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OPINION RENDERED OCTOBER 28, 2005 WITHDRAWN

# Commonwealth Of Kentucky

## Court of Appeals

NO. 2004-CA-001812-MR

GRIFFIN INDUSTRIES, INC.

APPELLANT

v. APPEAL FROM CAMPBELL CIRCUIT COURT  
HONORABLE LEONARD L. KOPOWSKI, JUDGE  
CIVIL ACTION NO. 04-CI-00002

COMMONWEALTH OF KENTUCKY,  
REVENUE CABINET, NOW KNOWN AS  
THE KENTUCKY DEPARTMENT OF REVENUE, AND  
THE KENTUCKY BOARD OF TAX APPEALS

APPELLEES

OPINION  
AFFIRMING IN PART,  
REVERSING IN PART AND REMANDING

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BEFORE: GUIDUGLI AND TAYLOR, JUDGES; HUDDLESTON, SENIOR JUDGE.<sup>1</sup>

HUDDLESTON, SENIOR JUDGE: The Kentucky Department of Revenue (Revenue), formerly known as the Kentucky Revenue Cabinet, audited Griffin Industries, Inc. for the period between August 1, 1993, and June 30, 1997, since Griffin had failed to pay sales and use taxes for machinery and replacement parts it had purchased during that time. Following the audit, Revenue

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<sup>1</sup> Senior Judge Joseph R. Huddleston sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and KRS 21.580.

assessed against Griffin \$16,940.21 in sales and use taxes for purchase of machinery and \$82,708.10 in sales and use taxes for the purchase of replacement parts. Griffin appealed the assessment to the Kentucky Board of Tax Appeals (KBTA). Before the KBTA, Griffin argued that it was a recycler and thus entitled to the exemption for the purchase of recycling machinery as set forth in Kentucky Revised Statutes (KRS) 139.480(23),<sup>2</sup> commonly known as the "recycling exemption". The KBTA affirmed Revenue's tax assessment against Griffin. Griffin appealed to Campbell Circuit Court which affirmed the KBTA's final order. Griffin then appealed to this Court seeking relief from its tax burden.

**APPLICATION OF THE RECYCLING EXEMPTION  
TO GRIFFIN'S PURCHASE OF MACHINERY**

On appeal, Griffin argues that the Revenue Department, the KBTA and the circuit court erred when they failed to apply the plain language of KRS 139.480(23).

Griffin operates two rendering plants in Kentucky, one in Butler and another in Russellville. It collects animal

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<sup>2</sup> Ky. Rev. Stat. (KRS) 139.480 provides, in relevant part, that "[a]ny other provision of this chapter to the contrary notwithstanding, the 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:

\* \* \*

"(23) Machinery or equipment purchased or leased by a business, industry, or organization in order to collect, source separate, compress, bale, shred, or otherwise handle waste materials if the machinery or equipment is primarily used for recycling purposes[.]"

waste, such as body parts, from poultry processing plants, slaughterhouses, meat packing plants and grocery stores for rendering. This material is ground into a uniform size. Then the material is loaded into a large cooker where it is heated at high temperature in order to break the material down into a solid substance, known as meal, and into animal fat, known as tallow. After cooking, the meal and tallow are poured into a drainer screen to separate them. The tallow is spun in a centrifuge and placed in settling tanks to remove any remaining solid material. The tallow is then allowed to cool. The meal is sent to hammer mills where it is repeatedly sifted and ground. When the tallow has cooled and the meal has been ground, Griffin is left with two marketable products.

In Henderson, Griffin operates a "bakery" rendering plant. At this plant, Griffin collects bakery waste such as dough, crackers and bread. As with the animal waste, it first grinds the bakery waste into a uniform size. This material is then loaded into a large dryer and heated to remove moisture. After drying, the material is screened to remove any paper product that may be present and is then sent to hammer mills to be ground. The material is screened again and allowed to cool. After cooling, Griffin is left with a marketable product.

Griffin cites KRS 139.095, which defines "recycling purposes" as

those activities undertaken in which materials that would otherwise become solid waste are collected, separated, or processed in order to be reused or returned to use in the form of raw materials or products.

Griffin insists that its industrial activities fall within this definition. Since it engages in recycling, it reasons that it is entitled to the recycling exemption.

In the alternative, Griffin argues that, in 1991, the General Assembly passed numerous statutes relating to recycling to encourage its practice. As a matter of public policy, Griffin insists, it must receive the recycling exemption in order to promote the General Assembly's recycling policy.

When we review the actions of the KBTA, we may not substitute our judgment for that of the KBTA regarding any question of fact.<sup>3</sup> And we may only reverse the KBTA's final order if one or more of the specific contingencies set forth in KRS 13B.150(2)<sup>4</sup> has occurred. Moreover, it is our responsibility to insure that the circuit court correctly determined that the KBTA's decision is supported by substantial evidence.

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<sup>3</sup> Ky. Rev. Stat. (KRS) 13B.150(2).

<sup>4</sup> According to KRS 13B.150(2), we may reverse the KBTA's final order, in whole or in part, if we find that the order is "(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 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."

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."<sup>5</sup> If the KBTA's decision is supported by substantial evidence and if it applied the correct law, then we must affirm.<sup>6</sup>

The KBTA made a finding of fact in its final order that Griffin acts as a manufacturer at its rendering plants when it processes animal and bakery waste into finished products which it sells. In reaching this finding, the KBTA relied upon KRS 139.170(2) which defines "manufacturing" as

any process through which material having little or no commercial value for its intended use before processing has appreciable commercial value for its intended use after processing by the machinery. The manufacturing or processing production process commences with the movement of raw materials from storage into a continuous, unbroken, integrated process and ends when the product being manufactured is packaged and ready for sale.

Clearly, Griffin's activities, as it describes them, fall within this definition.

However, this definition did not exist during the tax period in question, August 1, 1993, through June 30, 1997. In fact, KRS 139.170(2) was not enacted until 2001. And the legislative history of KRS 139.170 reveals that, for sales and

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<sup>5</sup> Commonwealth of Kentucky, Cabinet for Human Resources v. Bridewell, 62 S.W.3d 370, 373 (Ky. 2001).

<sup>6</sup> Id.

use tax purposes, no statutory definition of "manufacturing" existed prior to 2001. Thus, the KBTA erred when it retroactively applied this definition to Griffin.

Prior to 2001, the definition for "manufacturing" that did exist for sales and use tax purposes was found in Department of Revenue ex rel. Lockett v. Allied Drum Service, Inc.<sup>7</sup> In Allied Drum, the Supreme Court defined "manufacturing" as

[m]aterial having no commercial value for its intended use before processing has appreciable commercial value for its intended use after processing by the machinery.<sup>8</sup>

The KBTA should have considered this definition since it existed during the auditing period and since Griffin's industrial activities fall within it. But Griffin's activities also fall within the definition for "recycling purposes" found in KRS 139.095. The General Assembly enacted KRS 139.095, along with the recycling exemption, in 1991 to encourage recycling activities like those in which Griffin engaged during the auditing period. Since the statute which defines "recycling purposes" was the only one that existed during the auditing period and since Griffin's activities fall within the statutory definition, that statute controls. Thus, from August 1, 1993 through June 30, 1997, Griffin should have received the benefit of the recycling exemption for any recycling machinery purchased

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<sup>7</sup> 561 S.W.2d 323 (Ky. 1978).

<sup>8</sup> Id. at 325.

during that time. Because the KBTA erred by applying the wrong statutory definition, we reverse in part.

Subsequent to rendering the original opinion in this appeal, Griffin filed a motion to modify the opinion. And both parties agree that the opinion needs clarification. Both parties wish to know whether Griffin would still receive the benefit of the recycling exemption after 2001. Griffin contends that based on our reasoning above it should receive the benefit of the recycling exemption after 2001 despite the current definition for "manufacturing" found in KRS 139.170(2). Of course, Revenue insists that Griffin would not receive the recycling exemption since we have stated above that Griffin's activities clearly fall within the definition of manufacturing found in KRS 139.170(2). Griffin's industrial activities fall within both KRS 139.095 and KRS 139.170(2). However, we will not address the question of which statute would apply to Griffin's activities after 2001 since this question is not before us; we are only concerned with the applicability of the recycling exemption during the auditing period and do not issue advisory opinions.<sup>9</sup>

**APPLICATION OF THE RECYCLING EXEMPTION  
TO GRIFFIN'S PURCHASE OF REPAIR AND  
REPLACEMENT PARTS**

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<sup>9</sup> Commonwealth v. Deweese, 141 S.W.3d 372, 375 (Ky. App. 2003).

Griffin cites 103 Kentucky Administrative Regulations (KAR) 30:120, Section 2, which provides that

[t]he term "machinery" shall mean: machines, in general, or collectively; also, the working parts of a machine, engine, or instrument; as, the machinery of a watch. (Webster's New International Dictionary). . . . The machinery of a manufacturing operation is composed of all the components making up the process, including the fixed and nonmoving parts as well as the moving parts. This is illustrated in the example of the machinery of a watch.

Relying on 103 KAR 30:120, Griffin argues that the recycling exemption must include repair and replacement parts since they are machinery as well.

In the alternative, Griffin argues that KRS 139.480(23) is ambiguous. Griffin avers that only one of KRS 139.480's thirty-one subsections expressly excludes repair and replacement parts from the definition of machinery. According to Griffin, KRS 139.480(10) exempts the purchase of machinery for new and expanded industry from sales and use tax and this subsection expressly excludes repair and replacement parts. In contrast, however, Griffin insists that ten of KRS 139.480's thirty-one subsections expressly include repair and replacement parts as exempt from sales and use tax. Since the General Assembly included repair and replacement parts in ten subsections while only excluding said parts in one subsection,

Griffin continues, it intended the recycling exemption to include repair and replacement parts as well.

Griffin's reliance on 103 KAR 30:120, Section 2, is misplaced for two reasons. The stated purpose of 103 KAR 30:120 is to "interpret the sales and use tax as it applies to exemption qualification for '**machinery for new and expanded industry.**'"<sup>10</sup> Clearly, this regulation does not apply to and cannot interpret the recycling exemption. And, as Revenue has repeatedly pointed out, 103 KAR 30:120 cannot redefine machinery for new and expanded industry to include repair and replacement parts since KRS 139.170(1) explicitly excludes repair and replacement parts from the definition of machinery for new and expanded industry. A regulation cannot contradict the statute it seeks to interpret.<sup>11</sup>

No subsection of KRS 139.480 expressly excludes repair and replacement parts from exemption from sales and use taxes. KRS 139.480(10) should not be confused with KRS 139.170(1)(c) which clearly states that " '**machinery for new and expanded industry**' does not include repair, replacement, or spare parts of any kind[.]" Since the General Assembly expressly included repair and replacement parts in only ten of thirty-one subsections but did not mention exclusion of said parts in any

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<sup>10</sup> Emphasis supplied.

<sup>11</sup> Ruby Construction Company, Inc. v. Kentucky Department Of Revenue, 578 S.W.2d 248, 251 (Ky. App. 1978).

subsection, the inclusion of repair and replacement parts was the exception not the rule. Had the General Assembly meant to extend the recycling exemption to repair and replacement parts it would have expressly done so. KRS 139.480 is not ambiguous, and neither the circuit court nor the KBTA erred in applying it. Thus, the circuit court's order is affirmed in part.

**CONCLUSION**

The circuit court's order affirming the KBTA's decision is reversed in part regarding the application of the recycling exemption to Griffin's purchase of machinery and this case is remanded to the KBTA pursuant to KRS 13B.150(2) for further proceedings. The order as related to the application of the recycling exemption to the purchase of repair and replacement parts is affirmed.

TAYLOR, JUDGE, CONCURS.

GUIDUGLI, JUDGE, CONCURS IN RESULT.

BRIEF AND ORAL ARGUMENT FOR  
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ON BRIEF:

Erica L. Horn

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