

1990

# Morton International, Inc. v. Utah State Tax Commission : Reply Brief

Utah Supreme Court

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## Recommended Citation

Reply Brief, *Morton International, Inc. v. Utah State Tax Commission*, No. 900325.00 (Utah Supreme Court, 1990).  
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BRIEF

DOCKET NO. 900325

IN THE SUPREME COURT OF THE STATE OF UTAH

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MORTON INTERNATIONAL, INC.,	)	
	)	
Petitioner,	)	
	)	Docket No. 900325
vs.	)	
	)	Priority Category 15
UTAH STATE TAX COMMISSION,	)	
	)	
Respondent.	)	

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ON APPEAL FROM THE UTAH STATE TAX COMMISSION

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REPLY BRIEF OF PETITIONER

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**I. THE COMMISSION'S STATEMENT OF ISSUES IS OVERLY BROAD.**

Petitioner, Morton International, Inc. ("Morton") does not agree with the Statement of Issues set forth in Respondent's, Utah State Tax Commission (the "Commission"), Brief because it is overly broad and under inclusive.<sup>1</sup> Morton's Statement of Issues set forth in its Brief specifically defines the issues before the Court and should be followed.

**II. UNDER THE UTAH ADMINISTRATIVE PROCEDURES ACT, ISSUES AS TO STATUTORY CONSTRUCTION ARE REVIEWED DE NOVO WITH NO DEFERENCE TO THE COMMISSION'S PRIOR DECISION.**

The Commission's statement of the standard of review in this case is incorrect. This Court recently reconfirmed the well established principle that issues of law are to be reviewed de novo with no deference given to a lower court's decision. E.g., Kennecott Copper Corporation v. Salt Lake County, 145 Utah Adv. Rep. 3, 4 (October 12, 1990). This Court has likewise repeatedly held that the interpretation or construction of statutory

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<sup>1</sup> As stated by the Commission, the issues are whether the Commission correctly ruled in its favor and against Morton. While that statement of the issues is not incorrect, the Commission's statement is not helpful to this Court. Specifically the issues are (1) whether the Commission should narrowly define the statutory words "synthetic fuel" as a "term of art" or by the common and ordinary meaning of the words; and (2) whether "equipment" should be defined according to a common understanding of how property actually functions, rather than how it theoretically could operate.



language is a legal issue.<sup>2</sup> The "correction-of-error standard also applies when the issue is one of basic legislative intent."<sup>3</sup>

The Commission correctly notes that Section 63-46b-16 (1988) applies to this proceeding, and that a final determination in this matter must be made on the record.<sup>4</sup> However, the Commission is wrong in arguing that this Court must defer to the Commission's decision. In Bevans v. Industrial Commission of Utah, 790 P.2d 573 (Utah 1990), applying post-Utah Administrative Procedures Act ("UAPA") law, this Court confirmed its earlier decisions (applying pre-UAPA law) on the appropriate standard of review of an agency's interpretation or construction of a statute. In Bevans, this Court first noted that "[u]nder the relevant portion of section 63-46b-16(4)(d) (1989), we can grant relief to Bevans if the agency 'erroneously interpreted' the law to his substantial prejudice." Id. at 575. The Court continued

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<sup>2</sup> E.g., Chris & Dick's Lumber v. Tax Commission of Utah, 791 P.2d 511, 513 (Utah 1990) ("questions of statutory construction are matters of law for the courts, and we rely on a 'correction of error standard of review, according no deference to an administrative agency's interpretation.'") (Emphasis added).

<sup>3</sup> Hurley v. Board of Review of Industrial Commission of Utah, 767 P.2d 524, 527 (Utah 1988).

<sup>4</sup> This Court recently remanded a proceeding back to the Commission because of the Commission's failure to base its decision on the record. The Commission apparently believed it had the authority and discretion to make findings outside of the record. This Court rejected that notion stating "the Tax Commission [does not have] the unbridled discretion to make findings of fact beyond the scope of what is presented in the hearings. . . ." First National Bank of Boston v. County Board of Equalization, 145 Utah Adv. Rep. 8, 9 (October 16, 1990). In this case the Commission's failure is similar. As explained infra, the Commission disregarded the evidence presented at the hearing to make inadequate and unsupported findings.

to explain what is the appropriate standard of review to determine if the agency "erroneously interpreted" the law:

[C]ourts generally give little deference to the agency, with the result that a court may decide that the agency has erroneously interpreted the law if the court merely disagrees with the agency's interpretation.

Id. (emphasis added) (citing the official comment to the identical provision in the 1981 Model State Administrative Procedures Act). The Court then concluded:

[U]nder section 63-46b-16(4)(d) of the UAPA, it is still appropriate for a court to review an agency's interpretation of its statutorily granted powers and authority as a question of law, with no deference to the Agency's view of the law. We therefore apply the correction of error standard to such an issue and uphold the Commission's statutory interpretation only if we conclude it is not erroneous.

Id. at 576. (footnote omitted).

The facts in this case are not disputed. Instead, the issues in this case are legal issues involving the proper statutory construction or interpretation of Section 59-12-104(15) and (16). As this Court has repeatedly held, it should review the record de novo, and reach its own conclusion as to the appropriate construction of the statute in question giving no deference to the Commission's prior decision. Moreover, the Commission's decision is arbitrary and unsupported by

substantial evidence when viewed in light of the whole record as the Commission has selectively ignored the undisputed facts.<sup>5</sup>

For the reasons later explained herein and in Morton's Brief, the Commission erroneously interpreted the relevant law, and denied Morton's request for a refund of substantial amounts in sales taxes paid with respect to Morton's facilities. Morton has been and is being deprived of its property as a result of the Commission's improper and unlawful decision. Morton therefore has been "substantially prejudiced" and is entitled to the relief provided for under the UAPA.

### **III. THE COMMISSION FAILED TO STATE ALL RELEVANT FACTS.**

Pursuant to Rule 24 of the Utah Rules of Appellate Procedure, the Commission's Brief is required to state those facts "relevant to the issues presented for review." The Statement of Facts the Commission presented is clearly incomplete. Conspicuously absent from the Commission's Brief is a recitation of many facts relating to the special designs, materials and functions

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<sup>5</sup> No deference to Commission findings of fact should be given in this case because of the multiple fact-finding, prosecuting, and adjudicating functions the Commission exercised. These multiple functions raise due process and fairness issues because the same entity which supervises and formulates policies for the Auditing Division also sits as the supposedly impartial adjudicator of its own policies. See Utah Department of Administrative Services v. Public Service Commission, 658 P.2d 601, 608 (Utah 1983) ("examples of this correction of error type of review include whether the Commission has complied with the fairness requirements of due process"); Hurley v. Board of Review of Industrial Commission, 767 P.2d 524, 527 (footnote 3) (Utah 1988) ("in some cases, however, less deference is given to factual determinations. For example, a court may exercise greater scrutiny when constitutional rights are at stake"); and Pickering v. Board of Education of Township High School District, 391 U.S. 563, 578 (footnote 2) (1968).

which Morton's facilities serve, and their integral relation to the production process, which are critical to a proper determination of the case. To the contrary, Morton's Brief recited in detail all the relevant facts necessary for a proper determination in this case. Significantly, the Commission did not dispute any of the facts Morton recited. This Court should therefore adopt Morton's Statement of Facts as set forth in its Brief.

IV. SECTION 59-12-104(15)

A. The Commission Attempts To Raise New Issues On Appeal.

Respondent's Brief on page 19 states that "the Tax Commission properly denied an exemption under Utah Code Ann. § 59-12-104(15) of Petitioner's sodium azide facility because it is not a 'processing and upgrading plant.'" Likewise, on page 6, the Respondent states that the Commission defined "'upgrading' according to the usual, ordinary, and accepted definitions of those terms within the fuels industry." These statements are misrepresentations, and an apparent attempt to raise new issues on appeal. Nowhere do the Commission's Findings of Fact, Conclusions of Law and Final Decision (the "Decision") make any specific definition or finding as to what constitutes a "processing and upgrading plant," nor did the Commission base its decision to deny application of the sales tax exemption to Morton on a finding that Morton's facilities did not constitute a "processing and upgrading plant." These terms are ignored and undefined in the Commission's Decision. Based on the Commission's Decision,

therefore, the scope of review in this appeal is limited to an interpretation of the term synthetic fuel as used within the meaning of Section 59-12-104(15), without deference to the Commission, and not on what the Commission now apparently believes should have been decided.

B. The Commission Failed To Define "Synthetic Fuel" By Its Ordinary, Usually Accepted Meaning.

The Commission limited the definition of synthetic fuel to a "term of art" without any statutory or legislative guidance to so restrict or define the term. While case law provides that tax exemptions should be narrowly applied to the facts of a given case, this narrow application of law to facts does not give the Commission license to narrowly define statutory terms without some legislative or statutory directive.

Instead, the intent and meaning of statutory terms must first be understood before the statute can be narrowly applied to the facts of a given case. To determine a statute's meaning and intent, the normal rules of statutory construction should apply, which require that terms should be given their plain and ordinary meanings. An example of this process is Pacific Intermountain Express Co. v. State Tax Commission, 8 Utah 2d 144, 329 P.2d 650, 652 (1958) where this Court first defined the term "motor

vehicle" according to its ordinary and natural meaning, before application of the term in the context of the tax exemption statute.<sup>6</sup>

The Commission ignores this process by deviating from the common and ordinary definition of the term synthetic fuel, and substituting a more narrow "term of art" definition, without statutory authority and because the statute at issue is an exemption statute. Compounding its error, the Commission rejects (and even ridicules) Morton's use of a dictionary to define synthetic fuel. Morton's Brief cites several instances in which this Court has referred to dictionary definitions for guidance in interpreting statutory terms to ascertain their plain and ordinary meaning, as Morton did to define synthetic fuel.<sup>7</sup>

In opposition to this method of defining synthetic fuel, on page 16 of its Brief, the Commission states that "none of the cases which petitioner cites used dictionary definitions to define a term of art such as synthetic fuel which derives its meaning from the scientific community." The Commission's

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<sup>6</sup> See Ladish Malting Co. v. Wisc. Dept. of Revenue, 297 N.W.2d 56 (Wis. Ct. App. 1980) discussed in Section V.A. infra, where the Wisconsin court, applying a tax exemption statute, first defined statutory terms according to their ordinary and commonly accepted meanings before giving that definition a "strict but reasonable" application to the facts.

<sup>7</sup> Contrary to the Commission's argument, the Court has also used the dictionary to define technical or scientific words, see e.g., Savage Bros. Inc. v. Public Service Comm'n, 723 P.2d 1085, 1089 (Utah 1985) (in attempting to define "dry chemicals" and "barite" as used in a certificate of convenience and necessity, the Court used the following dictionary definition of "chemical": "[w]e note that a common, generally accepted definition of 'chemical' is 'a substance (as an element or chemical compound) obtained by chemical process or used for producing a chemical effect.'") (emphasis in original).

argument is improper and misleading because it assumes away the very issue of this case; i.e., whether, without any legislative or statutory direction or indication, the Commission can presume that synthetic fuel is to be defined as a term of art, and limited to Dr. Wiser's definition as used in the oil and gas fuels industry, to the exclusion of other fuels industries.<sup>8</sup>

Nowhere in the legislative history is synthetic fuel defined, nor is there any indication that synthetic fuel should be given a specific or "term of art" definition as used in one segment of the fuels industry. Nor is there any statutory directive that synthetic fuel should have any particular meaning. In fact, as Mr. Anderson testified, no one at the Commission knew what the term synthetic fuel was intended to mean. Tr. at 123. Words or phrases which are to be given a specific definition or treated as a "term of art" are, in most instances, specifically defined or set forth in a definitional section as a prelude to the statutory provision. No such statutory direction is present in this case.

There is no authority or basis for the Commission to reject a plain and ordinary definition of the term synthetic fuel, as provided by Dr. Taylor or as defined in the dictionary,

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<sup>8</sup> The Commission's reliance on a term of art advocated by Dr. Wiser is itself reversible error. As this Court has already stated in First National Bank of Boston, supra at 9, "the Tax Commission [does not have] the unbridled discretion to make findings of fact beyond the scope of what is presented in the hearings . . ." There was no testimony at the hearing to the effect that the Legislature used synthetic fuel as Dr. Wiser's "term of art" definition.

in favor of Dr. Wiser's narrow definition applicable only to the oil and gas segment of industry. In fact, the Commission never held that Morton's definition was not the plain or ordinary definition of the term synthetic fuel. Rather, the Commission rejected a common definition in favor of an oil and gas fuel's definition advocated by Dr. Wiser. As evident from the record, Dr. Wiser's experience and the framework from which he defines synthetic fuel is limited to the oil and gas industry. Yet, Dr. Wiser's testimony is riddled with inconsistencies. Under cross examination, Dr. Wiser admitted that he was not consulted when the Legislature passed the synthetic fuel exemption, and that he had no idea what the Legislature meant. He also admitted that his definition was at odds with the definition of synthetic fuel as defined in federal law, even though he claimed to have had input into federal statutes.<sup>9</sup>

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<sup>9</sup> Transcript p. 197 line 23 through p. 198 line 4.

Q [by Mr. Miller] Let me read it [the federal statute] again.

A [by Dr. Wiser] All right.

Q "The term 'synthetic fuel' means any solid, liquid, or gas." I'm not asking you whether you agree or disagree with the definition. That definition is inconsistent with what you just told us?

A That's correct. It is inconsistent.

Transcript p. 204 line 5 through line 12, (emphasis added).

Q [by Mr. Miller] All right. Let me probe your understanding of something else. Didn't you testify a moment ago that you

Footnote continued on next page.



The difficulty with the Commission's Decision is that the statutory terms are defined as if Dr. Wiser and the Commission had drafted them, rather than the Legislature. For example, the Commission first adopts Dr. Wiser's definition of synthetic fuel which applies only to liquid or gaseous materials.<sup>10</sup> To justify this definition, which is directed to the oil and gas industry, the Commission cites Dr. Wiser's testimony where he states: "foremost in the minds of the people involved in synthetic fuels [is] to try to take the pressure off of petroleum and off of natural gas to, in the first instance, to reduce our dependence on foreign oil." Commission's Brief at 12 (emphasis added). What is in the minds of Dr. Wiser or his associates in the oil and gas industry is irrelevant. The critical inquiry is what was in the minds of the legislators. The Commission improperly assumes that the mindset of Dr. Wiser was the mindset of the Legislature when the statute was enacted. Clearly absent is any indication that the legislators had in their minds to exclude

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Footnote continued from previous page.

had no conversations with the [Utah] Legislature when they passed this particular exemption?

A [by Dr. Wiser] That's correct. I did not.

Q You don't have any idea of what they mean, did you?

A No. . . .

<sup>10</sup> Once again, it should be noted that the only real difference between Morton's definition and that of Dr. Wiser's, is that Dr. Wiser's definition excludes solid synthetic fuels, otherwise Morton's fuel pellets satisfy Dr. Wiser's definition. See Morton's Brief at 25.

solid materials from the term synthetic fuel.<sup>11</sup> Moreover, nowhere is there any indication that synthetic fuels should be limited to only those applications in the oil and gas industry.

Dr. Wiser's definition is inappropriate not because it is technically wrong, but because it is underinclusive as it relates to the entire fuels industry. There are many applications of synthetic fuels as alternate energy sources to traditional combustible materials used in industry. Dr. Wiser and Dr. Taylor both testified that a synthetic fuel is a material combusted to produce energy. There are many other instances beyond the oil and gas industry where man-made materials are combusted to produce energy.<sup>12</sup> The fact is that the fuel pellet, like many other synthetic fuels which have applications outside of the oil and gas industry, is combusted to produce energy and as such represents an alternate energy source to natural, depleting resources of combustible fuels. It is arbitrary, unfair and improper to limit the application of Section 59-12-104(15) to only synthetic fuels used in the oil and gas industry, to the

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<sup>11</sup> See the Commission's Hearing Memorandum at 9, Record at 92, where the Commission first argued for a definition of synthetic fuel that followed a federal definition which includes solid materials.

<sup>12</sup> See e.g., Official Code of Georgia § 38-3-3(3) (1990) which defines "energy resources" to include "all forms of energy or power including. . . other fuels of any description. . ." (Emphasis added); O.C.G.A. § 38-3-3(4)(K) (1990) which defines "fuel" in part as any "other substance used primarily for its energy content." (Emphasis added); and Revised Code of Washington § 43.21F.025(1) which defines "energy" in part as "any other substance or process used to produce heat, light or motion;. . ." (Emphasis added.)

exclusion of other applications in the fuels industry, without some legislative or statutory guidance.

Aside from the general rule that statutory words are to be given their plain and ordinary meaning, the term synthetic fuel as used in Section 59-12-104(15) should not be interpreted as a term of art because there is no basis in case law for making such a definition. Terms or phrases which are treated as terms of art are phrases that have well-established, widely accepted, or previously defined meanings.<sup>13</sup> For instance, in Atlas Corp. v. Clovis National Bank, 737 P.2d 225, 231 (Utah 1987), Clovis asserted that the term "net profits interest" is a term of art in the mineral industry that defines an independent estate in land. Id. The Court rejected Clovis' assertion that "net profits interests" should be defined as a term of art because it has not:

acquired a fixed and immutable meaning. . . . There is no body of law that clearly defines the nature and incidents of the net profits interest. Because the term "net profits interest" has no uniform meaning, we believe that "the nature of the [net profits] interest and the rights of its owner must be determined from the provisions of the instrument which created it."

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<sup>13</sup> "[A]bsent express direction to the contrary, we presume that a term of art used in a statute is to be given its usual legal definition." Kelson v. Salt Lake County, 784 P.2d 1152, 1156 (Utah 1989).

Id. (citations omitted).<sup>14</sup>

There is no body of Utah law that defines synthetic fuel as Dr. Wiser defined it. There are no Utah statutes or cases which define the term.<sup>15</sup> Moreover, as Dr. Wiser admitted (Tr. at 197-205), the definitions of synthetic fuel found in federal law are inconsistent with the definition urged by Dr. Wiser and adopted by the Commission.

There is likewise no reason why the separate words or terms of a phrase cannot and should not be separately defined and then combined to define a given phrase, even if the phrase is a term of art. For example, in State v. Gaxiola, 550 P.2d 1298, 1303 (Utah 1976), a jury requested clarification of the term "extreme mental or emotional disturbance" as used in Section 76-95-205 (1973). The trial court instructed the jurors to give the terms the meaning they would have in common every day use and defined the words, "extreme," "mental" and "emotional" as defined

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<sup>14</sup> Examples of terms which have specific meanings, and are commonly understood as terms of art can be seen in various court decisions. See Hansen v. Salt Lake County, 794 P.2d 838, 842 (Utah 1989) ("The term 'governmental function'. . . is a term of art long in use by the courts to define those activities of governmental entities to which common law sovereign immunity applied"); State v. Standiford, 769 P.2d 254, 260 footnote 3 (Utah 1988) ("the term 'specific intent' has an accepted meaning as a term of art"); State v. Jordan, 665 P.2d 1280, 1285 (Utah 1983) (the Court used the dictionary to define "simulated" in the phrase "simulated sexual conduct" as it does not constitute a legal term of art, and is recognizable in simple lay terms).

<sup>15</sup> "Synthetic fuel" is not defined in Utah law although there are limited references to the term. The Utah Code and cases also include hundreds of references to "fuel" and a handful of references to "synthetic," where synthetic is used as an adjective modifying a noun.

in the dictionary. The defendant objected claiming that "extreme 'mental or emotional disturbance' is a term of art, which derives its meaning from usage and not from the individual words." Id. Upon review of the instruction given by the trial court, this Court found no error or prejudice to the defendant in individually defining the terms of the statutory phrase. Id.

In summary, the Commission erroneously assumes, without authority, evidence or findings that (1) synthetic fuel is a "term of art"; and (2) the legislature enacting Section 59-12-104(15) intended synthetic fuel to be defined as a term of art and given a restrictive meaning within a narrow segment of the oil and gas industry. Accordingly, the Commission's Decision is in error and should be reversed.

C. The Commission's Definition Of Synthetic Fuel Is Not Consistent With The Legislative History.

The Commission adopted a definition of synthetic fuel limited to liquid or gaseous materials used as substitutes in the oil and gas industry. By this definition, the Commission is taking an inconsistent position with what it believes is the legislative history underlying Section 59-12-104(15). The Commission argues that the statute's legislative history indicates a legislative intent to benefit the mining industry. Yet, the Commission's definition of synthetic fuel, limited to liquid or gaseous materials applicable in the oil and gas industry, has no relationship to Utah's mining industry and no relationship to Section 59-12-104(15). In fact, the Legislature specifically excluded

the oil and gas industry from consideration under this statute. In its Brief, page 22, the Commission cited Senator Bunnell who stated: "The gas and oil sector in Utah is not a problem that is in need of assistance and that is in need of investment." The Commission has failed to explain why an oil and gas definition should be followed when the Legislature specifically excluded the oil and gas industry from consideration.

Contrary to the Commission's assertions, Morton's operations do have a direct and real relation to the mining industry. While it is true that Morton does not engage in actual mining operations, Morton's fuel pellet is the product of the processing and upgrading of various minerals which are extracted (mined) from the ground. The statute does not require actual mining activity to be entitled to its benefit. A person who runs a mill or reduction works, but engages in no extraction activities, would be entitled to relief.

Finally, the Legislature's underlying intent behind the enactment of the statute was to promote investment in capital intensive industry and to stimulate employment in Utah. Morton's Hearing Memorandum at 26, Record at 159. Against this backdrop, the Legislature included "synthetic fuel processing and upgrading plants." At the time the Legislature included this term in the statute, there were no synthetic fuel plants in Utah, nor did the Legislature have a complete idea of what would constitute a synthetic fuel plant. Id. (footnote 6). As noted earlier, Mr. Anderson who drafted the rule underlying this exemption testified

that neither he, nor anyone at the Commission, understood what synthetic fuel was meant to include. To construe this statute against taxpayers who have brought capital intensive industry to Utah whose operations satisfy the normal and ordinary definition of the term synthetic fuel, is improper and contrary to the Legislature's intent.

V. SECTION 59-12-104(16).

A. As Applied In Other Jurisdictions, Morton's Facilities Should Be Treated As Equipment Because They Are Designed And Function As Equipment.

The Commission would have this Court believe that there is no case law or legal precedent which focuses on a structure's design and function to determine if it is machinery or equipment in connection with statutory provisions exempting machinery and equipment from taxation. The Commission has gone so far as to represent to this Court that no such test exists and that the courts have uniformly rejected such a notion, always concluding that buildings permanently attached to land can never be treated as tangible personal property.<sup>16</sup> These statements are incorrect, misleading and misrepresentations of existing case law applying "machinery and equipment" exemption statutes in other

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<sup>16</sup> See specifically the Commission's Brief at 42. "The far-reaching case law, in addition to supplemental sources, confirms that Petitioner's buildings or structures qualify as real property, and do not fall within the 'equipment' exemption allowed by Utah Code Ann. § 59-12-104(16) or Rule 85S(B). Essentially, each of the cases directs that any building or structure affixed to the land is indisputably real property in any sense of the word. Further, the Courts have found unpersuasive the argument that buildings permanently affixed to land can possibly qualify as tangible personal property as Petitioner argues." Commission's Brief at 42 (Emphasis added).

jurisdictions.<sup>17</sup> Morton did not create a functional use test to determine if a structure could qualify as machinery or equipment. The functional use test is well established and followed in various jurisdictions. In fact, the very cases cited by the Commission<sup>18</sup> apply this functional use test. For example, the Commission cites to Busch where the court held a greenhouse to be real property and not machinery for purposes of a Minnesota statute that excluded machinery from the definition of real estate subject to taxation. What the Commission failed to disclose is that in Busch, the court used a "functionality test" as follows:

To be exempt as equipment, an item must perform functions distinct and different from the functions ordinarily performed by buildings and other taxable structures.

Id. at 815, citing Crown Coco at 274.

The court in Busch held that the greenhouse was realty because the lower court made specific findings of fact that the greenhouse served the same shelter functions as a traditional building, and the court was unwilling to overturn those

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<sup>17</sup> The Commission's references to case law defining "buildings" or "real property" are likewise misleading because those cases do not involve "machinery and equipment" exemption statutes. As stated by the Utah Court of Appeals: "What is a building must always be a question of degree." Wagner Assoc. v. Hercules, Inc., 797 P.2d 1123, 1128 (Utah App. 1990). Accordingly, the definition of a "building" or "real property" will vary with the context in which it must be construed. See Crown Coco, Inc. v. Comm'r of Revenue, 336 N.W. 2d 272, 274 (Minn. 1983) (in determining whether a certain structure was a building or equipment, the Minnesota Supreme Court stated: "equipment is an exceedingly elastic term, the meaning of which depends on the context." (Emphasis added)).

<sup>18</sup> Busch v. County of Hennepin, 380 N.W.2d 813 (Minn. 1986) and Crown Coco, Inc. v. Comm'r of Revenue, 336 N.W.2d 272 (Minn. 1983).



findings.<sup>19</sup> The Commission would have this Court abide by the result in Busch, but not by its analysis or standards.<sup>20</sup>

This same functional use test has been repeatedly used in other jurisdictions. For example, the Wisconsin Court of Appeals has used this test<sup>21</sup> in applying a Wisconsin statute that exempts from property taxation "[m]anufacturing machinery and specific processing equipment, exclusively and directly used by a manufacturer in manufacturing tangible personal property." Ladish at 56. The Wisconsin statute is strikingly similar to the case at hand in that it also specifically excludes "buildings or building components" from application of the machinery and equipment exemption. Id.

In Ladish, the court was confronted with whether certain structures constituted machinery or equipment pursuant to the exemption statute. As noted by the court, all these

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<sup>19</sup> But see, Wisconsin Dept. of Revenue v. Greiling, 334 N.W.2d 118, 121 (Wisc. 1983) (the Wisconsin Supreme Court, applying the "functional use" test instead of the "narrow physical appearance" test, held that a greenhouse was machinery because it "has an active function of creating and controlling an environment conducive to the production of floriculture crops.")

<sup>20</sup> See Crown Coco, cited by the Commission, which also followed the functional use test; see KDAL Inc. v. County of St. Louis, 240 N.W.2d 560, 561 (Minn. 1970) (the court held that a support tower for a television antenna constitutes equipment because of its function irrespective of the fact the tower was anchored or otherwise attached to real property); see also, Union Grain Terminal Association v. County of Winona, Nos. 34855 and 35970 (Minn. T.C. Dec. 15, 1983) (holding that malt houses and kiln buildings were, in large part, the exterior shells of equipment).

<sup>21</sup> See Ladish Malting Co. v. Wisc. Dept. of Revenue, 297 N.W.2d 56 (Wis. Ct. App. 1980); Pabst Brewing Co. v. City of Milwaukee, 373 N.W.2d 680 (Wisc. Ct. App. 1985) and Heileman Brewing Company v. City of La Crosse, 381 N.W.2d 619 (Wis. Ct. App. 1985) (unpublished opinion, available on Lexis). Ladish and Pabst are attached hereto as Exhibits A and B.

structures "have walls, floors, and ceilings or roof. All are very large structures. . . . All have a 'building-like' appearance from the outside." Id. at 57. The court cited with approval the lower court's framing of the central issue:

What is the meaning of "buildings or building components"? The noun "building", considered outside of any factual context is an inert concept noting in its broadest possible sense the enclosure of space. . . . Was it the intent of the legislature to exclude from exemption any creation which encloses space, even though it also may functionally contribute to the "transformation of substance"?

Even applying a "strict but reasonable" meaning of the statute,<sup>22</sup> the court was unable to apply the statute to the structures at issue because, as the court noted, the structures all had "the external appearance of buildings, but are designed to function exclusively as machinery. Neither could the structures perform their intended functions without walls, floors, ceilings, and foundations which make them building-like in appearance." Id. at 58-59.

Because the application of the statute was unclear, the court went on to cite with approval various other jurisdictions, both state and federal investment tax credit cases, for their treatment of structures to be classified as buildings or machinery. See cases discussed in Ladish at 60-61. Most notable is the court's statement that:

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<sup>22</sup> "[A] strict construction is nonetheless a construction, and an exemption statute need not be given an unreasonable construction or the narrowest possible construction. A 'strict but reasonable' construction seems to be the pithy and popular statement of the rule." Id. (citations omitted).

We need not adopt a strict conformity test, however, in order to accept persuasive reasoning of courts in other jurisdictions which have construed statutes similar to our own. Several such cases, both federal and state, have resolved issues similar to that before us by rejecting a narrow "physical appearance" test and applying a "function or use" test. Under that test the central question is whether the structure is one "whose utility is principally and primarily a significantly contributive factor in the actual manufacture or production of the product itself." Mertens, 5 Law of Federal Income Taxation sec. 32A.14, at 50 (rev. ed. 1980).

Id. at 60 (emphasis added, footnote omitted).<sup>23</sup>

Finally, in sanctioning the use of a functionality test the court stated:

A definition of "buildings" and of "machinery and equipment" which emphasizes actual function and use over physical appearance, sheer size, and remotely potential use, elevates substance over form. It also makes sense.

Id. at 62.<sup>24</sup>

The court in Ladish ignored the structures' building-like appearance, noting that the structures did not

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<sup>23</sup> It should be noted that the test cited by the court, from Mertens, pertains to the federal investment tax credit provisions. Morton agrees with the court in Ladish and reasserts that the federal guidelines under I.R.C. § 38 provide "persuasive reasoning" as to the construction and application of Utah's machinery and equipment exemption statute.

<sup>24</sup> See also Gregory v. Helvering, 293 U.S. 465, 466-470 (1935) (the Gregory case is a landmark tax case which is repeatedly cited for the proposition that form should not be elevated over substance. "To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.")

serve the functions of a traditional building,<sup>25</sup> and concluded that because the structures were designed and functioned as machinery, they should be so treated.

Five years later the Wisconsin Court of Appeals reviewed a similar factual case in Pabst, supra, under the same machinery and equipment exemption statute. Once again, the court followed the functional use over an appearance test and concluded that Pabst's structures<sup>26</sup> were designed and functioned as equipment and should not be treated, for purposes of the exemption statute, as buildings. As stated by the court, "a structure's external appearance does not determine whether it is a building. Rather, the question is whether the structure is being used as a building in the taxpayer's hands." Id. at 685 (emphasis added).

The court went on to state:

The passive nature of the cellar walls and framing must not be allowed to obscure the fact that their sole reason for existence is to create the conditions that permit fermentation of beer on a mass-production scale.

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<sup>25</sup> "The three structures may be entered by employees for maintenance or clearing but are not generally occupied by employees during the course of manufacturing process." Id. at 58. Note the similarity with Morton's facilities where employees are not permitted inside the facilities during operations.

<sup>26</sup> The "head house" is "a 56-foot tall structure. . . of poured concrete" and the malt house "has six stores, multiple rooms, stairs, an elevator, and office space." Id. at 688.

Id. at 691.<sup>27</sup>

The fact that some human activity, incidental to a structure's function, is carried on within the structure, does not mean, that the structure provides general working space.

Id. at 688.

Contrary to the Commission's assertions, this issue has been addressed in various other jurisdictions which have adopted a functional use test. The record in this case is clear and uncontroverted, Morton's facilities were designed to function as equipment. These facilities are essential to production and thus qualify for exemption under the statute. The Commission's Decision and Brief demonstrate an unwillingness to admit that a facility which serves the function and purpose of equipment may be treated as such for purposes of Section 59-5-104(16). The Commission provided no testimony or evidence rebutting Morton's extensive testimony that the facilities operate as equipment and are essential to operations. The Commission's only attempt to

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<sup>27</sup> The court also cited Niagara Mohawk Power Corp. v. Wanamaker, 144 N.Y.S.2d 458, 462 (App. Div. 1955), aff'd, 157 N.Y.S.2d 972 (1956) which stated:

The structures and supports which house and steady the machinery are essential to production. They are physically annexed to the machinery, specially designed therefor, and necessary to the proper functioning thereof. As a whole, the plant is a producing unit. The structures do not play as active a role as, for example, the turbine. But activity is not the test of directness. The walls of the boiler have a "passive" function in one sense. The important thing is that all parts of the plant contribute, continuously and vitally, to production, and they are all integrated and harmonized. (Emphasis added)

show that the facilities are not essential to operations is a reference to Kurt Hallesy's testimony that it is theoretically possible to conduct operations with a skeletal infrastructure. See p. 29 of the Commission's Brief.<sup>28</sup> Yet, in a recent case dealing with sales taxation of computer software, this Court agreed with the Vermont Supreme Court's observation that for purposes of taxation, transactions should be taxed on what actually occurred and not based on some hypothetical, theoretical or unrealistic basis.<sup>29</sup>

B. The Uncontroverted Record Establishes that Morton's Facilities Are Not Real Property.

As this Court stressed in First National Bank of Boston, supra, any decision rendered by the Commission must be based upon the record. That rule is important because, in the present case, the record is clear and uncontroverted that Morton's facilities function as equipment; and consistent with prior Commission audits, the facilities should be treated as tangible personal property attached to real property. Consider the Testimony of Calon K. Anderson. Mr. Anderson has 18 years of auditing

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<sup>28</sup> This "theoretical" notion ignores the regulatory environment surrounding Morton's facilities which would prohibit Morton from operating its facilities as the Commission theorizes. See, for example, Chapters 11, 13 and 14 of Title 26 of the Utah Code relating to the regulation of water, air and hazardous waste pollution.

<sup>29</sup> "To base the tax consequences of a transaction on how it could have been structured 'would require rejection of the established tax principle that a transaction is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred.'" Mark O. Haroldsen v. State Tax Commission, 148 Utah Adv. Rep. 26, 28 (November 27, 1990) (emphasis added) (citations omitted). See also Gregory, supra.

experience with the Commission, personally drafted Rule 85S, and conducted over 100 audits. His testimony was clear that Morton established an uncontroverted record that its facilities were entitled to the relief provided by Section 59-12-104(16). The Commission failed to call a single witness or provide any evidence to refute Mr. Anderson's testimony. The Commission's only rebuttal to Morton's witnesses is to make negative innuendos regarding his motives. See page 25, footnote 7 of the Commission's Brief ("Calon K. Anderson is a former employee of the Auditing Division of the Utah State Tax Commission who parted on unpleasant terms from the Tax Commission because of differences between himself and the present Director of the Auditing Division.")<sup>30</sup>

Based on his extensive experience as an auditor, Mr. Anderson applied the same tests in evaluating Morton's claim for an exemption from sales taxes which the Commission used in prior

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<sup>30</sup> This Court has already stated its opinion as to such remarks. "Derogatory references to others or inappropriate language of any kind has no place in an appellate brief and is of no assistance to this Court in attempting to resolve any legitimate issues presented on appeal." State v. Cook, 714 P.2d 296, 297 (Utah 1986).


American logicians Morris Cohen and Ernest Nagel have given a brief definition of the Commission's technique in Cohen and Nagel, An Introduction to Logic and Scientific Method (1934), 380: "The fallacy of the argumentum ad hominem, a very ancient but still popular device to deny the logical force of an argument (and thus to prove the opposite), is to abuse the one who advances the argument."

audits.<sup>31</sup> Mr. Anderson likewise cited prior circumstances where permanent, building-like structures were not treated by the Commission as real property.<sup>32</sup> This testimony lies in the record uncontroverted, but ignored. The Commission has not explained its inconsistent treatment of Morton's facilities, compared to other similar facilities, as required by Section 63-46b-16(4)(h)(iii).

#### CONCLUSION

The Commission grossly erred in its responsibility to establish evidence or support in the record for its interpretation of the relevant statutes. If this Court is to give real meaning to its prior decisions that a final decision must stand upon the record, this Court must rule in favor of Morton and reverse the Decision of the Commission.

DATED this 15th day of January, 1991.

  
MAXWELL A. MILLER  
RANDY M. GRIMSHAW  
RICHARD M. MARSH  
of and for  
PARSONS BEHLE & LATIMER  
Attorneys for Petitioner

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<sup>31</sup> Moreover, Mr. Anderson used the same three part test followed by this Court. "In determining whether equipment has become a fixture, this Court has applied a three-part test: annexation, adaptation, and intent." General Leasing v. Manifest Corp., 667 P.2d 586, 597 (Utah 1983).

<sup>32</sup> See Morton's Brief at 36.




MAILING CERTIFICATE

I hereby certify that I caused to be mailed, postage prepaid, four true and correct copies of the foregoing REPLY BRIEF OF PETITIONER to the following on this 15th day of January, 1991:

James H. Rogers  
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Heber M. Wells Bldg.  
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**EXHIBIT A**

98 Wis.2d 496

**LADISH MALTING CO., a Wisconsin corporation, Plaintiff-Respondent,**

v.

**WISCONSIN DEPARTMENT OF REVENUE, Defendant-Appellant,**

**Town of Aztalan, Defendant.**

**Nos. 79-495 to 79-498.**

Court of Appeals of Wisconsin.

Argued Aug. 21, 1980.

Opinion Released Aug. 21, 1980.

Opinion Filed Aug. 21, 1980.

Review Denied.

Department of Revenue appealed from judgment of the Circuit Court, Jefferson County, John B. Danforth, J., determining that certain property used by taxpayer in manufacture of malt was exempt from property taxes. The Court of Appeals, Bablitch, J., held that attemporators, kilns, and malt elevators used in the malting process were machinery or equipment and not buildings within contemplation of statute exempting manufacturing machinery and processing equipment, but not buildings, from property taxation.

Affirmed.

#### **Taxation ⇌ 237**

Attemporators, kilns, and malt elevators, building-like structures used in transformation of barley into malt, were machinery or equipment and not buildings within contemplation of statute which exempted manufacturing machinery and processing equipment, but not buildings, from property taxation. W.S.A. 70.11(27).

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John C. Murphy, Asst. Atty. Gen., for defendant-appellant; Bronson C. La Follette, Atty. Gen., and E. Weston Wood, Asst. Atty. Gen., on brief.

John A. Hazelwood (argued) and Elwin J. Zarwell, Quarles & Brady, Milwaukee, on brief, for plaintiff-respondent.

Before GARTZKE, P. J., and BABLITCH and DYKMAN, JJ.

BABLITCH, Judge.

This is an appeal by the Wisconsin Department of Revenue (department) from a judgment determining that certain property used by the Ladish Malting Company (taxpayer) in the manufacture of malt was exempt from property taxes under sec. 70.11(27), Stats. The taxpayer brought four separate actions seeking declaratory judgment and a refund of taxes paid to the defendant Town of Aztalan from 1974 through 1977 based on the department's assessments. The town is not a party to this appeal. The actions were heard together on the basis of a detailed stipulation of facts, disposed of by a single judgment ordering a total refund of \$375,125, and consolidated on appeal. We affirm.

Section 70.11(27), Stats., was created by ch. 90, Laws of 1973, as a part of the budget bill. The subsection embodies the so-called "M & E" exemption from property taxation of "[m]anufacturing machinery and specific processing equipment, exclusively and directly used by a manufacturer in manufacturing tangible personal property." The exempted property is defined by the statute as:

any combination of electrical, mechanical or chemical means, including special foundations therefor, designed to work together in the transformation of materials or substances into new articles or components, including parts therefor, regardless of ownership and regardless of attachment to real property. *This shall not be construed to include materials, supplies, buildings or building components; nor shall it include equipment, tools or implements used to service or maintain manufacturing machinery or equipment. [Emphasis supplied.]*

The disputed items of property are attemporators, kilns, and malt elevators. It is undisputed that each of these items is used

exclusively and directly by the taxpayer in the transformation of barley into malt. The parties stipulate that "but for the building-building component exception" to the M & E exemption, the property would not be taxable.

The department's main contention is that none of the properties is a machine because each of them is a "building" within the meaning of the italicized exclusion from the definition of machinery and equipment set forth above. In its reply brief on appeal, however, it also contends that the exemption "applies only to *machinery which is not a building or building component.*"

The department thereby proffers, though it does not press, two inconsistent views of the statute. Under its first contention machinery and equipment on the one hand, and buildings or building components on the other, are mutually exclusive categories of property. Under its second contention they are not. Because we agree with the trial court's determination that the structures in question are machinery or equipment and are not buildings within the contemplation of the statute, we need not address the question whether it is possible for one structure to fit both categories simultaneously nor whether any such structure would be entitled to the statutory exemption.

The structures involved in this case share certain characteristics. All have walls, floors, and ceilings or roofs. At least the kiln and the attemporator have foundations. All are very large structures comparing, as the trial court noted, with the magnitude of the taxpayer's operations. All have a "building-like" appearance from the outside. Each performs an independent, essential function in the manufacturing process by which malt meeting the various specifications of the taxpayer's customers is made.

The parties agree that an attemporator is similar to a "giant air conditioner-humidifier." Its function is to maintain the exact temperature and humidity conditions required to induce the germination of barley

kernels—the first step of the malt-making procedure—within "growing compartments" inside the taxpayer's malt house.<sup>1</sup> Each attemporator consists of a fan and three compartments attached to a growing compartment. The fan forces air to circulate past water sprays in the compartments of the attemporator, where it is saturated to 100 percent humidity. The air is then forced into the growing compartments. The parties agree that no part of the attemporator's walls, ceiling, or floor has any value solely on its own, and that the same are designed to channel the moisturized air through the attemporator and into the growing compartments. The outer shells of the taxpayer's attemporators, which are custom made, are composed of one-half inch of transite (a corrugated asbestos and concrete material), the same as the outer shell of the malt houses to which they are attached. Commercially produced attemporators made of stainless steel are available on the market. They perform exactly the same function as the taxpayer's attemporators and do not look like buildings.

After germination has occurred to the desired degree, the resultant "green malt" is transferred to kilns, which are self-supported brick wall enclosures, for heating and drying. Huge fans at the top of the structure draw heated air up through three tiers of trays with perforated bottoms upon which the grain is spread. The trays have louvers which are opened manually from time to time to allow the grain at the higher levels to fall to the tray beneath at the appropriate stage in the drying process. The temperature inside the kiln may reach as high as 220 degrees Fahrenheit, depending on the type of malt being produced.

After drying is completed to the required specifications, the grain is placed in malt elevators for aging and blending according to the individual customer's order. Aging is an organic process during which the moisture content in the kernels of green malt stabilize at a uniform level from the center of each kernel to its outer shell. The tax-

1. The taxable status of the malt house itself is not at issue on this appeal

payer has more than 50 brewery customers, each of which specifies the length of time the ordered malt is to be aged and the particular mix of different malts desired. Externally the malt elevators look like barley elevators in which the barley is stored prior to the malt-making process. The taxable status of the storage elevators is not challenged by the taxpayer. The malt elevators contain rows of bins in which different types of malts are kept. The particular mix ordered by the customers is blended by regulating the flow of various malts onto conveyor belts beneath the bins. The final mix is transported to shipping bins, which are not involved in this appeal.

The three structures may be entered by employees for maintenance or cleaning but are not generally occupied by employees during the course of the manufacturing process. The attemporators, kilns and malt elevators are monitored on an almost totally automated basis from a central control room in a different location.

Employees are not inside the attemporators during any time they are operating. When employees enter the kilns each day to manually rotate the louvers and dump the tray floors, they must pass through an air lock adjoining the kiln because of the enormous difference in external and internal air pressure. The temperature within the kiln is reduced to 100 degrees during such times. Access to the top of the malt elevators for servicing the conveyor equipment is provided by a concrete stair tower or a man lift. It is very unusual for an employee to be inside a malt bin, and this never occurs when there is an appreciable amount of malt within the bin.

There are no plumbing, heating or cooling facilities within the three structures except as they specifically relate to the manufacturing processes which occur within them. There is electric wiring for lighting and manufacturing purposes, but no toilets, rest areas or other "creature comforts" inside any of them.

We cannot improve on the trial court's designation of the central issue. It asked:

What is the meaning of "buildings or building components"? The noun "building", considered outside of any factual context is an inert concept noting in its broadest possible sense the enclosure of space. . . . Was it the intent of the legislature to exclude from exemption any creation which encloses space, even though it also may functionally contribute to the "transformation of substance"?

The answers to these questions are not clear from the face of the statute, even applying the appropriate rules of construction. Pursuant to those rules, a tax exemption statute is to be strictly construed against granting the exemption since "tax exemptions, deductions and privileges are matters of legislative grace." *Ramrod, Inc. v. Department of Revenue*, 64 Wis.2d 499, 504, 219 N.W.2d 604, 607 (1974). Moreover, the burden of bringing the property in question within the terms of the exemption is on the taxpayer, and any doubts that he has done so are to be resolved in favor of taxation. *Ramrod*, 64 Wis.2d at 504, 219 N.W.2d at 607; *First Nat. Leasing Corp. v. Madison*, 81 Wis.2d 205, 208, 260 N.W.2d 251 (1977). On the other hand, the supreme court has stated:

"[A] strict construction is nonetheless a construction, and an exemption statute need not be given an unreasonable construction or the narrowest possible construction. A 'strict but reasonable' construction seems to be the pithy and popular statement of the rule." *Columbia Hospital Assn. v. Milwaukee*, 35 Wis.2d 660, 668, 151 N.W.2d 750, 754 (1967), quoted with approval in *First Nat. Leasing Corp.*, 81 Wis. at 208-09, 260 N.W.2d at 253.

The "strict but reasonable" meaning of the statute in question is elusive when applied to the structures at issue. The legislature plainly intended to exempt manufacturing machinery and equipment exclusively used in transforming raw products into merchantable goods, while withholding the exemption from buildings and building components. The three structures in this case all have the external appearance of

buildings, but are designed to function exclusively as machinery. The attemporators are giant air-conditioners and humidifiers. The kilns are giant ovens. Neither could perform their intended functions without the walls, floors, ceilings, and foundations which make them building-like in appearance. The malt-elevators, though less machine-like than the other two structures, are nonetheless more than passive storage units such as the barley or shipping elevators. Within them an organic change in the malt takes place which is essential to the production process. They are designed to custom-mix the different varieties of separately aged malts to the specifications of each customer. Their function is not dissimilar from that of smaller specific processing equipment designed, for example, to custom blend paints, dyes, or foods.

Neither the attemporators nor the kilns could be used as "buildings" in the commonly used sense of providing shelter for persons or animals, or storage space for property, without substantial alterations. While the malt elevators could conceivably be used to shelter and store malt, their use is committed to a more ambitious purpose.

When the meaning of a statute is not clear on its face, we may look to extrinsic sources to determine legislative intent.<sup>2</sup> Our examination of the legislative history of sec. 70.11(27), Stats., persuades us that the legislature did not intend to include structures such as those at issue, which function as manufacturing machinery or equipment, within the "building-building component" exception to the M & E exemption.

The parties have stipulated that the language of the statute as finally enacted was adopted by a conference committee of the legislature after meetings with representatives of the department and of industry. The meetings were requested by the committee, which was studying a proposed draft of a senate bill creating the M & E

exemption. As a result of these meetings, the representatives of industry and of the department agreed on certain changes in the original language, which were incorporated by the committee in the bill reported out to and passed without further alteration by both houses of the legislature.

The original draft of the bill excluded "structures or fixtures," rather than "buildings or building components," from the M & E exemption. It also required that property attached to real estate must be "capable of removal without substantial damage" to the real estate in order to qualify for the exemption. The latter requirement was stricken from the bill which was finally enacted, and the broad "structures or fixtures" language was replaced by the present, narrower "buildings and building components." But for these changes, there is little doubt that the property in question would not have qualified for the exemption.

The stipulation recites that the phrase "buildings and building components" was adopted by the committee at the suggestion of industrial representatives, who expressly stated that the change in language would bring the bill into conformity with a similar phrase in 26 U.S.C.A. sec. 48(a)(1)(B) of the federal Internal Revenue Code relating to investment credits. That section provides the credit for tangible personal property "used as an integral part of manufacturing," but excludes "a building and its structural components." A known body of federal law had developed to interpret this phrase.

The taxpayer contends that the legislature's adoption of the phrase suggested by the industrial representatives evinces its intent that the M & E exemption be construed in conformity with the federal investment credit statute. Under this approach, any property qualifying for the credit under federal authority, such as each of the structures involved in this case,

2. *Monson v. Monson* 85 Wis.2d 794, 800, 271 N.W.2d 137 (Ct. App. 1978). *State ex rel. Gutbrod v. Wolke* 49 Wis.2d 736, 742, 183 N.W.2d 161 (1971). *Kindy v. Hayes* 44 Wis.2d 301, 308, 171 N.W.2d 324 (1969). *Perry Creek C.*

*Corp. v. Hopkins Ag. Chem. Co.* 29 Wis.2d 429, 435, 139 N.W.2d 96 (1966). *City of Milwaukee v. Milwaukee County* 27 Wis.2d 53, 56, 133 N.W.2d 393 (1965).

would presumably be entitled to the M & E exemption. We agree with the department that this approach is unwarranted.<sup>3</sup> Although the credit and the exemption were doubtless enacted for similar reasons—to stimulate business and encourage industrial investment—they relate to different kinds of taxes and serve the intended purpose in different ways. In addition, the expressed intention of individuals advising the legislature, through a conference committee, is inconclusive evidence of an identical legislative intention.<sup>4</sup>

We need not adopt a strict conformity test, however, in order to accept persuasive reasoning of courts in other jurisdictions which have construed statutes similar to our own.<sup>5</sup> Several such cases, both federal and state, have resolved issues similar to that before us by rejecting a narrow "physical appearance" test and applying a "function or use" test. Under that test the central question is whether the structure is one "whose utility is principally and primarily a significantly contributive factor in the actual manufacture or production of the product itself." Mertens, 5 *Law of Federal Income Taxation* sec. 32A.14, at 50 (rev. ed. 1980).

In *Brown-Forman Distillers Corporation v. United States*, 499 F.2d 1263, 205 Ct.Cl. 402 (1974), for example, the court held that large structures designed to age whiskey in a controlled environment, and which were entered by the taxpayer's employees only for repairs, maintenance, loading and unloading, were entitled to the investment

credit. The fact that the structures "have features in common with buildings" was held not to be determinative. The real question, the court said, was "whether they are functioning or being used as 'buildings' in the taxpayer's hands." 499 F.2d at 1271. A major consideration in answering that question was that the working space provided in the structures for employees was no more than "merely incidental to the principal function or use of the structure." 499 F.2d at 1271. Cf. *Sunnyside Nurseries*, 59 T.C. 113 (1972), appeal dismissed, see *Thirup v. Commissioner of Internal Revenue*, 508 F.2d 915, 918 n.2, A.L.R.Fed. 299 (9th Cir. 1974), and *Arne Thirup*, 59 T.C. 122 (1972), rev'd. sub nom. *Thirup v. Commissioner of Internal Revenue*, 508 F.2d 915, 39 A.L.R.Fed. 299 (9th Cir. 1974), holding that certain greenhouses were buildings, rather than machines, because the taxpayer's employees spent their full work days within them.

The fact that a structure could be physically altered to serve building-like, as well as machine-like functions, was held to be irrelevant to its tax status in *Yellow Freight System, Inc. v. United States*, 413 F.Supp. 357 (W.D.Mo.1975), rev'd. on other grounds, 538 F.2d 790 (8th Cir. 1976). The court observed:

Indeed, in their present form the structures are of no use to plaintiff or anyone else except for the purposes for which they were specifically designed and for which they are used. The fact that expenditures for labor and materials might render a structure suitable for other uses

3. *Ladish Co. v. Department of Revenue*, 69 Wis.2d 723, 233 N.W.2d 354 (1975), upon which the taxpayer relies, is inapposite. The case dealt with the construction of a state income tax statute which was virtually identical to its counterpart in the Internal Revenue Code, and an explanatory note to the bill which became the statute indicated that uniformity between state and federal laws was intended. *Master Lock Co. v. Department of Revenue*, 62 Wis.2d 716, 215 N.W.2d 529 (1974) and *Industrial Comm. v. Woodlawn Cemetery Assn.*, 232 Wis. 527, 287 N.W. 750 (1939), both of which dealt with identical state-federal statutes, are similarly distinguishable.

4. See *A. O. Smith Corp. v. Department of Revenue*, 43 Wis.2d 420, 427, 168 N.W.2d 887, 890 (1969), where the supreme court ruled that

"[L]egislative acts must be construed from their own language, uninfluenced by what the persons introducing or preparing the bill actually intended to accomplish by it." *Moorman Mfg. Co. v. Industrial Comm.*, 241 Wis. 200, 5 N.W.2d 743" [quoting *Estate of Matzke*, 250 Wis. 204, 208, 26 N.W.2d 659, 661 (1947)]. But see *Buehler Bros. v. Industrial Comm.*, 220 Wis. 371, 373-74, 265 N.W. 227 (1936); *Pellet v. Industrial Commission*, 162 Wis. 596, 601, 156 N.W. 956 (1916), *Sutherland*, 2A *Statutory Construction* sec. 48.12 at 214-15 (4th ed. 1973).

5. Cf. *Master Lock Co. v. Department of Revenue*, 62 Wis.2d 716, 215 N.W.2d 529 (1974); *Columbia Hospital Assn. v. Milwaukee*, 35 Wis.2d 660, 670, 151 N.W.2d 750 (1967).

does not alter the fact that the structure in its unaltered state is not a 'building' *Id.* at 370.

The use-function approach has also been employed by state courts. In *Gulf Oil Corp. v. Philadelphia*, 357 Pa. 101, 53 A.2d 250, 172 A.L.R. 302 (1947), the Pennsylvania Supreme Court overturned a lower court's ruling that oil refinery tanks were not "machinery" entitled to exemption. In language especially pertinent to the malt elevators at issue in this case, the supreme court criticized the lower court's logic in concluding that because the action which took place in the tanks was "chemical," and not "mechanical," the tanks were merely processing agents and not manufacturing machinery. 357 Pa. at 108, 53 A.2d at 253, 172 A.L.R. at 307. The court said:

Much of the machinery today has only passive or motionless functions to perform in manufacturing.

It is as logical to hold that the storage tanks in which take place physical and chemical processes necessary to the refinement of oil, are machinery as it is to hold that the smelters used in making metal are machinery. 357 Pa. at 109-110, 53 A.2d at 254, 172 A.L.R. at 307-08. [Footnote omitted.]<sup>6</sup>

See also *Board of Assessors of Swampscott v. Lynn Sand & Stone Co.*, 360 Mass. 595, 277 N.E.2d 97, 99 & 99 n.3 (1971), which held that "certain very bulky machinery:" such as a 50-ton silo and a 300-ton sand bin did not lose their "predominant aspect" as manufacturing machinery entitled to tax exemption merely by virtue of bulk or being affixed to buildings which themselves were taxable as real estate.

The department has brought to our attention *Public Service Elec. & Gas Co. v. TP. of*

6. The supreme court was also critical of the lower court's conviction that silos, to which it had likened the refinery tanks, would not be exempt from taxation, observing

Insofar as a silo's function is merely preservative it has no part in manufacturing but as the fermentation of the silage in the silo forms certain organic acids which prevent the development of molds on the fodder a silo does have, pro tanto, a part in the manufacturing of silage. The fermentation which

*Woodbridge*, 73 N.J. 474, 375 A.2d 1165 (1977), which held that structures housing energy generating apparatus of electric light and power companies were taxable "buildings," and not exempt "machinery" under that state's statutes. A lower court had held that such structures were exempt because they were "'adapted and adaptable only to shelter and support generating equipment' and are therefore, in effect, 'Electric Generating Stations' and hence part of the 'machinery, apparatus and equipment' exempt from direct property taxation under the act." 73 N.J. at 477-78, 375 A.2d at 1166. The New Jersey Supreme Court's disapproval of the lower court's determination does not support the department's position on this appeal. The supreme court noted that the structures in question were more than just shelters for equipment because they "are also workplaces for personnel," containing control rooms with such conveniences as heating, air conditioning, and toilets. It said that the word "building" must be given its "generally accepted meaning," and approved the following definition:

A "building" in the usual and ordinary acceptation of the word is a structure designed and suitable for habitation or sheltering human beings and animals, sheltering or storing property, or for use and occupation for trade or manufacture. 73 N.J. at 479, 375 A.2d at 1167. [Emphasis in original.]

That definition, which is comparable to the more detailed definition of "building and structural components" set forth in 26 C.F.R. sec. 1.48-1(e) with respect to the investment credit exception,<sup>7</sup> cannot be said to apply to any of the three structures at issue in this case. None of them is designed or suitable for the shelter of persons, occu-

goes on in the silo produces, under proper conditions, sweet 'silage' as fodder. To that extent the silo may be properly considered as part of the machinery of producing fodder. 357 Pa. at 110 n.2, 53 A.2d at 254 n.2, 172 A.L.R. at 308 n.2

7. 26 C.F.R. sec. 1.48-1(e)(1) defines "buildings and structural components" in pertinent part as follows

The term "building" generally means any structure or edifice enclosing a space within



pation, or simple storage. Each is designed to process raw materials into a final product, and for no other purpose. They are also used for that and no other purpose.

A definition of "buildings" and of "machinery and equipment" which emphasizes actual function and use over physical appearance, sheer size, and remotely potential use, elevates substance over form. It also makes sense. Internal correspondence of the department, which are exhibits to the parties' stipulation, indicate that the department has inclined towards the functional approach as a matter of policy with respect to air conditioners and humidifiers, wood-kilns, brewery fermenting tanks, certain equipment used to age natural cheeses, and other items which in its view either are or "may have to be considered" as machinery entitled to exemption under the statute. As to such items, the department, like the other authorities cited in the opinion, has taken a broader view of the scope of the tax benefits granted to manufacturing machinery, as opposed to buildings, than the view which it now urges on this court. It offers no basis for distinction between air conditioners and attemporators, wood kilns and malt kilns, cheese aging equipment and

*its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores*

*Such term does not include (i) a structure which is essentially an item of machinery or equipment, or (ii) a structure which houses property used as an integral part of an activity specified in section 48(a)(1)(B)(i) if the use of the structure is so closely related to the use of such property that the structure clearly can be expected to be replaced when the property it initially houses is replaced. Factors which indicate that a structure is closely related to the use of the property it houses include the fact that the structure specifically designed to provide for the stress and other demands of such property and the fact that the structure could not be economically used for other purposes. Thus, the term "building" does not include such structures as oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns, and coal tipples.*

malt aging-blending elevators. This court perceives no possible distinction.

For these reasons the judgment of the trial court is affirmed.

Judgment affirmed.



98 Wis.2d 511

**Thomas SCHWAAB, Plaintiff-Appellant,**  
v.

**TOWN OF SUMMIT, Robert Hasselkus  
and Michael Jones, individually and as a  
member of the Town Board, Defendants-Respondents.**

No. 79-1831.

Court of Appeals of Wisconsin.

Argued May 28, 1980.

Opinion Released Aug. 22, 1980.

Opinion Filed Aug. 22, 1980.

Town chairman brought declaratory judgment action challenging validity of an

(2) The term "structural components" includes such parts of a building as walls, partitions, floors, and ceilings, as well as any permanent coverings therefor such as paneling or tiling, windows and doors; all components relating to the operation or maintenance of a building. However, the term "structural components" does not include machinery the sole justification for the installation of which is the fact that such machinery is required to meet temperature or humidity requirements which are essential for the operation of other machinery or the processing of materials or foodstuffs. Machinery may meet the "sole justification" test provided by the preceding sentence even though it incidentally provides for the comfort of employees, or serves, to an insubstantial degree, areas where such temperature or humidity requirements are not essential. For example, an air conditioning and humidification system installed in a textile plant in order to maintain the temperature or humidity within a narrow optimum range which is critical in processing particular types of yarn or cloth is not included within the term "structural components." [Emphasis supplied.]

**EXHIBIT B**

125 Wis.2d 437

**PABST BREWING COMPANY, a foreign corporation,  
Plaintiff-Respondent,**

v.

**CITY OF MILWAUKEE, a municipal corporation, Defendant and  
Co-Appellant,**

**Wisconsin Department of Revenue,  
Defendant-Appellant.**

No. 84-2023.

Court of Appeals of Wisconsin.

Submitted on Briefs May 7, 1985.

Opinion Released July 15, 1985.

Opinion Filed July 15, 1985.

Review Denied.

Brewing company sought declaratory judgment on the tax status of certain structures. The Circuit Court, Milwaukee County, Hugh R. O'Connell and Rudolph T. Randa, JJ., determined that such structures were exempt from property tax and that brewing company was entitled to refund of taxes paid between 1974 and 1983. City and Department of Revenue appealed. The Court of Appeals, Sullivan, J., held that: (1) barley bins, malt house, head house, and cellars were machinery or equipment exclusively and directly used in the production of beer and, thus, were exempt from property tax, but (2) trial court's declaration as to tax status of such structures for the years 1981, 1982, and 1983, which years were subsequent to the years in issue at trial, was improper.

Judgment and order affirmed in part and reversed in part.

#### 1. Appeal and Error §842(9)

When question on appeal is whether statutory concept embraces a particular set of factual circumstances, reviewing court is generally presented with a mixed question of law and fact.

#### 2. Stipulations §14(10)

Where party stipulated to the essential facts, Court of Appeals was faced only with ultimate question of whether the facts fulfilled statutory standards that would exempt the structures from property tax, which question was a question of law to which the Court would not defer to the trial court. W.S.A. 70.11(27).

#### 3. Appeal and Error §842(1)

On questions of law, the Court of Appeals does not defer to the trial court.

#### 4. Administrative Law and Procedure §760

Where administrative agency's expertise is significant to the determination, Court of Appeals will accord some weight to agency's decision, but that decision not controlling.

#### 5. Taxation §204(2)

Tax exemption statute is to be strictly construed against granting the exemption.

#### 6. Taxation §251

Burden of bringing property in question within terms of tax exemption is on taxpayer.

#### 7. Taxation §204(2)

Tax exemption statute need not be given the narrowest possible construction.

#### 8. Taxation §237

A structure's external appearance does not determine whether it is a "building" for purposes of W.S.A. 70.11(27), exempting manufacturing machinery and equipment, but not buildings, from property tax; rather, question is whether structure is being used as a building in taxpayer's hands.

#### 9. Taxation §237

In determining whether a structure functions as a "building" in taxpayer's hands, for purposes of W.S.A. 70.11(27), exempting manufacturing machinery and

equipment, but not buildings, from property tax, court must first determine whether structure was designed, and is principally employed, to provide shelter or housing to humans or animals; storage for property; or working, office, parking, sales, or display space for trade or industry.

#### 10. Taxation ⇌237

Under the function or use test used to determine whether a structure constitutes manufacturing machinery or equipment exempt from property tax under W.S.A. 70.11(27), question asked is whether structure's utility is "principally and primarily" a significant contributing factor in a product's manufacture.

#### 11. Taxation ⇌237

Incidental use of manufacturing property for nonexempt purpose does not violate requirement of W.S.A. 70.11(27), exempting manufacturing machinery and equipment from property tax, that manufacturing machinery and specific processing equipment be exclusively used in manufacturing tangible personal property.

#### 12. Taxation ⇌237

Phrase "directly used," used in W.S.A. 70.11(27), exempting manufacturing machinery and equipment from property tax, must be defined without resort to hyper-technicality.

#### 13. Taxation ⇌237

Degree of passivity in a structure, e.g., motionless character of its walls, is not an absolute bar to the structure functioning directly as a machine and, thus, being exempt from property tax under W.S.A. 70.11(27); thus, chemical action within a structure may be as legitimate, for such exemption purposes, as mechanical action.

#### 14. Taxation ⇌237

Overliteral approach is not to be used in resolving issue as to whether a structure constitutes a building or building component, or whether structure constitutes machinery/equipment exclusively and directly used in manufacture of property and, thus, exempt from property tax under W.S.A. 70.11(27).

#### 15. Taxation ⇌237

Barley bins, in which barley kernels were "rested" or maintained at controlled temperatures and humidity to prevent premature germination, were directly and exclusively used in process of brewing beer to foster an organic process and not merely to store grain and, thus, were exempt from property tax as processing "equipment" under W.S.A. 70.11(27).

See publication Words and Phrases for other judicial constructions and definitions.

#### 16. Taxation ⇌237

Fact that some human activity, incidental to a structure's function, is carried on within the structure does not mean that the structure provides general working space so as to preclude exemption from property tax as manufacturing machinery or equipment under W.S.A. 70.11(27).

#### 17. Taxation ⇌237

Working space provided in malt house was merely incidental to principal function or use of malt house as an artificial environment conducive to transformation of barley into malt for the production of beer and, thus, did not preclude exemption of malt house from property tax as processing "equipment" under W.S.A. 70.11(27), where employee activity in malt house was generally confined to machinery hall, due to fact that kiln in malt house was too hot and germinating room was too humid.

#### 18. Taxation ⇌237

Malt house was not merely a shelter for equipment or storage place for grain but, instead, was a significant factor in the production of beer and, thus, was exempt from property tax as processing "equipment" under W.S.A. 70.11(27), where walls, floors, and roof of malt house were integral to its function insofar as they kept in attemperated air, and principal and primary function of germinating room portion of malt house was to create artificial environment conducive to transformation of barley into malt.

**19. Taxation** ¶237

If major portion of structure is conceded to be machinery or equipment used exclusively and directly in manufacturing, portion of that structure containing equipment incidental to that structure's function is also exempt from property tax under W.S.A. 70.11(27), exempting manufacturing machinery or equipment from property tax.

**20. Taxation** ¶237

Head house, which sat atop malt bins and was 56-foot tall structure of poured concrete whose sole purpose was to support cleaning and transferring equipment through which malt had passed on its journey from malt house into malt bins and from those bins to brew house, was incidental portion of malt bins, which were exempt from property tax under W.S.A. 70.11(27) as machinery or equipment exclusively and directly used in the production of beer, so that head house itself was also exempt from property tax under that statute.

**21. Taxation** ¶237

Cellars were not mere shelter, storage, or working space but, instead, were "machinery" that primarily, directly, and significantly contributed to the processing of wort into beer and, thus, were exempt from property tax under W.S.A. 70.11(27), where cellars' purpose was to support and envelop tanks of wort-yeast mixture in chilled, temperature-controlled environment essential for fermentation and aging of beer, and cellars were all in effect huge walk-in refrigerators and were designed and used for no purpose other than fermentation and aging of beer.

See publication Words and Phrases for other judicial constructions and definitions.

**22. Taxation** ¶543(9)

Issue as to whether brewing company was not entitled to refund of property taxes, due to its failure to pay any of the disputed property taxes involuntarily or under protest, was not raised at trial and, thus, was waived on appeal.

**23. Taxation** ¶251

Trial court's declaration as to tax status of disputed property for years subsequent to years in issue at trial was improper, since record could contain no evidence to support the judgment. W.S.A. 70.11(27).

**24. Taxation** ¶237

Tax exemption under W.S.A. 70.11(27) for manufacturing machinery is based on property use, which must be determined yearly.

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Bronson C. La Follette, Atty. Gen., Madison (John C. Murphy, Asst. Atty. Gen., Madison, of counsel), for defendant-appellant Wis. Dept. of Revenue.

Grant F. Langley, City Atty., Milwaukee (Patrick B. McDonnell, Milton Emmerson, and Scott G. Thomas, Asst. City Attys., Milwaukee, of counsel), for defendant and co-appellant City of Milwaukee.

Michael, Best & Friedrich, Milwaukee (Rickard T. O'Neil, Jerome H. Kringel, and John C. Lapinski, Milwaukee, of counsel), for plaintiff-respondent.

Before WEDEMEYER, P.J., and MOSER and SULLIVAN, JJ.

SULLIVAN, Judge.

The City of Milwaukee (City) and the Wisconsin Department of Revenue (Department) appeal from a judgment determining that certain structures owned by Pabst Brewing Company (Pabst) and used in the brewing process were exempt from taxation because they were machinery or equipment, and not buildings or building components, within the meaning of sec. 70.11(27) Stats. We affirm the trial court's determination that the structures are exempt and that Pabst is entitled to a refund of the taxes paid between 1974 and 1980. However, we reverse that portion of the judgment extending Pabst's entitlement to a tax refund to years beyond those stipulated by the parties as being in issue. We do not reach the issue whether Pabst paid the subject taxes under protest; that issue was waived for failure to raise it at trial.

After execution of an extensive stipulation of facts, this case was tried to the court for one and one-half days in 1980. The trial was followed by the filing of extensive post-trial briefs. The trial court issued its findings of fact and conclusions of law in September of 1983. Stated briefly, the court determined that each disputed structure functioned as machinery in the production of beer and was thus exempt from property taxation under sec. 70.11(27), Stats. The court also concluded that Pabst was entitled to a refund of general property taxes paid with respect to the misclassified structures. In August of 1984 the court ordered that the order for judgment must include an order for refund of taxes paid, not only between 1973 and 1980, but also in 1981, 1982, and 1983. The order for judgment and judgment were entered on September 4, 1984. This appeal followed.

It was stipulated by the parties that the demands of quality control in brewing and modern mass production "have led to the design and construction of specialized structures which are in every sense of the term 'custom-built' with particular beer-making functions in mind." The chief legal issue presented is whether certain of these structures are "buildings or building components" and not exclusively or directly used in the manufacture of beer, as the Department and City contend, or are, by their function in the beer-making process, not buildings but beer processing equipment exclusively and directly used in manufacturing beer, as Pabst contends and as the trial court held. This issue was briefed by the Department, with the City joining in its arguments. The City briefed the issues whether Pabst's failure to introduce evidence that it paid under protest bars its recovery and whether the trial court erred in ordering the refund of property taxes paid after 1980.

Four of the structures at issue here are associated with the malting process, and four are associated with the fermenting process. The structures at issue that are associated with malting are the barley bins (structures 36 and 24), the malt house

(structure 25), and the head house portion of the malt bins (structure 16A). The structures associated with the fermenting process are cellars 1, 3, 5 and 6. All of the structures involved in the lawsuit are part of Pabst's manufacturing plant. Not involved in this case are Pabst's brew house (which is also part of its manufacturing plant), its offices and warehouse, and certain of its cellars that the Department conceded were exempt.

The malt bin portion of structure 16A is conceded to be exempt from property tax by virtue of this court's ruling on equivalent malt bins in *Ladish Malting Co. v. Department of Revenue*, 98 Wis.2d 496, 297 N.W.2d 56 (Ct.App.1980). However, the head house portion of the structure, which sits atop the malt bins, is in issue here. The Department also concedes exemption under *Ladish* for Pabst's kiln, except for one wall that adjoins the malt house.

The structures in controversy function in the brewing process in the following manner. During the malting stage, the barley is cleaned and graded and then "rested," first in structure 36 and then in structure 24. "Resting" is a stage in which, under controlled temperature and humidity, the barley undergoes an organic change. The barley is next transferred to the malt house, structure 25. There, the barley is steeped in water and then placed in large germination compartments, where warm, moist air is directed over and through the barley. In this environment the barley germinates. At a prescribed phase in the germination, the barley is transferred to the kiln, which adjoins the malt house. The kiln generates a flow of hot, dry air over the barley, which is now called green malt. The flow of air dries the malt and halts germination. After kilning, the malt returns to structure 24, where it is cooled; and then it passes into the malt bins, structure 16A, for aging and blending. From the malt bins, the aged and blended malt is sent to the brew house, a structure not involved in this case. There, the malt undergoes a process called "mashing" which

transforms it into a sweet liquor called "wort." The wort is then piped into tanks in the cellars, which are like giant refrigerators, where fermenting and aging take place. The end result is beer.

# I.

[1-4] The principal question presented for review is whether the trial court correctly ruled that Pabst's grain bins, malt house, the head house portion of its malt bin, and certain cellars not conceded by the Department to be exempt were exempt from property tax under sec. 70.11(27), Stats. because they were not buildings or building components and were exclusively and directly used in the manufacture of tangible personal property within the meaning of sec. 70.11(27). When the question on appeal is whether a statutory concept embraces a particular set of factual circumstances, the reviewing court is generally presented with a mixed question of fact and law. See *Nottelson v. DILHR*, 94 Wis.2d 106, 115-16, 287 N.W.2d 763, 767-68 (1980). In this case the parties stipulated to the essential facts, i.e., the various roles of the structures in the brewing process. Thus, we are faced only with the ultimate question of whether the facts, in the case of each structure, fulfill the statutory standards that would exempt the structures from property taxation. This is a question of law. See *Department of Revenue v. Bailey-Bohrman Steel Corp.*, 93 Wis.2d 602, 606, 287 N.W.2d 715, 717 (1980). On questions of law, we do not defer to the trial court. *Id.* Where an administrative agency's expertise is significant to the determination, we will accord some weight to its decision, but it is not controlling. *Nottelson*, 94 Wis.2d at 117, 287 N.W.2d at 768.

Section 70.11(27), Stats., exempts from property taxation "[m]anufacturing machinery and specific processing equipment, exclusively and directly used by a manufacturer in manufacturing tangible personal property." The section defines manufacturing machinery and specific processing equipment as

any combination of electrical, mechanical or chemical means, including special foundations therefor, designed to work together in the transformation of materials or substances into new articles or components, including parts therefor, regardless of ownership and regardless of attachment to real property. *This shall not be construed to include materials, supplies, buildings or building components....* (Emphasis added).

This section has been in effect since the 1974 tax assessment. See ch. 90, Laws of 1973.

[5-7] A tax exemption statute is to be strictly construed against granting the exemption, and the burden of bringing the property in question within the terms of the exemption is on the taxpayer. *Ladish*, 98 Wis.2d at 502, 297 N.W.2d at 58. An exemption statute need not be given the narrowest possible construction. "A strict but reasonable construction seems to be the pithy and popular statement of the rule." *Id.* (citations omitted).

In enacting sec. 70.11(27), Stats., the "legislature plainly intended to exempt manufacturing machinery and equipment exclusively used in transforming raw products into merchantable goods, while withholding the exemption from buildings and building components." *Ladish*, 98 Wis.2d at 503, 297 N.W.2d at 58. Thus, we are primarily concerned with two concepts contained in sec. 70.11(27). We are concerned with whether the disputed property is "manufacturing machinery" "exclusively and directly" used in manufacturing tangible personal property and with whether the disputed property is a "building" or "building component."

In making these determinations we follow the "function or use" test adopted by this court in *Ladish*, 98 Wis.2d at 506-11, 297 N.W.2d at 60-62, and by the supreme court in *Department of Revenue v. Greiling*, 112 Wis.2d 602, 607, 334 N.W.2d 118, 121 (1983). In *Ladish* we held that *Ladish* Malting Company's attempters, kilns and malt elevators were exempt from taxation under sec. 70.11(27), Stats., despite the

fact that all of the structures had "walls, floors, and ceilings or roofs" and had a "building-like" appearance from the outside." See 98 Wis.2d at 499, 297 N.W.2d at 57. We rejected the "physical appearance" test in favor of a functional analysis under which the central question is whether the structure is one "whose utility is principally and primarily a significantly contributive factor in the actual manufacture or production of the product itself." *Id.* at 506, 297 N.W.2d at 60 (citation omitted). We concluded that each disputed structure was "designed [and used] to process raw materials into a final product, and for no other purpose." *Id.* at 510, 297 N.W.2d at 62.

Citing *Ladish*, the supreme court in *Greiling* adopted the "use or function" test. In *Greiling* the issue was whether a greenhouse was a "machine" exempt from the use tax under sec. 77.54(3), Stats. The supreme court decided that the functional characteristics of a greenhouse made it a machine for purposes of the use tax exemption: "[This greenhouse] cannot be viewed merely as a storage facility because it has an active function of creating and controlling an environment conducive to the production of floricultural crops. . . . On this record, it has no other purpose or function, nor could it be successfully adapted to another use." 112 Wis.2d at 607, 334 N.W.2d at 121.

[8] *Greiling* and *Ladish* make it clear that a structure's external appearance does not determine whether it is a building. Rather, the question is whether the structure is being used as a building in the taxpayer's hands. *Ladish*, 98 Wis.2d at 506, 297 N.W.2d at 60 (citing *Brown-Forman Distillers Corp. v. United States*, 499 F.2d 1263, 1271, 205 Ct.Cl. 402 (1974)). An emphasis on function elevates substance over form. *Ladish*, 98 Wis.2d at 510, 297 N.W.2d at 62.

The question whether a structure is a building arises frequently under federal tax law in relation to the investment credit section of the Internal Revenue Code, which employs the phrase, "building and its structural components." See I.R.C. sec.

48(a)(1)(B). We note that when sec. 70-11(27), Stats., was drafted, representatives of industry asked the legislature to substitute the more restrictive phrase "buildings or building components" for the originally drafted phrase "structures or fixtures" in order to obtain greater conformity with I.R.C. sec. 48(a)(1)(B) and the body of case law that had developed around it. See *Ladish*, 98 Wis.2d at 504-05, 297 N.W.2d at 59. The federal regulations define "building" as "any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space." 26 C.F.R. sec. 1.48-1(e)(1) (1984). The term does not include "a structure which is essentially an item of machinery or equipment" and "does not include such structures as oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns, and coal tipples." *Id.*

A similar definition, referred to in *Ladish*, 98 Wis.2d at 509, 297 N.W.2d at 61, was that of the New Jersey Supreme Court in *Public Service Electric & Gas Co. v. Township of Woodbridge*, 73 N.J. 474, 375 A.2d 1165, 1167 (1977): "A building in the usual and ordinary acceptance of the word is a structure designed and suitable for habitation or sheltering human beings and animals, sheltering or storing property, or for use and occupation for trade or manufacture."

[9] Thus, in asking whether a structure functions as a building in the taxpayer's hands, we must first ask whether the structure was designed, and is principally employed, to provide shelter or housing to humans or animals; storage for property; or working, office, parking, sales, or display space for trade or industry. The Department would have us conclude, under the instant facts, that the structures at issue house people and machines and provide industrial working space and, thus, are buildings. The Department also urges that, whatever label one affixes to the



structures, they are not "exclusively and directly used in the manufacture of tangible personal property."

[10,11] The phrase "exclusively used" is defined for tax exemption purposes in Black's Law Dictionary 507 (5th ed. 1979) as "[having] reference to primary and inherent [use] as over against a mere secondary and incidental use." While neither *Ladish* nor *Greiling* defines "exclusive and direct use," their adoption of the function or use test implies that "exclusively" does not have to mean "solely" or "purely" but rather "principally and primarily." Under the function or use test, the question asked is whether the structure's utility is "principally and primarily" a significant contributing factor in the product's manufacture. *Ladish*, 98 Wis.2d at 506, 297 N.W.2d at 60. Incidental use of manufacturing property for a nonexempt purpose does not violate the exclusivity requirement of sec. 70.11(27), Stats. *Manitowoc Co. v. City of Sturgeon Bay*, 122 Wis.2d 406, 414, 362 N.W.2d 432, 437 (Ct.App.1984).

[12,13] Similarly, the phrase "directly used" must be defined without resort to hypertechnicality. A degree of passivity in a structure, e.g., the motionless character of its walls, is not an absolute bar to its functioning directly as a machine. Chemical action within a structure may be as legitimate, for these purposes, as mechanical action. See *Ladish*, 98 Wis.2d at 507-08, 297 N.W.2d at 61.

[14] Thus, we do not deem it inconsistent with the rule of strict construction to reject an over-literal approach to the question whether a structure constitutes a building or building component or machinery/equipment exclusively and directly used in the manufacture of property. See *Honeywell Information Systems, Inc. v. County of Sonoma*, 44 Cal.App.3d 23, 118 Cal.Rptr. 422, 425 (1974) (phrase "exclusively used," in context of property tax exemption for property exclusively used for public schools, construed to allow incidental other uses necessary to and in furtherance of primary use). Our supreme

court has avoided hypertechnical applications of property tax exemption statutes. See, e.g., *Family Hospital Nursing Home v. City of Milwaukee*, 78 Wis.2d 312, 320-23, 254 N.W.2d 268, 273-75 (1977) (phrase "used exclusively," in context of tax exemption for property used exclusively for benevolent purposes, construed to allow benevolent association to charge fees to nursing home patients, to reimburse directors for expenses, and to claim exemption for post-construction period when nursing home was being readied for patient occupancy). We now turn to an analysis of each structure at issue.

#### THE BARLEY BINS

[15] The barley bins in structures 36 and 24 are separate physical entities for historical reasons not germane to this case; the two barley bins perform a common function in the beer making process. Both bins "rest" or maintain the barley kernels at controlled temperatures and humidity to prevent premature germination. Properly timed and uniform germination is essential to large scale malting, and this uniform germination could not take place without resting the barley. Contrary to the Department's assertion, the function of the barley bins is not the passive storage of barley kernels. The barley actually undergoes an organic change when it rests, and the parties so stipulated:

For reasons which have not been scientifically pinpointed, freshly harvested, "country-run" barley goes through a period of "dormancy" following harvesting, during which time individual barley kernels will germinate at uneven, non-uniform rates or not at all. The period of dormancy varies for different barley strains, but is generally around six weeks. Since large scale malting requires even, uniform barley germination, the barley must be permitted to "rest" until the dormancy period "breaks" in order to reach good germinating energy and capacity for malting.

It appears to us to be beyond controversy that the use of the barley bins "is commit-

ted to a more ambitious purpose' than mere storage. See *Ladish*, 98 Wis 2d at 503, 297 N.W.2d at 59.

Pabst cites a federal court case concerning the tax status, for investment credit purposes, of tobacco sheds used to age tobacco. In *Brown & Williamson Tobacco Corp. v. United States*, 369 F.Supp. 1283 (W.D.Ky. 1973), *aff'd per curiam*, 491 F.2d 1258 (6th Cir. 1974), the district court noted that the aging process was an essential and integral part of the manufacture of tobacco products and that the sheds in issue were specially designed and built for fostering this organic process. *Id.*, 369 F.Supp. at 1285. The court concluded that the sheds were not "buildings," but storage facilities entitled to the investment credit. *Id.* at 1288.

Insofar as the barley bins perform an integral function in the production of malt, we must conclude that they are "directly used" in the brewing process. They are also "exclusively" so used since their use is devoted entirely to maintaining proper temperature and humidity ranges under different weather conditions for the resting of barley. The bins are used for no other purpose. The bins were designed and constructed to foster an organic process and not merely to store grain. As such, they do not function as buildings but, rather, as processing equipment. Just as in *Greiling*, these structures create "the artificial environment necessary to produce" a product and, as such, can be considered machines. 112 Wis 2d at 606, 334 N.W.2d at 120.

We conclude that the principal utility of Pabst's barley bins is a significant factor in the production of beer. We thus hold that the bins are exempt from property tax under sec. 70.11(27), Stats.

#### THE MALT HOUSE

The malt house, structure 25, has two main parts, the germinating room and the malt kiln. The Department concedes exemption for three of the four kiln walls. The Department acknowledges, with the exception of the fourth wall, that the kiln is equivalent to the kiln held tax-exempt in

*Ladish*. The Department's refusal to exempt the fourth wall of the kiln rests on its refusal to exempt the malt house as a whole. It contends that the remainder of the malt house (the germinating room) is a building or building component.

The function of the malt house is to convert barley into malt on a large scale. The house has six stories, multiple rooms, stairs, an elevator, and office space. The principal parts of the germinating room portion of the malt house are the steep tank area, the germination compartment area, and the spray deck. The germinating room's steep tanks are filled with heated, aerated water into which barley is submerged to begin the germination process. The barley is conveyed to germination compartments after it has been steeped. The compartments are large vats or troughs in which the temperature, moisture, and carbon dioxide content are controlled. The steep tanks and germination compartments are themselves exempt from taxation.

A complex air circulation and attemperation system is built into the malt house. Through a network of air shafts, fresh air is directed in and through the grain beds, and foul air out, in such a way as to achieve the transformation of the barley into green malt. The very walls, floors, and roof of the structure are part of the network of fresh and foul air shafts. The process of attemperating the fresh air starts in the "spray deck" on the top floor of the malt house, where outside air is conditioned and humidified. From there, the air is sent through openings to flow into the grain compartments throughout the malt house. Twenty-four-hour monitoring of the temperature levels in each germination compartment is maintained by Pabst employees who make the necessary air flow adjustments to keep the temperature within a specific range.

The Department stipulated before trial that the spray deck was a giant air conditioner-humidifier, the Department asserts, however, that the malt house as a whole is not principally or primarily a giant air conditioner-humidifier, as were the attempera-

tors in *Ladish*. See 98 Wis 2d at 499-500, 297 N W 2d at 57. The Department contends that the malt house is no different from any ordinary industrial building containing an air circulation system to get rid of smoke, dust or smells generated by the manufacturing activities carried on within. The malt house, argues the Department, is simply housing for the machinery, equipment, and employees who facilitate the conversion of barley into malt.

We are persuaded otherwise. Again, under a functional analysis, we cannot say that the malt house was designed, and is principally employed, merely to provide shelter for equipment, storage for grain, and working space for employees.

[16, 17] We first reject the notion that the malt house is a shelter for employees to work. Granted, there are control room areas where employees monitor equipment function, and there is an office for the supervisor of malt house employees. However, it appears that the employee activity in the malt house for purposes of temperature monitoring, operation, and maintenance is no different in type or degree from that considered incidental in *Ladish*. See *id.* at 501, 297 N W 2d at 58. Employee activity in the malt house is generally confined to the machinery hall, which contains levers for operating the kiln floors, monitoring and other equipment for the germinating room and kiln, the supervisor's office, the elevator, and the stairwell. The elevator and stairwell provide access to the different levels to check the machinery. Outside of the machinery hall, there is little employee involvement in the malt house, the kiln is too hot and the germinating room too humid. The germinating room is monitored on an almost totally automated basis. Indeed, as in *Ladish*, human entry may be gained only through an airlock, due to vast differences in air pressure. See *id.* The fact that some human activity incidental to a structure's function, is carried on within the structure, does not mean that the structure provides general working space. See *Brown & Williamson Tobacco*, 369 F Supp at 1288. We conclude that the

working space provided in the malt house is merely incidental to its principal function or use. See *Ladish*, 98 Wis 2d at 506, 297 N W 2d at 60.

[18] We likewise reject the assertion that the malt house is merely a shelter for equipment or a storage place for grain. The grain undergoes an organic transformation in the malt house, just as in the barley bins. Pabst presented uncontradicted expert testimony to the effect that each area of the malt house is the large scale functional equivalent of small-scale machinery counterparts in Pabst's small pilot plant. The walls, floors, and roof of the malt house are integral to its function insofar as they keep in the attemperated air.

The principal and primary function of the germinating room portion of the malt house is to create an artificial environment conducive to the transformation of barley into malt. In that sense, it is analogous to the greenhouse in *Greiling*. See 112 Wis 2d at 606-07, 334 N W 2d at 120-21.

The Department contends that exempting the Pabst malt house would invalidate the "buildings or building components" exception to the exemption provided in sec. 70.11(27), Stats., by placing "untold numbers" of custom-built factory buildings "completely beyond taxation." We can only determine whether the structures in the case before us are exempt under the statute as it is written. This court does not make tax policy.

We conclude that the entire malt house functions as machinery or equipment because its principal utility is a significant factor in the production of beer. Accordingly, we hold that the entire malt house is exempt from taxation under sec. 70.11(27), Stats.

#### THE HEAD HOUSE

The head house, which sits atop the malt bins, structure 16A, was described in the Stipulation of Facts as a "56-foot tall structure of poured concrete" whose "sole purpose is to support cleaning and transferring equipment through which the

malt must pass on its journey from the Malt House into the bins and from the bins to the Brew House." Although the Department is now exempting all of the malt bin portion of structure 16A, it argues that the head house portion of the structure may not be exempted because it is a building. The Department asserts that the head house encloses and protects cleaning and conveying equipment from the elements and, as such, is merely a shelter for property.

According to the Stipulation of Facts, structure 16A was designed and is used "to protect the malt from moisture and extreme variations of temperature and humidity and to age and blend the malt on a large scale." To get to the malt bins for aging and blending, the malt must be conveyed from the malt house. After aging and blending, the malt must be conveyed from the malt bins to the brew house for mashing. The cleaning and transferring equipment that takes the malt in and out of the malt bins is contained in the head house. The cleaning and transferring equipment is itself exempt.

[19, 20] It is undisputed that the head house is a "part" of structure 16A and that structure 16A, except for the head house, is exempt from taxation under *Ladish*, which held that malt elevators (equivalent to the instant malt bins) were exempt. If the major portion of structure 16A is conceded to be machinery or equipment used exclusively and directly in manufacturing, we must conclude that the portion of the structure containing equipment incidental to that structure's function is also exempt. Hence, we hold that structure 16A, in its entirety, is exempt from taxation because it is machinery or equipment exclusively and directly used in the production of beer.

### THE CELLARS

After leaving the malt bins (structure 16A), the aged and blended malt goes to the brew house for mashing. There, it becomes a sweet liquor called wort. From the brew house the wort is piped to tanks in cellars for fermentation and aging. The

Department argues that cellars 1, 3, 5, and 6 do not themselves perform a manufacturing function but rather create a workplace for persons to operate already-exempted equipment to make beer. Pabst responds that the cellars function as refrigerators and, thus, as machines.

The parties stipulated that fermentation is a carefully temperature-controlled process consisting of two stages. In the first, or primary, stage the wort is combined with yeast and subjected to a temperature of 50°–57°F for seven to nine days. Under these conditions, the yeast converts the sugar in the wort into alcohol and carbon dioxide. In the second stage of fermentation, the beer is transferred to other tanks for separation of most of the yeast from the wort and subjection to a temperature of 32°F. The yeast cells remaining in the wort become lethargic at that temperature, and fermentation continues at a substantially diminished rate for several weeks. As the wort gains in alcohol and carbon dioxide, it develops the taste found in commercial beer.

In earlier times, wort could be fermented and aged only during cool periods of the year or in deep subterranean cellars. Modern-day cellars are giant, above-ground structures that permit fermentation to take place the year round.

[21] The cellars vary somewhat in construction, but all serve the same purpose. The parties stipulated that the cellars' purpose is "to support and envelop the tanks of the wort-yeast mixture in the chilled, temperature controlled environment essential for fermentation and aging." The parties also stipulated that the "cellars are all in effect huge walk-in refrigerators and were designed and are used for no purpose other than fermentation and aging of beer."

Cellar 5, the oldest cellar, is essentially a huge block of poured concrete in which an array of hollow chambers was formed as the concrete was being poured. The resulting structure resembles a honey comb.

The parties stipulated to the following description:

[S]ome of the chambers are shaped and used to hold fermenting wort. The tops, bottoms, and sides of these fermenting chambers consist of the very same concrete of which the structure of cellar 5 itself is made. Other chambers run above, below and in between the fermenting chambers and form an interconnected network of ducts through which refrigerated air is circulated to cool the fermenting wort. The walls of the ducts themselves are the opposite face of the walls of the fermenting chambers. Thus, the ducts themselves, like the fermenting chambers, are formed of the very concrete of which Cellar 5 is made.

The stipulation goes on to state that "[t]here is absolutely no purpose for which Cellar 5 could be used, other than the fermentation or aging of beer, without substantial alterations and improvements."

Cellars 1, 3, and 6 are constructed differently. They all have an interconnected network of columns and beams forming a gallery of horizontally spaced and vertically stacked cubicles with a single fermentation tank occupying each cubicle. Each tank rests on supports affixed directly to the beams and fully occupies a complete bay area or cubicle. The weight of each tank is entirely supported by the horizontal beam on which it rests. The beam is then connected to the column nearest the tank. The parties stipulated that "[c]ellars 1, 3 and 6 are custom designed for and used only for the process of fermenting and aging beer" and that "[b]ecause of their custom designed nature, they could be converted to another use only at great expense and only after making substantial changes to the existing structural arrangement."

The Department's concessions that the cellars could be used for no other purpose than fermentation and aging of beer without substantial alterations and improvements is in flat contradiction to its assertion that the cellars' sole purpose is to create employee work areas. The record indicates that the presence of employees in

the cellars is occasional and is limited mainly to connecting or disconnecting hoses and taking wort samples and temperatures. Except for narrow drainage aisles, there is very little space for employees even to walk. Further, the temperatures are too low, and the air too damp, for regular human occupation. Again, this employee activity is comparable in type and degree to that considered incidental in *Ladish*, 98 Wis.2d at 501, 297 N.W.2d at 58.

In *Brown-Forman*, 499 F.2d at 1268-73, certain large whiskey aging structures were held not to be building components excluded from qualifying for the investment tax credit despite the fact that employees regularly entered them to load and unload barrels, search for and repair leaks, and check for temperatures and humidity. A case even more closely analogous to the one before us is *Adolph Coors Co. v. Commissioner*, 27 T.C.M. 1351 (1968). At issue in *Coors* were cellars virtually identical to the Pabst cellars; they were described as shells with steel supports to enclose and support very large beer tanks and related equipment. *Id.* at 1357. Employees entered the cellars to check temperatures, pressures, and cooling systems; take beer samples; and fill, empty, and clean the tanks. The court ruled that the cellars were not buildings for purposes of the investment tax credit. *Id.* at 1358.

The Department also argues that the cellars do no more than shelter the large tanks within and that, thus, they do not directly transform a substance into tangible personal property. The framing and walls of the cellars, it is true, play a passive role in the fermentation process, but so do the walls and framing of any refrigerator. The cellar walls hold in the air that cools the tanks and permits fermentation and aging; the cellar framing holds the tanks in place. In *Niagara Mohawk Power Corp. v. Wanamaker*, 286 A.D. 446, 144 N.Y.S.2d 458 (1955), *aff'd*, 2 N.Y.2d 764, 157 N.Y.S.2d 972, 139 N.E.2d 150 (1956), in the context of a sales and use tax exemption for property directly and exclusively used in the production of tangible personal

property, the court said: "[A]ctivity is not the test of directness. The walls of the boiler have a 'passive' function in one sense. The important thing is that all parts of the plant contribute, continuously and vitally, to production, and they are all integrated and harmonized." *Id.*, 144 N.Y. S.2d at 462. The passive nature of the cellar walls and framing must not be allowed to obscure the fact that their sole reason for existence is to create the conditions that permit the fermentation of beer on a mass-production scale.

We conclude that cellars 1, 3, 5, and 6 are used principally and directly to process wort into beer; thus, they function as machines. The cellars were not designed, and are not primarily used, to provide mere shelter, storage, or working space; thus, they are not buildings or building components. Because the cellars are machinery that primarily, directly, and significantly contributes to the manufacture of tangible personal property, they are exempt from property taxation under sec. 70.11(27), Stats.

## II.

We now turn to the issues surrounding Pabst's entitlement to a refund of property taxes paid on the disputed structures. We first dispose of the City's charge that Pabst is entitled to no refund because it failed to prove that it had paid any of the taxes on the disputed property involuntarily or under protest.

The City did not raise the issue whether Pabst paid under protest at any time in the proceedings before the trial court. The issue was neither raised in pretrial briefs, nor during the trial, nor in post-trial briefs. The parties stipulated that the issues to be decided by the trial court were whether the structures were buildings or building components and whether the property was exclusively and directly used in manufacturing.

The trial court noted in its findings of fact and conclusions of law that "none of the major defenses raised in *Heilman [sic] Brewing Co. v. City of LaCrosse*, 105

Wis.2d 152, 312 N.W.2d 875 [Ct.App.1981], was raised in this action and are accordingly not here present." The defenses in *Heileman* to which the trial court alluded included payment under protest. *See id.* at 155, 312 N.W.2d at 876.

[22] As a general rule, an appellate court will not consider issues raised for the first time on appeal. *County of Columbia v. Bylewski*, 94 Wis.2d 153, 171, 288 N.W.2d 129, 138-39 (1980). As it appears that the payment under protest question was not considered a genuine issue until after the City lost the case, we deem the issue waived.

Both the City and the Department complain on appeal that the trial court erred in including in its judgment the years 1981, 1982, and 1983. The parties stipulated that the only years to be covered by the judgment were 1974 through 1980. The Department briefs the issue whether Pabst was entitled to a declaratory judgment on the tax status of the subject property for years after 1980, and the City briefs the issue whether Pabst was entitled to a judgment ordering a refund for years after 1980. The Department is not a defendant in Pabst's claim for a refund.

This case dates back to 1975 when Pabst filed a complaint seeking a declaratory judgment on the tax status of certain structures for the year 1974. The complaint was amended and expanded in 1976 to seek relief for 1974 and subsequent years. The parties subsequently entered into several stipulations that included agreements on the years to be covered by the judgment sought. The last of these stipulations was entered into in February, 1980, immediately prior to an evidentiary hearing. This final stipulation provided that the years to be covered by the declaratory judgment were 1974 through 1980. In the final judgment entered in 1984 (four years after trial), the court ruled that the judgment also included the years 1981 through 1983.

[23, 24] The trial court's declaration as to the tax status of the disputed property for years subsequent to the years in issue

at trial was improper because "the record could contain no evidence to support" the judgment. *See Family Hospital Nursing Home*, 78 Wis.2d at 327, 254 N.W.2d at 276. The tax exemption for manufacturing machinery is based on property use, which must be determined yearly. *Manitowoc Co.*, 122 Wis.2d at 413, 362 N.W.2d at 436.

Accordingly, we reverse that portion of the judgment extending the court's ruling

to the years 1981, 1982, and 1983. In all other respects, the judgment is affirmed.

Judgment and order affirmed in part and reversed in part.

