

Commonwealth Of Kentucky

Court Of Appeals

NO. 1997-CA-003233-MR

CAMERA CENTER, INC.
D/B/A MURPHY'S CAMERA
AND VIDEO AND LIBERTY
NATIONAL LEASING COMPANY
(NOW BANK ONE KENTUCKY
LEASING CORPORATION)

APPELLANTS

v. APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE STEPHEN K. MERSHON, JUDGE
ACTION NO. 97-CI-643

REVENUE CABINET,
COMMONWEALTH OF KENTUCKY

APPELLEE

OPINION
AFFIRMING

** ** * * * ** **

BEFORE: GUDGEL; CHIEF JUDGE, COMBS AND GARDNER, JUDGES.

GARDNER, JUDGE: Appellants, Camera Center, Incorporated doing business as Murphy's Camera & Video (Murphy's) and Liberty National Leasing Company (Liberty) (now Bank One Kentucky Leasing Corporation), appeal from an opinion of the Jefferson Circuit Court upholding a final order of the Kentucky Board of Tax Appeals which denied Murphy's claim for a refund of certain Kentucky sales and use taxes. The issue in this case concerns the definition of "plant facilities" as used in Kentucky Revised

Statute (KRS) 139.170(1) and 103 Kentucky Administrative Regulation (KAR) 30:120 in regards to allowing a tax exemption for machinery for new and expanded industry. This Court affirms the circuit court's opinion.

Murphy's operates six camera stores and photo processing centers in the Louisville and Lexington, Kentucky areas. Two of the locations in Louisville have on-site photo processing labs, and the other locations send undeveloped film to those two locations for processing. Murphy's, through Liberty, purchased new machinery for use in its photo processing operations.

In April 1993, Liberty, acting on behalf of Murphy's, filed with the Kentucky Revenue Cabinet (the Cabinet) an application for Kentucky sales and use tax refund for \$5,389.49 for sales taxes collected between December 1, 1988 and December 31, 1992. Liberty and Murphy's asserted that they were entitled to the refund because photo processing equipment purchased by Murphy's was machinery for new and expanded industry which qualified for the Kentucky sales and use tax exemption pursuant to KRS 139.480(10), KRS 139.170 and 103 KAR 30:120. In August 1993, the Cabinet denied the refund application. It maintained that Murphy's photo processing locations were not considered "plant facilities" pursuant to 103 KAR 30:120. Murphy's and Liberty protested the Cabinet's denial, and the Cabinet issued a final ruling of denial in August 1995. Murphy's and Liberty appealed the Cabinet's denial to the Kentucky Board of Tax Appeals (the Board). In January 1997, the Board issued an order

affirming the Cabinet's denial of the refund application. The Board concluded that Murphy's facilities were primarily retail in character. Murphy's and Liberty appealed the Board's order to the Jefferson Circuit Court pursuant to KRS 13B.140. In November 1997, the circuit court upheld the Board's final order. Murphy's and Liberty have now appealed to this Court.

Upon appeal, Murphy's and Liberty argue that the circuit court erroneously interpreted the term "plant facilities" set forth in KRS 139.170(1) to mean locations that are used almost exclusively for industrial manufacturing. They maintain that the exemption is based upon the type and use of machinery, not the extent of industrial manufacturing occurring at a location, that the term "plant facilities" includes more than just factories or industrial manufacturing establishments, and that the Cabinet's definition of "plant facilities" is overly restrictive and arbitrary. They also argue that the circuit court erroneously determined that the exemption in KRS 139.480(10) has a volume employee requirement. After reviewing the applicable statutes, regulations and the record, this Court has concluded that the circuit court correctly upheld the Board's decision.

In general, the party claiming a tax exemption bears the burden of demonstrating its entitlement to the exemption and that all the statutory requirements for the exemption have been met. Epsilon Trading Co. v. Revenue Cabinet, Ky. App., 775 S.W.2d 937, 941 (1989). Taxation exemptions are generally disfavored, and all doubts are resolved against an exemption.

Id. See also Revenue Cabinet v. James B. Beam Distilling Co., Ky., 798 S.W.2d 134 (1990). In considering such provisions, courts must look at the apparent objective of the legislature in enacting such statutes. Commonwealth of Kentucky ex rel. Lockett v. WLEX-TV, Inc., Ky., 438 S.W.2d 520, 522 (1968).

Courts adhere to the rule found in KRS 446.080(4) which provides that all words and phrases shall be construed according to the common and approved usage of the language. Commonwealth of Kentucky, Dept. of Revenue v. Kuhlman Corp., Ky., 564 S.W.2d 14, 16 (1978). Statutory language must be given its clear and commonly accepted meaning. Barnes v. Dept. of Revenue, Ky. App., 575 S.W.2d 169, 171 (1978). The practical construction of a statute by administrative officers over a long period of time is entitled to controlling weight. Id. See also Grantz v. Grauman, Ky., 302 S.W.2d 364, 367 (1957); Allphin v. Joseph E. Seagram & Sons, Inc., Ky., 294 S.W.2d 515, 517 (1956). Great deference is given to an administrative agency in the interpretation of a statute which is within its specific province. Commonwealth of Kentucky ex rel. Beshear v. Kentucky Utilities Co., Ky. App., 648 S.W.2d 535, 537 (1982).

Under KRS 139.480,

[t]he terms 'sale at retail,' 'retail sale,' 'use,' 'storage,' and 'consumption,' as used in this chapter, shall not include the sale, use storage, or other consumption of: . . .
(10) Machinery for new and expanded industry.
. . .

KRS 139.170(1) provides

[m]achinery for new and expanded industry means machinery used directly in the manufacturing or processing production

process, which is incorporated for the first time into plant facilities established in this state, and which does not replace machinery in the plants. . . .

103 KAR 30:120 provides for four specific requirements before machinery qualifies for exemption: (1) it must be machinery, (2) it must be used directly in the manufacturing process, (3) it must be incorporated for the first time into plant facilities established in this state, and (4) it must not replace other machinery.¹ It has been held that the ultimate purpose of the machinery for new and expanded industry exemption is to enhance the competitive position of this state as against other states in encouraging the location and expansion of the industries whose manufacturing processes require volume employment of people. Commonwealth of Kentucky ex rel. Lockett v. WLEX-TV, Inc., 438 S.W.2d at 522. The former Court of Appeals in Dept. of Revenue v. Spalding Laundry and Dry Cleaning Co., Ky., 436 S.W.2d 522, 524 (1968), noted that in considering exemptions, the legislature could distinguish between large plants and small plants. "It is entirely reasonable for such a body to conclude that the development of manufacturing plants would have a greater beneficial impact on the state economy than the development of other industries." Id.

In the case at bar, the issue centers on whether the photo processing facilities at the two Murphy's locations fall within the term of "plant facilities" contained in the statutes and regulation. Both sides apparently concede that photo

¹There is no definition of "plant facilities" provided in the statutes or regulations.

processing does constitute manufacturing. Under prior interpretations of the provision by the Cabinet and language from cases addressing similar issues, it is evident that the term "plant facilities" as used by the legislature meant a larger manufacturing facility rather than a retail facility with some manufacturing thrown in as an aside. The record in the instant case shows that Murphy's stores are primarily considered retail and supply shops. Murphy's existed as this first and then later added photo processing. As the parties' stipulations reveal, for purposes of insurance and other reasons, Murphy's stores are listed as retail establishments. Some of Murphy's employees must work at times in both the retail sales and photo processing. Based upon the record, we do not believe that Murphy's two stores are the "plant facilities" envisioned when statutory exemptions were enacted by the legislature. The plain meaning of "plant facilities" and the other statutory language also command this result.

We have carefully reviewed State Dept. of Assessments and Taxation v. Consumer Programs, Inc., 626 A.2d 360 (Md. 1993), relied upon heavily by Murphy's and Liberty. The statutory exemption in that case appears distinguishable as it does not contain a "plant facilities" type requirement as exists in the case at bar. We believe Stop 'N Save, Inc. v. Dept. of Revenue Services, 562 A.2d 512 (Conn. 1989), which supports the Cabinet's position is more closely akin to the instant case. Murphy's and Liberty's construction of the statutes and regulation are not within the intent of the legislature in enacting the exemptions.

We must give deference to the Cabinet's interpretation of the statutory term. This Court does not believe that Murphy's and Liberty have met their burden of showing entitlement to the exemption.² Thus, we hold that the exemption does not apply to manufacturing equipment that is located in a retail facility that is not predominately dedicated to manufacturing. The circuit court and the Board ruled correctly as a matter of law, and we decline to disturb the ruling below. See KRS 13B.150; Revenue Cabinet v. Joy Technologies, Inc., Ky. App., 838 S.W.2d 406 (1992); Revenue Cabinet v. Moors Resort, Inc., Ky. App., 675 S.W.2d 859 (1984).

For the foregoing reasons, the opinion of the Jefferson Circuit court is affirmed.

GUDGEL; CHIEF JUDGE, CONCURS.

COMBS, JUDGE, DISSENTS AND FILES A SEPARATE OPINION.

COMBS, JUDGE, DISSENTING: I respectfully dissent from the majority opinion. Murphy's installation of photo processing equipment complied with all four requirements of 103 KAR 30:120 that must be satisfied in order for machinery to qualify for a tax exemption in the context of new and expanded industry. It has been mutually conceded by the parties that Murphy's photo

²We have reviewed Murphy's and Liberty's other arguments, but they primarily raise the same issue, that the circuit court and the Board erroneously interpreted the statutes and that there was insufficient evidence to support the conclusion that Murphy's facilities were primarily retail establishments. This Court has already concluded these arguments lack merit. We also do not believe that the "plant facilities" provision in the exemption for energy producing fuels contained in KRS 139.480(3) has any direct application to the issue at hand.

processing business constitutes manufacturing. The case truly turns upon the correct definition of "plant facilities."

We have no basis (other than the administrative fiat of the Revenue Cabinet and the Kentucky Board of Tax Appeals) for holding KRS 139.170(1) to apply to an entity "larger" than Murphy's; if so, how large must a business be in order to come within the ambit of the statute? The statute itself is wholly silent as to size of the manufacturing operation. I do not believe that we are at liberty to speculate as to the "size" of a plant facility in order to defeat the applicability of the statute where Murphy's has met the specific, clearly articulated statutory criteria that would qualify it for the tax exemption:

Machinery for new and expanded 'industry' means machinery used directly in the manufacturing or processing production process, which is incorporated for the first time into plant facilities established in this state, and which does not replace machinery in the plants, or that machinery purchased to replace existing machinery which will increase the consumption of recycled materials at a facility by not less than ten percent (10%). . . . The term 'processing production' shall include: the processing and packaging of raw materials, in-process materials, and finished products

Additionally, the statute is silent as to other activities that may occur in conjunction with the manufacturing or processing of raw materials into a finished product. It neither encompasses nor excludes other merchandising activities, such as retail sales, catalogue sales, promotional ventures, etc. Again, we have no legitimate basis for reading such a prohibition by implication into the statute and refusing the exemption for manufacturing merely because sales are involved in the business

as well. Clearly, Murphy's is operating a hybrid business, consisting of both retail sales and manufacturing. The statute does not mandate an election of activities in order for the business to qualify for manufacturing exemption.

I would not hold that the statute is void for vagueness merely because it is silent as to the economies of scale concerning plant facilities or the conducting of commercial activities other than manufacturing. Rather, I would hold that the action of the Revenue Cabinet (as upheld by the Kentucky Board of Tax Appeals) was an arbitrary and capricious mis-interpretation of the statute.

BRIEF FOR APPELLANTS:

Alan N. Linker
Louisville, Kentucky

ORAL ARGUMENT FOR APPELLANTS:

Phillip Moilanen
Jackson, Michigan

BRIEF AND ORAL ARGUMENT FOR
APPELLEE:

Michael D. Kalinyak
Frankfort, Kentucky