and is deluged with 1,800 gallons of water per minute. The rock that is trapped by the screen at the wash plant is placed into small, temporary piles where it dries.[7]

26. Once the rock is dried, it is moved via a 980F II wheel loader to a large storage pile and is ready to be sold to customers.

27. The water from the wash plant goes through a series of sand screws that separates the sand from most of the water. The resulting wet sand is then placed into a series of smaller, temporary piles where it dries.

28. Once the sand is dried, it is moved via a 980F II wheel loader to a large storage pile and is ready to be sold to customers.

29. The purpose of drying the rock and sand is to comply with customer desire for dry product. Drying occurs on surfaces that are designed to allow water to drain from the material.

30. Customer preference for dry material grows out of petitioner's practice to price all of its products based on weight. Moisture in the product adds weight. Since a wet product weighs more and, therefore, costs more than dry product, customers prefer dry products. Moreover, for applications such as sand for redi-mix concrete, customers desire a consistently dry product.

31. After the rock and sand have dried, the operation of the quarry would be impaired if these materials remained in piles at the end of the conveyors until sold to customers. There might not be enough room for additional product to come off the conveyor, and loading of customer trucks might interfere with the operation of the quarry.

32. The 980F II wheel loader was used virtually exclusively to stockpile dewatered material to the first point of storage.

33. A very small portion of largely undesirable material—called manufactured fines—does not go through the wash plant. Although the record is not clear on this point, it may be that the 980F II wheel loader transports these manufactured fines to the first point of storage.

34. During the audit period, petitioner purchased a 980F II wheel loader for a net cash price of $163,702.76.

Skid Steers

35. Petitioner has approximately 4,000 feet of conveyors at the Richfield quarry, in five or six sections.

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[7] The drying process is sometimes referred to as "dewatering."

36. These sections of conveyors meet at transfer points where material regularly falls off of the conveyors.

37. Petitioner employs skid steer loaders exclusively to pick up the material that falls off of the conveyors at transfer points and replace the material onto the conveyors. These skid steer loaders are used for no other purpose.

38. During the audit period, petitioner purchased two skid steer loaders for a total net cost of $39,541.38.

Silt and Bedding Sand

39. Once the sand is removed from the water by the sand screws, the water is pumped to the first of a series of settling ponds. As the water flows from one pond to the next, minute particles of sand, called fines, settle at the bottom of the ponds.

40. By the time the water flows to the last pond, the water is clean enough to be used again at the wash plant. Petitioner recycles approximately 90 percent of the water used in the Richfield quarry.

41. About once per month, petitioner removes the fines from the four upstream settling ponds[8] using a 322BL hydraulic excavator—a device specifically designed for this purpose. The 322BL hydraulic excavator has a small bucket at the end of a 65-foot boom.

42. The 322BL hydraulic excavator deposits the fines into a dump truck that transports the fines to a stockpile, where they dry. Once dry, the resulting product is

[8] The fines that end up in the "lower" four settling ponds are not suitable for sale.

called silt or bedding sand, and is moved to a storage pile where it is sold to petitioner's customers.

43. Petitioner purchased a 322BL hydraulic excavator for a net price of $60,289.

44. Petitioner rented the 322BL hydraulic excavator to a customer on one occasion during which the excavator was operated for 29 hours. As of October 11, 2000, the 322BL hydraulic excavator had been operated by petitioner in excess of 2,681 hours.

45. Other than the single rental described above, up to the date of trial, the 322BL hydraulic excavator had not been rented to any other person or used for any purpose other than removal of silt or bedding sand.

Winter Operation

46. Except for its washing operation, each of petitioner's quarries is able to crush bank run during the winter months.

47. Breaker run that is crushed but not washed during winter operation is still washed, when weather permits, and then dried before it is sold.

Light Towers

48. From time to time, petitioner operated the Richfield plant at night.

49. In order to operate during evening hours, petitioner used two light towers, each powered with a self-contained diesel generator.

50. Light towers illuminated the primary crusher and head pulley that drives the conveyor so that petitioner's employees could monitor the effective and safe operation of this equipment.

Mine and Mining Approvals and Regulation

51. The Federal Mine Safety and Health Administration regulate petitioner's quarries.

52. Petitioner obtained from the Wisconsin Department of Natural Resources a storm water discharge permit for its Richfield quarry.

53. On its application for the storm water discharge permit, petitioner described the type of activity at the Richfield quarry as "Mine-process sand & gravel" and included a narrative description of the quarry as a "mining area and plant site. . . ."

54. Petitioner's Richfield quarry is subject to reclamation reporting and permitting requirements as a non-metallic mining site under Chapter 18 of the Washington County ordinance code.

55. Petitioner's application for a conditional use permit from Sawyer County for its Hayward operation described the planned use as "Non-metallic Mineral Extraction including rock crusher and asphalt plant."

Jurisdictional Facts

56. Under the date of January 27, 1999, respondent issued a sales and use tax assessment against petitioner in the amount of $61,997.65 in tax, $24,084.38 in interest, and $15,499.42 in penalty.

57. The assessment included use tax on several items purchased from out-of-state vendors.

58. Under the date of February 16, 1999, petitioner filed with respondent its petition for redetermination objecting to the assessment. Under the date of December 14, 1999, respondent issued its notice of action denying the petition for redetermination.

59. On February 3, 2000, petitioner filed a timely petition for review with the Commission. On November 9, 2001, the Commission granted leave to petitioner to file its amended petition for review, which had previously been submitted on May 3, 2001.

Prior Assessment

60. Under the date of July 7, 1993, respondent issued a sales and use tax assessment against petitioner for the period November 1, 1988, through October 31, 1992 ("prior assessment"). Petitioner did not appeal this assessment.

61. In the current assessment, respondent has assessed use tax on certain fixed assets which it did not assess in the prior assessment. However, respondent assessed use tax on light towers in both the prior assessment and the current assessment.

Stipulations

62. The parties have entered into certain stipulations with respect to the value of some items and resolving some items, including parts and repair expenses. These stipulations will not be recited here, but they will be incorporated in the Order.

APPLICABLE LAW

Statutes

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

(6) The gross receipts from the sale of and the storage, use or other consumption of:
(a) Machines and specific processing equipment and repair parts or replacements thereof, exclusively and directly used by a manufacturer in manufacturing tangible personal property and safety attachments for those machines and equipment.

* * *

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

* * *

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

Administrative Code

Tax 11.39 Manufacturing.

* * *

(2) SCOPE OF MANUFACTURING.
(a) Manufacturing includes the assembly of finished units of tangible personal property and packaging when it is a part of an operation performed by the producer of the product or by another on the producer's behalf and the package or container becomes a part of the tangible personal property as the unit is customarily offered for sale by the producer. It includes the conveyance of raw materials and supplies from plant inventory to the work point of the same plant, conveyance of work in progress directly from one manufacturing operation to another in the same plant and conveyance of finished products to the point of first storage on the plant premises. It includes the testing or inspection throughout the scope of manufacturing.

CONCLUSIONS OF LAW

1. Petitioner's two 988F wheel loaders were used directly and exclusively in manufacturing under section 77.54(6) because they conveyed raw material to the work point of petitioner's quarries. § TAX 11.39(2)(a), Wis. Admin. Code.

2. The activity of picking up bank run at the base of the quarry face and conveying it to the primary crusher is not mining.

3. Petitioner's 980F II wheel loader was used exclusively and directly in manufacturing under section 77.54(6) because it moved material from the end of the conveyor and/or drying areas to the point of first storage. § TAX 11.39(2)(a), Wis. Admin. Code.

4. Petitioner's skid steers were used exclusively and directly in manufacturing under section 77.54(6) because they were used exclusively to pick up and replace material that fell off of conveyors.

5. Petitioner's 322BL excavator was used exclusively and directly in manufacturing because it was used exclusively to remove fines from settling ponds as part of the process of producing silt and bedding sand, products that petitioner sold to customers.

6. Petitioner's use of light towers to illuminate the manufacturing operation at the Richfield quarry was too far removed from the step-by-step manufacturing process to be considered directly used in manufacturing.

7. Petitioner has failed to show that its errors in failing to report and pay its use tax liabilities were due to good cause and not neglect.

OPINION

This case primarily concerns petitioner's use of eight items of equipment that it purchased during the period under review for a total net price of $639,666. Petitioner argues that each of these items of equipment is directly and exclusively used in

the manufacture of tangible personal property and, therefore, is exempt from the sales and use tax pursuant to section 77.54(6) of the Statutes. Respondent disagrees. The Commission will consider each item of equipment.

988F Wheel Loaders

Section TAX 11.39(2)(a)

The two 988F wheel loaders at issue were used exclusively[9] to transport bank run from the base of the quarry face and deposit the bank run into the primary crusher. Manufacturing "includes the conveyance of raw materials and supplies from plant inventory to the work point of the same plant". § TAX 11.39(2)(a) Wis. Admin. Code. The threshold issue is, therefore, whether the bank run at the base of the quarry face constitutes raw material from plant inventory.

Respondent correctly observes that because this case involves an exemption statute, this statute must be narrowly construed. *Ramrod, Inc. v. Dep't of Revenue*, 64 Wis. 2d. 499, 504 (1974). However, our interpretation of this exemption "need not be unreasonable or the narrowest possible." *Department of Revenue v. Greiling*, 112 Wis. 2d 602, 605 (1983). To conclude that the bank run at the base of the quarry face is not raw material would be unreasonable and unnecessarily narrow.[10]

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[9] Petitioner's one-time use of one of the 988F wheel loaders to control dust at the Richfield quarry was *de minimus*.

[10] Respondent also argues that the Commission may not consider the integrated plant test in this case. The integrated plant test was first articulated in *The Manitowoc Co., Inc. v. Sturgeon Bay*, 122 Wis. 2d 406, 417 (Ct. App. 1984), and has been applied in a number of cases over the years, including a few cited in this opinion. We need not determine whether the legislature has repealed the integrated plant test because it is not essential to our holding here. We note, however, that most of the provisions cited by respondent to support its assertion that the integrated plant test was repealed pertain to the property tax exemption in section 70.11(27), not to the sales tax

Respondent argues that the "bank of the quarry" cannot be raw material inventory because it is real property, and that inventory is personal property:

> "Inventory" is defined as, "[t]he quantity of goods and material on hand; stock." The dictionary, in turn, defines "goods" as follows:
>
> a. Commodities; wares
>
> b. Portable personal property
>
> The applicable definition of "commodity" is:
>
> An article of trade or commerce, esp. an agricultural or mining product, that can be transported.[11]

Respondent's Brief at 28. This definition of inventory might not apply to the entire reserve of the quarry that has not sloughed off the quarry face, but it certainly applies to the bank run that has fallen to the base of the wall. It is, in the words of the definition quoted by respondent, "portable personal property" or product "that can be transported." At a minimum, petitioner's inventory includes the bank run that has fallen from the quarry face. It matters not how the bank run got there.

By the plain language of the rule, the transport of the raw material (i.e., bank run at the base of the quarry face) to the primary crusher is included in the scope of manufacturing.

It is significant that petitioner does not argue that the removal of the overburden is part of the manufacturing process. In fact, petitioner apparently concedes

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exemption in section 77.54(6). The Commission's conclusions are based primarily on the plain language of respondent's Administrative Rule section TAX 11.39(2)(a).

[11] Respondent cites THE AMERICAN HERITAGE DICTIONARY (1991 2d Coll. Ed.), at 298, 567, and 675.

that this activity precedes the manufacturing process.[12]

Mining vs. Manufacturing

Respondent argues that petitioner's use of 988F wheel loaders to remove bank run from the base of the quarry face is mining, and that it occurs prior to the commencement of the manufacturing process. Respondent relies upon decisions in two circuit court appeals of Commission decisions: *Department of Revenue v. Edward Kraemer & Sons, Inc.*, Case No. 82-CV-3516, Slip Op. (Dane Co. Cir. Ct. Mar. 17, 1983) ("*Kraemer II*"), and *Department of Revenue v. A.F. Gelhar Co., Inc.*, Case No. 82-CV-2609, Slip Op. (Dane Co. Cir. Ct. Dec. 15, 1982). Respondent's reliance is misplaced.

In *Kraemer II*, the taxpayer was in the business of processing granite and limestone materials into commercial products. *Edward Kraemer & Sons, Inc. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶ 202-041 (WTAC 1982) ("*Kraemer I*"). The taxpayer's operation included the use of machinery and equipment to drill and blast rock. *Kraemer I,* at 1. The Commission concluded that the taxpayer's entire operation constituted manufacturing. *Kraemer I,* at 3.

Notably, one member of the Commission dissented from the Commission's holding in *Kraemer I,* observing that the taxpayer made purchases of equipment,

[12] The result in this case is more restrictive from a taxpayer's point of view than the result in *Hammersley Stone Co., Inc v. Wisconsin Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶ 400-698 (WTAC 2003) (appeal pending). When the Commission considered the definition of manufacturing set forth in section 77.54(6m) in *Hammersley*, the Commission listed a number of Hammersley's activities under the element of "production by machinery." One of these activities listed by the Commission was the removal of overburden by machine. If the courts on appeal take the position adopted by respondent that removal of overburden in *Hammersley* occurs prior to the commencement of the manufacturing process, that holding alone would not affect the Commission's conclusion in this case with respect to the 988F wheel loaders.

machinery, and parts that were used in its drilling and blasting operation. The dissenting Commissioner also observed that the taxpayer appeared to concede that its extraction activities using this machinery and equipment were not part of the manufacturing process. The dissenting Commissioner, therefore, concluded that the taxpayer's purchases of "drilling and blasting equipment, machinery and parts" should be subject to the use tax. *Kraemer I*, at 4.

On appeal, the Dane County Circuit Court affirmed the Commission's decision except with respect to the taxpayer's extraction activities. Specifically, the court held "that the procedures the raw stone material goes through *after it is extracted from the ground* constitutes manufacturing." *Kraemer II*, at 5-6 (emphasis supplied). However, the court in *Kraemer II* did not specify the precise moment in which the manufacturing process began. All we know is that unspecified extraction activities do not constitute manufacturing. It is certain, however, that the court in *Kraemer II* reviewed the opinion from the learned dissenting Commissioner, and it is likely that the court was referring to the drilling and blasting equipment, machinery, and parts cited in the dissent.

The court's decision in *Kraemer II* does not stand for the proposition that petitioner's use of 988F wheel loaders to convey bank run to the primary crusher is outside of the manufacturing process. Moreover, based on the dissenting opinion, it appears that the court in *Kraemer II* equated "extraction" with "blasting and drilling." In the present case, the analog of blasting and drilling is the removal of overburden, a step that petitioner concedes in this case precedes the manufacturing process.

The *Gelhar* decision, likewise, provides no support for respondent's argument. In *Gelhar*, the taxpayer conceded that manufacturing did not include blasting and removal of raw material from its pit to its plant. *Gelhar*, Slip Op. at 2. A taxpayer's concession in one case is not binding upon petitioner or the Commission in this case.

Respondent also argues that petitioner's operation must be considered mining because with respect to certain governmental approvals petitioner's operation has been labeled a mine or mining, and that its operations might meet the dictionary definition of a mine. However, the only relevant question is whether petitioner's use of the 988F wheel loaders at issue is within the definition of manufacturing under the statutes and administrative rules. The Dane County Circuit Court in *Gelhar* concluded:

> In light of these considerations, the Commission could properly (as it apparently did) accord less weight to the written, conclusory characterizations of [the taxpayer's] operations [as a mine] than to the undisputed underlying facts regarding the actual nature of the business. As already discussed, these latter facts provided substantial support for the Commission's determination that [the taxpayer] is engaged in manufacturing within the meaning of secs. 77.54(6)(a) and 77.51(27), Stats.

Gelhar, Slip Op. at 8. As we pointed out in *Hammersley*, if an activity falls within the statutory definition of manufacturing, it is still considered manufacturing, even if it might otherwise be considered mining. *Hammersley*, at 7.[13]

We conclude that petitioner's use of the 988F wheel loaders falls squarely within the language of section TAX 11.39(2)(a), in that they exclusively convey raw

[13] Respondent argues that section TAX 11.39(4)(n)4 of the Wisconsin Administrative Code provides that "nonmanufacturers" include persons engaged in mining. This rule does not define mining. It may be true that some of what petitioner does is mining (e.g., removal of overburden). We cannot conclude that mining involves the transport of bank run from the base of the face to the primary crusher.

material from plant inventory to the primary crusher. Therefore, the two 988F wheel loaders are exempt from the sales and use tax.

980F II Wheel Loader

Respondent argues that petitioner's use of the 980F II wheel loader at the Richfield quarry was outside of the scope of manufacturing. Respondent's argument fails on two accounts.

Drying of Materials

Virtually all of the materials at the Richfield quarry went through the wash plant and were deposited temporarily in a series of small piles to dry or dewater. Respondent argues that where the wet aggregate drops off of the conveyor is the point of first storage because drying cannot be considered part of the scope of manufacturing.

As an initial matter, we believe that the process of drying material by setting it in the open air is popularly regarded as part of the manufacturing process. While the context was different, the Wisconsin Supreme Court came to the same conclusion:

> Obviously it would be in process of manufacturing when drying in an artificially fired kiln. Removal of water is no less a manufacturing operation when performed out of doors by solar heat.

United States Plywood Corp. v. Algoma, 2 Wis. 2d. 567, 576-77 (1958).[14]

Respondent argues that the wet product coming from the wash plant is finished product, and that no further process was needed to finalize its name or character.

Respondent relies on the testimony of its expert witness to assert that the product could be sold directly from the wash plant. The testimony of respondent's expert, on this point, was devoid of credibility.

Petitioner offered testimony about the specific customer preferences for dry product. One aspect of this preference had to do with the weight of water in the product and the cost this water adds to the price of all petitioner's product, because they are all sold on the basis of weight. Respondent's expert offered no explanation of how customers would react to being offered wet product at a higher cost.

While it may be true that the wet product could be used in place of the dry product, the uncontradicted testimony at trial is that petitioner's customers preferred the dry product. Even if there was demand by some customers for wet product, it is up to petitioner—not respondent—to determine the demand it wishes to meet. Would the fact that there may be a market for headless Barbie dolls mean that the manufacture of these dolls ends prior to application of the head? Of course not. As long as the drying or dewatering step is not a sham, we conclude that the product is not complete until dry.

With respect to the manufactured fines that are not washed, this appears to be a very small portion of the material that comes from the secondary crushing spread, and it is not even clear that the 980F II wheel loader moves this material. Assuming the 980F II wheel loader was used to move non-washed material, the amount appears to be so small as to be *de minimus*.

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[14] The Commission held that drying was within the scope of manufacturing in *Artex Corp. v. Dep't of Revenue*, Wis. Tax Rptr. (CCH) ¶ 202-476 (WTAC 1984), *aff'd* Wis. Tax Rptr. ¶ 202-585 (Dane Co.

Respondent points out that breaker run that goes through the secondary crushing spread in the winter months is not washed, and the 980F II wheel loader is used to stockpile this material. However, when weather permits, this material is washed and then dried. This storage is within the scope of manufacturing in the same way that storage into surge piles is within the scope of manufacturing. Therefore, the use of the 980F II wheel loader to pile unwashed material until the weather permits washing is within the scope of manufacturing.

Point of First Storage

Section TAX 11.39(2)(a) provides that the scope of manufacturing includes "conveyance of finished products to the point of first storage". The Commission has previously held that lime handling and conveying equipment at the beginning of the manufacturing process was within the scope of manufacturing because it maintained a controlled supply of lime and prevented the lime from hardening. *Fort Howard Paper Co. v. Dep't of Revenue,* Wis. Tax Rptr. (CCH) ¶ 202-974 at 13,857-58 (WTAC 1988). The Commission held that storage was incidental to the purpose of the handling and conveying equipment: to feed the lime slaking machinery at the required rate. *Id.* at p. 13,865.

The Commission in *Fort Howard* relied on its decision in *Thiry Daems Cheese Factory, Inc. v. Dep't of Revenue,* Docket No. S-9281 (WTAC 1985), *aff'd* Wis. Tax Rptr. (CCH) ¶ 202-657 (Dane Co. Cir. Ct. 1986). The Commission in *Thiry Daems* concluded that a milk tank that merely gathered enough milk for a once-a-day batch feed into the cheese-

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Cir. Ct. 1985).

making process was within the scope of manufacturing, because it was not only essential to the operation of the plant but was an actual part of the plant's operation. *Fort Howard*, at p. 13,864.

In the present case, leaving material in small piles at the end of the conveyor would interfere with the operation of the plant. At some point, the piles would be too large and would interfere with the operation of the plant. Moreover, loading customer trucks from these piles would also interfere with the operation of the plant. Moving the material from the small piles at the end of the conveyor promotes the efficient operation of the plant.

We cannot conclude, therefore, that the first point of storage is the place where the material drops off the conveyor, because to leave it in this location would interfere with the efficient operation of the plant.

We disagree with respondent's position on a more fundamental level. Respondent would have the point of first storage be the point at the end of the production line where widgets become widgets. We cannot believe that the point at which a widget drops off the conveyor onto the factory floor is necessarily the point of first storage.

We conclude that the use of the 980F II wheel loader was within the scope of manufacturing, and, therefore, its purchase was exempt from the sales and use tax.

Discovery Responses

Respondent argues that the 980F II wheel loader was not used exclusively to move dried product to the point of first storage. Respondent cites discovery responses in which petitioner asserted that this machine was used to load the crushers. We find

respondent's argument irrelevant because we have already concluded that loading the crushers is within the scope of manufacturing.

We must also reject respondent's argument because the Commission concludes that, as a matter of fact, the 980F II wheel loader was not used to feed the crushers. In an interrogatory, petitioner said the "980Fs were also used to load the crushers." In an affirmative assertion after denying one of respondent's requests to admit, petitioner asserted that the "CAT 980F II was used to load crushers for the portable operations." These discovery requests are not binding upon the Commission, nor is petitioner estopped from offering facts to the contrary.[15]

Respondent never used these discovery responses to impeach petitioner's president, a witness whom the Commission finds very credible. In fact, we find respondent's failure to use these discovery responses telling. Respondent cannot expect the Commission to accept facts from discovery documents that would not ordinarily be admissible—they were actually offered by petitioner—unless it is willing to confront petitioner's witnesses with apparent inconsistencies in testimony. This is especially so when the witness who was not confronted is so credible. There are any number of explanations for these apparent inconsistencies, but we will not know because petitioner's president was not confronted with these discovery responses. Respondent will not benefit from its failure to ask.

Skid Steers

Respondent apparently concedes that use of the skid steers to pick up spilled material and replace it on conveyors is within the scope of manufacturing. It argues, however, that they were used for some unspecified nonmanufacturing purpose.

Respondent relies on notations that its auditor made on his work papers. On a table next to the entry for skid steers, the auditor wrote "mixed use." He testified that he would have only made these notations based on conversations with petitioner's president. Notably, he could not recall any specific conversation with petitioner's president about the skid steers, and he could not testify as to what nonmanufacturing use the skid steers were allegedly put. Essentially, respondent's auditor testified that since the words "mixed use" appear next to these entries, petitioner's president must have told him about some nonmanufacturing use.

We are not suggesting that respondent's auditor is less than truthful, but his testimony is not credible for several reasons. He could not recall specifics of the conversation with petitioner's president or of the nonmanufacturing use. He apparently had no notes with respect to the alternative use of the skid steers other than the conclusory "mixed use" notation. Testimony at trial demonstrated other mistakes on the schedules in the work papers. Finally, the testimony of petitioner's president was very credible.

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[15] Even though one of these responses was to a request to admit, it is not binding on petitioner. Section 804.11(2) provides only that matters admitted are deemed conclusively established. Petitioner never admitted the statement.

Respondent points to a demonstration exhibit offered by petitioner that attempted to show petitioner's manufacturing process in a schematic format. A box on that demonstration exhibit includes the notation "End Loader Grader Skid Steer (Disputed)" and is connected by a dotted line to another box with the notation "Move Finished Products to First Point of Storage." Respondent argues that this shows that the skid steers were also used to move product to the point of first storage and, therefore, supports the conclusion that the skid steers had a mixed use. Because we conclude that movement of material from the end of the conveyor to the permanent storage is conveyance to point of first storage, even if we agreed with respondent, it would not change the outcome.

However, we reject the notion that this notation, in and of itself, impeaches the credible testimony of petitioner's president. Petitioner's president testified that skid steers were used exclusively to replace material on the conveyors, and on one version of this demonstration exhibit, directed that the words "skid steers" be written next to the box on the demonstration exhibit that contained the notation "Crushing." Respondent's counsel was free to ask petitioner about this possible contradiction. Petitioner's president may or may not have had a credible answer. Respondent will not get the benefit of an assumption that there was no credible explanation by failure of its counsel to ask the question.

We should also note that even if we found the testimony of respondent's auditor more credible, we could still not accept it as respondent asks because we do not

know exactly which "nonmanufacturing" use was meant by the auditor's notation. It could be a use that the Commission considers to be within the scope of manufacturing.

We conclude, therefore, that the skid steers were used entirely within the scope of manufacturing, and their purchase was exempt from the sales and use tax.

322BL Hydraulic Excavator

Petitioner argues that the production of silt or bedding sand was a manufacturing process that necessarily required removal of fines from settling ponds and the drying of the fines to produce the silt or bedding sand. Thus, petitioner argues that the 322BL hydraulic excavator was used to remove the fines and, therefore, was used exclusively and directly within the scope of manufacturing.

In the alternative, petitioner argues that the 322BL hydraulic excavator was engaged in waste reduction or recycling and, therefore, exempt under section 77.54(26m) of the Statutes. Because the Commission concludes that the 322BL hydraulic excavator was used within the scope of manufacturing, we will not address the claimed exemption under section 77.54(26m).

Fines are produced when crushed material from the secondary crusher spread is deluged with water. After sand screws separate the sand from the water, the fines remain suspended in the water. Fines settle out in the settling ponds and must be removed before they can be sold as silt or bedding sand. The 322BL hydraulic excavator removes the fines from the settling ponds so that they can be transported to a drying area.

The 322BL hydraulic excavator is clearly used exclusively[16] and directly in the scope of manufacturing.

Respondent first argues that the 322BL hydraulic excavator is involved in mining or extraction. All of the definitions of mining put forth by respondent include the extraction of minerals or ores from the ground or earth. These definitions do not include removal of a settled particulate from a settling pond.

Respondent challenges the notion that the production of animal bedding or silt was anything other than the removal of waste from settling ponds. Respondent relies on the testimony of its expert. For the most part, we find the credibility of this expert's testimony lacking.

Respondent's expert testified that silt was unacceptable fill under standards maintained by the Wisconsin Department of Transportation ("DOT"). However, he admitted that he was unfamiliar with the DOT's standard for unclassified fill. Petitioner's expert offered credible testimony that silt was acceptable as unclassified fill under DOT standards.

Respondent's expert also attempted to challenge the testimony of petitioner's president and its expert that bedding sand was sold to farmers. Respondent's expert had no demonstrated experience in agricultural uses of bedding sand, his testimony was equivocal on this point (e.g., "I believe it's an agricultural product")[17], and

[16] The rental of the 322 BL hydraulic excavator for 29 hours was clearly a *de minimus* potentially nonmanufacturing use.

[17] Transcript, Day 3, p. 90, l. 14.

it was largely based on a conversation with one of petitioner's customers, who told the expert what the customer *believed*. It is hard to give weight to such testimony.

In contrast, the credible testimony of petitioner's president and its expert showed that petitioner had ready markets for silt and bedding sand, and that during the period under review, petitioner sold between 15,000 and 20,000 tons per year at an approximate average price of $1.10 per ton, of which $0.25 was the charge for loading.

Respondent also questions the wisdom of purchasing the 322BL hydraulic excavator for the stated purpose. Respondent claims that the 322BL hydraulic excavator is worth $200,000 based on its expert's testimony. Respondent's expert witness testified that petitioner could have rented this same item for $2,200 per week. Respondent supports this assertion with a notation in one of the auditor's schedules of an expense of $18,750[18] for "rental of CAT excavator & bucket from 4/95 – 7/95; for excavating ponds" to support the expert's testimony.

Our initial reaction to this argument is, so what? Whether petitioner is wasteful in its decision to buy—rather than rent—the equipment to remove fines from the settling ponds has no bearing on whether the activity is within the scope of manufacturing. The definition of manufacturing has no element of economic efficiency.

Moreover, we find that the evidence offered by respondent is less than credible. First, respondent is relying on an entry on a schedule prepared by its own auditor. We have no evidence to compare the item rented in 1995 with the 322BL

hydraulic excavator. Perhaps the rented item was largely inferior to the purchased excavator. Additionally, we do not know if it was possible to rent the excavator for weekly periods. Perhaps the lessor required a minimum term. Finally, we do not know the actual price, including trade-in. Respondent's witness had no background or experience that would justify his estimate that the 322BL hydraulic excavator was worth $200,000. It could be that, over the useful life of the 322BL hydraulic excavator, paying $18,750 to rent an excavator would exceed the net after-tax cost of purchasing the 322BL hydraulic excavator. The record shows that petitioner paid $60,389 plus trade-in. It is not clear what value was assigned to the trade-in. We cannot know the answers to these issues, because respondent's counsel did not ask petitioner's president or its expert about these.

We also note that respondent goes to great lengths to rebut petitioner's argument that the 322BL hydraulic excavator was used for waste reduction or recycling purposes, an issue the Commission is not going to address. This begs the question: If petitioner is not removing the fines from the settling ponds for waste reduction, recycling, or for sale, then why go to the time and expense to remove the fines? We doubt that petitioner purchased the 322BL hydraulic excavator and paid its employees to remove silt from the settling ponds with no prospect of economic gain. The overwhelming amount of evidence leads the Commission to conclude that the removal of fines from the settling ponds is to prepare the fines for sale as silt or bedding sand.

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[18] It appears that petitioner may have challenged respondent's assessment of use tax on this expense in its petition for review. Petitioner did not raise this challenge at trial or in its post-

We conclude that the removal of fines from the settling ponds is part of the manufacturing process, and, therefore, the purchase of the 322BL hydraulic excavator is exempt from the sales and use tax.

Light Towers

Respondent argues that the light towers employed by petitioner to illuminate portions of the Richfield quarry were neither directly nor exclusively used in manufacturing. While petitioner has offered credible evidence that the lights were used exclusively in manufacturing, we cannot agree that the lights were directly used in manufacturing.

Petitioner cites the Commission's decision in *Fort Howard,* in which we held that an overhead crane used to relieve jams was part of the manufacturing process and, therefore, exempt from the sales and use tax under section 77.54(6)(a) of the Statutes. *Fort Howard,* at p. 13,877-78. Petitioner argues that in the same way that the crane facilitated the manufacturing process in *Fort Howard,* the lights were necessary to the manufacturing operation of the quarry. We disagree.

The outer limits of "direct use" are not entirely clear with respect to the exemption in section 77.54(6). Respondent has attempted to define this limit in section TAX 11.40(2)(c) of the Administrative Code, which provides that equipment that is only indirectly used in the step-by-step process does not qualify for direct use. This section provides several examples of indirect use equipment:

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hearing briefs. Therefore, the Commission will not address this expense.

> Machines and equipment are not used directly in manufacturing if used for sweeping a plant; disposing of scrap or waste; plant heating or air conditioning; communications; lighting, safety, fire protection or prevention; research; storage; or delivery to or from a plant or repair or maintenance of machines, processing equipment or facilities. In addition, electric substations, tool storage facilities, water softening equipment, refrigerated storage facilities and catwalks that provide access to various parts of a building are not used directly in manufacturing.

We need not decide whether the entire list in this example is outside of the definition of direct use in every case. We are convinced, however, that lighting in this case is too far removed to be considered as direct use. Rare would be the manufacturing process that could safely occur in the dark. This is not to say, however, that lighting could never be considered direct use.

We conclude that the light towers were not directly used in the scope of manufacturing and, therefore, were not exempt from the sales and use tax.

Negligence Penalty

Virtually the entire assessment in this case is based upon petitioner's failure to pay sales and use tax on the purchase of routine expenses and fixed assets. The total added measure of tax was $1,227,222, and this generated an additional sales and use tax liability of $61,998 and a 25% negligence penalty of $15,499. By virtue of the holdings above, the measure of tax will be reduced by a minimum of $639,666, which equals the net purchase price of the equipment the Commission has determined is exempt from the sales and use tax.[19] Thus, the negligence penalty will be reduced to no more than $6,704.

[19] The parties have stipulated that parts and repairs associated with equipment determined to be exempt when this case is final and conclusive shall also be exempt. The record does not readily reveal the amounts subject to this stipulation.

Petitioner bears the burden to show that the failure to properly report sales and use tax was due to "good cause and not due to neglect." Wis. Stat. § 77.60(3).

Petitioner has not met this burden.[20]

Petitioner argues that it instituted a compliance program as the result of an audit for the period November 1, 1988, through October 31, 1992. Despite this compliance program, petitioner was assessed use tax on nearly $114,000 in routine purchases. While some of these were parts and repair expenses for the items determined exempt above and will fall out of the measure of added tax, the volume of routine purchases for which use tax was imposed is significant.

It should be noted that petitioner made a number of purchases from out-of-state vendors for which no use tax was paid. Any compliance program should raise a red flag with respect to any purchase from an out-of-state vendor.

With respect to purchases of fixed assets, more than $373,000 remains in the measure of added tax after considering the holdings above. This includes nearly $40,000 for light towers that are similar to light towers that were assessed in the prior assessment.

Petitioner may have instituted a compliance program, but it was not well executed. Petitioner has not come close to showing that its errors were due to good cause.

Equitable Estoppel

Petitioner argues, in the alternative, that if the equipment at issue in this case (except the light towers) is found to be subject to the sales and use tax, then respondent is estopped from imposing the use tax in this case because respondent did not

[20] Petitioner complains about the rationale cited by respondent for imposing the negligence penalty. We note that the statute places the burden on petitioner to show the error was due to good cause. This is not to say that there would never be a case in which respondent's rationale

issue assessments on similar equipment in the prior assessment. Because we determine that all of the items at issue, except the light towers, are exempt machinery and equipment, we need not consider petitioner's equitable estoppel argument.

ORDER

Respondent's action on the petition for redetermination is modified and affirmed, in accordance with the terms of the stipulations reached by the parties and by the holdings in this Decision and Order.[21]

Dated at Madison, Wisconsin, this 29th day of January, 2004.

WISCONSIN TAX APPEALS COMMISSION

Don M. Millis, Commission Chairperson

(Not participating

Thomas M. Boykoff, Commissioner

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

can be examined. However, we find nothing in the facts of this case to merit examination of respondent's motives.

[21] This Decision and Order is issued by a single Commissioner under the authority provided by section 71.01(4)(em)2 of the Statutes as created by 2003 Wisconsin Act 33, § 1614d.