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NOT TO BE PUBLISHED

Commonwealth Of Kentucky

Court of Appeals

NO. 2002-CA-000794-MR

D.C. CONTRACTING COMPANY, INC. APPELLANT

v.

APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE ROGER L. CRITTENDEN, JUDGE
ACTION NO. 93-CI-00195

REVENUE CABINET OF THE
COMMONWEALTH OF KENTUCKY APPELLEE

OPINION

AFFIRMING

** ** ** ** **

BEFORE: EMBERTON, CHIEF JUDGE; BARBER, AND COMBS, JUDGES.

BARBER, JUDGE: The events leading up to the above-styled appeal began sometime in 1981. The Environmental Protection Agency (EPA), and, apparently the Kentucky Department of Natural Resources and Environmental Protection (KyDNREP), started an investigation of Pennwalt Corporation (Pennwalt), a chemical

manufacturer headquartered in Pennsylvania that had a plant in Calvert City, Kentucky. As a result of its operation, Pennwalt's Calvert City plant produced large amounts of industrial waste that it stored in earthen reservoirs or lagoons on its premises adjacent to the Tennessee River. On March 4, 1982, the EPA ordered a massive clean up of Pennwalt's Calvert City plant. As part of this clean up, the EPA required Pennwalt to close one of its waste lagoons, specifically its chlor-caustic lagoon. After previously firing at least one contractor, Pennwalt hired D.C. Contracting Company, Inc. (D.C.), in 1984, a local contractor to close the chlor-caustic lagoon. According to D.C., it had previously worked for Pennwalt on several projects. According to the record, D.C. and Pennwalt parted company in 1985 before the completion of the chlor-caustic lagoon closure project (closure project).

Subsequently, the Kentucky Revenue Cabinet (Cabinet) audited D.C. for the period from January 1, 1980 to May 31, 1985. The Cabinet determined that D.C. owed sales/use tax in the amount of $96,883.87, excluding interest and penalties, for purchases it made. Approximately ninety percent (90%) of D.C.'s tax liability arose from purchases for the closure project. D.C. appealed the Cabinet's assessment to the Kentucky Board of Tax Appeal (Tax Board). The Tax Board upheld the Cabinet's assessment in a July 31, 1991 order. D.C. eventually appealed

the Tax Board's order to the Franklin Circuit Court, which affirmed the Tax Board in an opinion and order entered on February 20, 2002. D.C. then appealed to this Court. We will develop the facts further as needed.

D.C. contends its purchases were tax exempt pursuant to KRS 139.480(12) because on November 11, 1981, the Cabinet issued a pollution control tax exemption certificate to Pennwalt. D.C. argues that the Cabinet made the certificate a joint issuance that covered Pennwalt and its contractors. As D.C. points out, it was one of Pennwalt's contractors. D.C. argues that this 1981 certificate exempted D.C.'s purchases for the chlor-caustic lagoon closure project. This seems simple enough. This is where the simplicity ends.

According to D.C., in late 1981, Pennwalt anticipated that the EPA would issue an order adverse to it. So Pennwalt decided to build a new chlor-caustic lagoon. On October 5, 1981, Pennwalt filed with the Cabinet an application for a pollution control tax exemption certificate for this construction project. However, according to D.C., Pennwalt's 1981 application was exceedingly broad. So broad, in fact, that it covered not only the construction of a new lagoon but also all the clean up activities that might be ordered by the EPA. D.C. argues that Pennwalt did not just anticipate a future adverse order that would require the construction of a new

lagoon. It anticipated an order that would include everything the EPA would subsequently require. D.C. insists that Pennwalt intended the 1981 application to cover all this because it had checked the box on the application form provided by the Cabinet that was very general. Since the application was so broad, the resulting certificate was as equally broad and covered all clean up activities required by the EPA's 1982 clean up order.

In support of this argument, D.C. argues that Pennwalt obtained a $15 million tax exemption pollution control revenue bond from Calvert City on October 1, 1982. D.C. argues that the bond required Pennwalt to pay all taxes and it covered all the clean up activities ordered by the EPA.

D.C. also argues that Pennwalt filed approximately thirty-four (34) other applications relating to the EPA's 1982 clean up order. D.C. contends Pennwalt needed only the 1981 certificate to exempt from the sales/use tax all the clean up activities required by the EPA. Oddly, D.C. appears to argue in its reply brief that had the Tax Board known about Pennwalt's thirty-four (34) subsequent applications for pollution control tax exemption certificates, it would have realized that the Pennwalt's October 5, 1981 application was all-inclusive and the resulting November 11, 1981 certificate exempted all subsequent clean up activities including the closure project.

Alternatively, D.C. claims that the Tax Board failed to consider relevant law. D.C. argues that the Tax Board ignored the "primary purpose" test. D.C. argues that if a project's "primary purpose" was pollution control then all related purchases were tax exempt even if the taxpayer failed to file an application for a pollution control tax exemption. In support, D.C. cites Central Illinois Public Service Commission v. Department of Revenue, Ill. App., 453 N.E.2d 1167 (1983). In Central Illinois, the Central Illinois Light Company (CILCO) failed to pay use tax on equipment purchases related to certain pollution control facilities. CILCO claimed that the purchases were tax exempt. According to D.C., the Illinois Court of Appeals looked at the "primary purpose" of the equipment purchased and considered the fact that the EPA had issued a certificate that stated the equipment's primary purpose was pollution control. According to D.C., the Illinois court held that the EPA's certificate was conclusive evidence that the CILCO's purchases were tax exempt. D.C. argues that the closure's primary purpose was pollution control. Furthermore, the EPA required the closure of the chlor-caustic lagoon and that the KyDNREP opined that the closure would qualify as a pollution control facility. Given this, D.C. argues it should get the tax exemption.

D.C. also argues that the Tax Board ignored the integrated plant concept. D.C. cites Schenely Distillers, Inc. v. Commonwealth, ex rel Luckett, Ky., 467 S.W.2d 598 (1971) and argues that the Court of Appeals of Kentucky, now the Supreme Court of Kentucky, held that a conveyor belt was an integrated part of the production process; was clearly used in the manufacturing process and was tax exempt. However, the Supreme Court determined the conveyor belt was tax exempt pursuant to KRS 139.480(8)[1] that exempted machinery purchased for new and expanded industry. Schenely Distillers, Ky., 467 S.W.2d at 598. D.C. cites Department of Revenue v. State Contracting & Stone Co., Inc., Ky., 572 S.W.2d 421 (1978) and argues that the Supreme Court of Kentucky determined that equipment purchased by taxpayer, State Contracting, was pollution control equipment; was indispensable to the operation of Stone's business; was required by federal law and was tax exempt. As in Schenely, the Supreme Court determined that the equipment was tax exempt pursuant to KRS 139.480(8). Id. at 422.

D.C. argues that the Cabinet violated several statutes because it failed to promulgate regulations governing the form and manner for filing an application for a pollution control tax exemption certificate. D.C. cites part of KRS 224.01-310(1) that reads an "application for a pollution control tax exemption

[1] KRS 139.480(8) is now KRS 139.480(10).

shall be filed with the Revenue Cabinet in such a manner and such form as **may** be prescribed by regulations issued by the Revenue Cabinet[.]" (Emphasis ours) D.C. argues that the word "may" in the above quote, which is normally permissive, should contextually mean "shall", which is mandatory. Thus, D.C. insists the Cabinet was required to issue regulations.

D.C. cites KRS 13A.100(1) and (2)[2] and argues that it required the Cabinet to promulgate regulations governing the application process. Absent the required regulations, a taxpayer has no way of knowing how to apply for a pollution control tax exemption certificate. Thus, the Cabinet violated not only KRS 224.01-310 but also KRS 13A.100.

In addition, D.C. argues that the Cabinet issued a circular instead of regulations. D.C. cites KRS 13A.120(6) which reads, "No administrative body shall issue standards or by any other name issue a document of any type where an administrative regulation is required or authorized by law." D.C. argues the Cabinet violated KRS 13A.120(6) when it issued

[2] Subject to limitations in applicable statutes, any administrative body which is empowered to promulgate administrative regulations shall, by administrative regulation prescribe, consistent with applicable statutes: (1) Each statement of general applicability, policy, procedure, memorandum, or other form of action that implements; interprets; prescribes law or policy; describes the organization, procedure, or practice requirements of any administrative body; or affects private rights or procedures available to the public; (2) The process for application for license, benefits available or other matters for which an application would be appropriate unless such process is prescribed by a statute[.]

the circular because KRS 224.01-310(1) required it to issue regulations instead.

D.C. cites GTE v. Revenue Cabinet, Ky., 889 S.W.2d 788 (1994) and argues the Supreme Court held that the Cabinet cannot through its policies alter a statute, and that the Cabinet is required to announce any general interpretation of law through a regulation. D.C. argues because the Cabinet has refused to issue a regulation, it had no way of knowing the Cabinet's policy or procedure regarding the application process.

Of course, the Revenue Cabinet disagrees with D.C. The Cabinet contends that KRS 224.01-310(1) clearly requires a taxpayer to file an application for a pollution control tax exemption certificate with the Cabinet and it must issue a certificate that grants the tax exemption found in KRS 139.480(12). The Cabinet cites Camera Center, Inc. v. Revenue Cabinet, Ky., 34 S.W.3d 39 (2000) and argues that the party who claims an exemption must demonstrate that it has met the statutory requirements entitling it to the exemption. According to the Cabinet, D.C. has failed to meet this burden.

The Cabinet points out that D.C., in its petition of appeal to the Tax Board, declared that Pennwalt never made a formal application for a pollution control tax exemption certificate for the closure project. Furthermore, in response to admissions propounded by the Cabinet, D.C. again admitted

that Pennwalt never applied for a pollution control tax exemption certificate for the closure project. The Cabinet argues that D.C.'s admissions were judicial admissions and judicial admissions are conclusive. Berries v. Bizer, Ky., 57 S.W.3d 271 (2001) and Center v. Stamper, Ky., 318 S.W.2d 853 (1958). D.C.'s admissions conclusively established that neither D.C. nor Pennwalt ever filed an application and the Cabinet never issued a certificate for the closure project. This constituted substantial evidence that supported the Tax Board's ruling. In addition to these admissions, the Cabinet points out that at a hearing on February 13, 1991, Charles Miffline, Pennwalt's former purchasing and accounting manager at Calvert City, testified that Pennwalt intended to get a pollution control tax exemption certificate, but it never did. According to the Cabinet, the Tax Board correctly concluded D.C. did not qualify for the tax exemption because neither it nor Pennwalt ever filed an application pursuant to KRS 224.01-310(1).

As expected, the Cabinet argues that it did not violate KRS Chapter 13A by failing to promulgate regulations. The Cabinet argues that KRS 224.01-310(1) clearly sets forth the statutory requirements for obtaining a pollution control tax exemption certificate. Thus, it did not need to issue regulations. Furthermore, it contends that KRS Chapter 13A does not prevent it from enforcing the statutory requirements found

in KRS 224.01-310(1) nor does it need regulations to enforce KRS 224.01-310(1). The Cabinet argues that D.C. has failed to show that the circular limited, expanded or otherwise modified the tax exemption found in KRS 139.480(12) or the application process found in KRS 224.01-310(1). Furthermore, the word "may" found in KRS 224.01-310(1) is permissive according to KRS 446.010(20). The Cabinet also argues that the context of KRS 224.01-310(1) does not require the word "may" to be interpreted as mandatory. Thus, it was not statutorily required to promulgate any regulations.

The Cabinet also argues that the Franklin Circuit Court exceeded its scope of review when it ordered the Cabinet to produce documents that D.C. had originally requested by subpoena *duces tecum* from the Cabinet while before the Tax Board. However, we will not address this issue since the Cabinet failed to file a cross-appeal regarding it.

When reviewing an appeal from an administrative agency, KRS 13B.150(2) requires that we not substitute our judgment for that of the agency regarding questions of fact. Furthermore, we can only reverse an agency's final order for very specific reasons also set forth in KRS 13B.150(2)[3]. Since

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[3] (a) In violation of constitutional or statutory provisions; (b) In excess of the statutory authority of the agency; (c) Without support of substantial evidence on the whole record; (d) Arbitrary, capricious, or characterized by abuse of discretion; (e) Based on an ex parte communication which substantially prejudiced the rights of any party and likely affected the

this appeal presents questions of fact, we must insure that the circuit court correctly determined substantial evidence supported Tax Board's decision. Substantial evidence is evidence taken by itself or as a whole, that "has sufficient probative value to induce conviction in the minds of reasonable men." Commonwealth of Kentucky, Cabinet for Human Resources v. Bridewell, Ky., 62 S.W.3d 370, 373 (2001). If the agency applied the correct law and substantial evidence supported its decision, we must affirm. Id.

D.C. argues that the Pennwalt's October 5, 1981 application and the resulting November 11, 1981 pollution control tax exemption certificate was so broad that it covered all the activities required by the EPA's 1982 clean up order or, at the very least, the closure project. However, the record does not support this contention. The record reveals a letter attached to Pennwalt's October 5, 1981 application for a pollution control tax exemption certificate that read, "Enclosed is an Application for Pollution Control Tax Exemption Certificate for a hydrofluoric (HF) acid plant residue lagoon which we propose to construct at our plant site located in Calvert City, Kentucky." TR 494. Also, Pennwalt attached to the application a list of equipment and materials, which was

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outcome of the hearing; (f) Prejudiced by failure of the person conducting a proceeding to be disqualified pursuant to KRS 13B.040(2); or (g) Deficient as otherwise provided by law.

entitled “New HF Lagoon Calvert City, Kentucky”. This contradicts D.C.’s argument that Pennwalt intended this application and its resulting certificate to cover all the clean up activities. Obviously, Pennwalt intended the application and certificate to cover the construction of a new HF lagoon only.

As the Cabinet argues, D.C. stated in its petition of appeal to the Tax Board that neither it nor Pennwalt filed an application for a pollution control tax exemption certificate for the closure of the chlor-caustic lagoon. D.C. subsequently admitted that fact in response to admissions propounded by the Cabinet. Further, Charles Miffline, a former Pennwalt employee, testified that Pennwalt intended to obtain a certificate but never did.

The General Assembly set forth the requirements for obtaining the tax exemption for property purchased in connection with a pollution control facility in KRS 224.01-310(1).[4] KRS

[4] Application for a pollution control tax exemption certificate shall be filed with the Revenue Cabinet in such manner and in such form as may be prescribed by regulations issued by the Revenue Cabinet and shall contain plans and specifications of the structure or structures including all materials incorporated and to be incorporated therein and a descriptive list of all equipment acquired or to be acquired by the applicant for the purpose of air, noise, waste or water pollution control and any additional information deemed necessary by the Revenue Cabinet for the proper administration of Acts 1974, Chapter 137. The cabinet shall provide technical assistance and factual information as requested in writing by the Revenue Cabinet. If the Revenue Cabinet finds that the facility qualifies as a pollution control facility as defined in KRS 224.01-300(1), it shall enter a finding and issue a certificate to that effect. The effective date of said certificate shall be the date of the making of the application for such certificate.

224.01-310(1) requires that an application for a pollution control tax exemption certificate be filed with the Revenue Cabinet and that the Cabinet then issue such a certificate before anyone gets the benefit of the pollution control tax exemption found in KRS 139.480(12). D.C. admits that neither it nor Pennwalt ever filed an application for a certificate regarding the closure project. Since neither filed an application, the Cabinet never issued a certificate for the closure project. Without a certificate, D.C. cannot claim the tax exemption for a pollution control facility; therefore, it is liable for the sales/use tax assessed against it.

D.C. argues the $15 million bond required Pennwalt to pay all the taxes incurred. While this may be true, this does not relieve D.C. of its tax burden. D.C. also emphasizes the fact that Pennwalt filed, subsequent to the 1981 application, thirty-four (34) other applications for pollution control tax exemption certificates. However, this Court fails to see how this supports D.C.'s argument that the 1981 certificate covered the closure project.

D.C. cites Central Illinois Public Service Commission v. Department of Revenue, Ill. App., 453 N.E.2d 1167 (1983) and argues it should get the tax exemption because the EPA required the closure; the KyDNREP opined it was a pollution control

facility and its primary purpose was pollution control. However, we decline to adopt the holding in Central Illinois since it would render the application process set forth in KRS 224.01-310(1) meaningless.

D.C. argues that the Tax Board ignored the integrated plant concept. However, the integrated plant concept applies to the tax exemption for machinery purchased for new and expanded industry. KRS 139.480(10). D.C. is not arguing that the closure project qualified as tax exempt pursuant to KRS 139.480(10). Even if it did, D.C. fails to show that the closure project was an integrated part of Pennwalt's manufacturing process.

Neither are we convinced by D.C.'s argument that the Cabinet violated KRS Chapter 13A or KRS 224.01-310(1). First, according to KRS 446.010(20), "may" is permissive, unless the context suggested otherwise. The context of KRS 224.01-310(1) does not require "may" to be mandatory. Thus, the Cabinet was not required to promulgate regulations. Second, KRS 224.01-310(1) unambiguously sets forth the application process to obtain a pollution control tax exemption certificate. Given the statute's clarity, regulations were not necessary.

D.C. argues that the Cabinet by issuing a circular regarding KRS 224.10-310(1) violated several provisions of the KRS Chapter 13A. However, this circular is not a part of the record nor does D.C. explain how this circular violated KRS

Chapter 13A. D.C. fails to show that how this circular expanded, limited or modified KRS 224.01-310.

D.C. admitted that neither it nor Pennwalt ever filed an application for a pollution control tax exemption certificate with the Revenue Cabinet to exempt the purchases for the chlor-caustic lagoon closure project. The Kentucky Board of Tax Appeal applied the correct law and correctly concluded that D.C. did not qualify for the tax exemption found in KRS 139.480(12). Thus, its July 31, 1991 order was indeed supported by substantial evidence. This Court affirms both the Franklin Circuit Court opinion and order of February 20, 2002 and the Kentucky Board of Tax Appeals order of July 31, 1991.

COMBS, JUDGE, CONCURS.

EMBERTON, CHIEF JUDGE, CONCURS IN RESULT.

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