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Big Kentucky Tax Cases
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There is a lot going on with Kentucky tax cases in 2022. Let us dive on in....

MANUFACTURING SUPPLIES MATTER!

Manufacturers across the Commonwealth use manufacturing supplies in their manufacturing operations to produce many different kinds of products.

The Kentucky Supreme Court recently granted discretionary review in Century Aluminum of Kentucky, GP v. Department of Revenue, 2020-CA-0301-MR (Ky. App. July 9, 2021), discretionary review granted, 2021-SC-0300 (Ky. Feb. 16, 2022). This case involves the manufacturing supplies exemption of KRS 139.470(9)(b)2.b. The Court of Appeals relied upon an exception from the supplies exemption, i.e., "**'Supplies' does not include repair, replacement, or spare parts of any kind**..." and "**The exemption ... does not include repair, replacement, or spare parts[.]**", Id. at 2-3 (emphasis in original, quoting KRS 139.470(9)(b)2.b & (e)), to hold that the involved items were not tax-exempt. The Court of Appeals, borrowing heavily from the Circuit Court, focused its analysis on whether each item at issue was a repair, replacement, or spare part because it was (or was not) "tangible personal property used to maintain, restore, mend, or repair machinery or equipment". Id. at 3-4.

The Kentucky Board of Tax Appeals (then the Kentucky Claims Commission) held for Century Aluminum, but the Franklin Circuit Court reversed the KBTA, and the Court of Appeals upheld the Circuit Court. Century Aluminum argues that the definition of exempt supplies must be harmonized with the definition of non-exempt parts and that the test of whether supplies are used up or merely wear out must be used in determining the supplies exemption.

Notably, the Kentucky Association of Manufacturers joined by the Kentucky Chamber of Commerce filed an *amicus* brief in support of Century Aluminum.[1]* Consistent with the taxpayer, *amici* argue, "Indeed, all text in the manufacturing supplies exemption and repair, replacement, or spare parts exception should be given effect, and the legislature's objective to encourage manufacturing by providing the exemption must be effectuated... [and] [p]yramiding should be avoided...." *Amici* go on to argue, "The text 'parts' in the exception itself should be construed to limit its application to 'parts' and not literally 'any tangible personal property'."

Hopefully, the Kentucky Supreme Court will hold for Century Aluminum and construe the exemption in a way that benefits Kentucky manufacturers the way the General Assembly intended!

TAXPAYERS MAY OBTAIN REVIEW OF LOCAL GOVERNMENT ACTIONS!

Ventas, Inc. ("Ventas") is a national healthcare real estate investment trust ("REIT") that owns real estate all over the nation with its headquarters in Chicago and an office in Louisville, Kentucky. In 2019, Ventas filed a declaration of rights action seeking an order that it is entitled to a variance from the standard apportionment formula used to calculate its Metro Louisville occupational license tax. Metro Revenue moved to dismiss the case on the grounds of sovereign immunity, mootness, and ripeness. The Jefferson Circuit Court denied the motion, and the Revenue Commission appealed the sovereign immunity issue to the Court of Appeals, which affirmed the Circuit Court. *Louisville/Jefferson County Metro Revenue Commission v. Ventas, Inc.*, No. 19-CI-000899 (Jefferson Cir. Ct. Feb. 8, 2021), *affirmed,* No. 2021-CA-0235-MR (Ky. App. Feb. 11, 2022).[2]* The Court of Appeals held that the Revenue Commission was not entitled to sovereign immunity in a declaratory judgment action – "...the Revenue Commission [contends] that a refund claim is implicit in the declaratory judgment action filed by Ventas and that a refund 'presents a harm to state or government resources that implicates sovereign immunity.' However, the only claim presented in the complaint filed by Ventas is one for declaratory judgment....it simply asked the circuit court to decide whether it was entitled to relief in the form of an alternative and equitable apportionment. Consequently, the declaratory judgment action did not impinge upon the Revenue Commission's governmental immunity." Because of this holding, Ventas's declaratory judgment action is proceeding at the Circuit Court.

WILL LONGSTANDING PRECEDENT AND CONSTITUTIONAL UNIFORMITY AND EQUAL PROTECTION RIGHTS PREVAIL?

The KBTA issued its Final Order in *LWAGLVKY 1, LLC, et al. c/o Walgreen Co. v. Jefferson County PVA*, No. K19-S-88, 207-210 (KBTA Aug. 25, 2021), *on appeal,* 21-CI-005434 (Jefferson Cir. Co. Sept. 24, 2021),[3]* concerning the assessment value of 15 properties leased by Walgreens throughout the Louisville Metro Area. Walgreens obtained fee simple appraisals for each property, using local market conditions and market rent, and argued that the fee simple appraisals represented the fair cash values for the properties under Kentucky law. PVA put forth evidence of a leased fee valuation for each property, using above-market contract rent and

[1] * The author and his law firm, Dentons, represents KAM and the Chamber in this appeal.

[2] * The author and his law firm, Dentons, represents Ventas in this litigation.

[3] * The author and his law firm, Dentons, represents Walgreens in this litigation.

national sales, arguing that the value of the leased fee represented the properties' fair cash value for *ad valorem* tax purposes. The KBTA held that, through its presentation of evidence, Walgreens overcame the presumption in favor of the PVA's valuation. The KBTA found in favor of Walgreens for the two Walgreens-owned properties, but sided with the PVA on the 13 properties with leases. The KBTA made no findings concerning Walgreens' constitutional claims that the PVA's assessments violate uniformity and equal protection when PVA's assessments were double or more than those of comparable retail properties in the county. Walgreens appealed the KBTA's order concerning the 13 leased properties and the constitutional claims to Jefferson Circuit Court, where the case has been briefed.

Agree Hazard KY, LLC dba Walmart v. Perry County PVA, No. K17-S-163 (KCC May 22, 2019), *on appeal,* No. 19-CI-00285 (Perry Cir. Ct. June 21, 2019) similarly involves whether the fair cash value of the therein involved property leased by Walmart should be the leased fee value or the fee simple value. However, on March 31, 2022, that case was dismissed for lack of prosecution.

WHAT'S EVIDENCE OF A PROPERTY'S FAIR CASH VALUE FOR PROPERTY TAX PURPOSES?

Valuation is often ***the*** issue in property tax cases. In a case involving the valuation of a big box grocery store for property tax purposes, the Court of Appeals recently reversed the decision of the Scott County Circuit Court, holding that "Based upon [the Court of Appeals'] review of the properties relied upon by the PVA to determine comparable sales, we must agree with Kroger that the evidence it presented to counter the PVA's assessment compels a finding that the Property was overvalued."

Kroger Ltd. P'ship I v. Scott Cnty. Prop'y Valuation Adm'r, et al, No. 2019-CA-01133-MR (Ky. App. July 17, 2020); *remanded, Kroger Ltd. Partnership I v. Tim Jenkins, Scott Cty. Property Valuation Admr.,* K15-S-30 (Ky. Bd. Tax. App. May 28, 2021).[4]* The Court of Appeals ultimately agreed with Kroger, explaining, "Kroger's expert relied upon both the comparable sales approach and the income approach to reach his opinion on the valuation of the Property at $6.7 million." The Court continued, "the properties the PVA relied upon were subject to leases, unlike the Property in this case. Kroger points out that a lease has its own value...and additional information is needed to value properties with leases....Because the PVA did not introduce any evidence of this type to apply the necessary adjustments, Kroger argues that the valuation was erroneous." The Court went on to hold "Based upon our review of the properties relied upon by the PVA to determine comparable sales, we must agree with Kroger that the evidence it presented to counter the PVA's assessment compels a finding that the Property

[4] * The author and his law firm, Dentons, represents Kroger in these property tax appeals.

was overvalued." The Court explained that, "As [Kroger's expert] testified before the Board, each of the property sales the PVA relied upon were not comparable to the Property in this case. They were subject to leases or were parts of other specific transactions, such as being part of a portfolio sale or a 1031 exchange, or were not a big box store. Therefore, these sales could not provide a basis for the PVA's assessment, and the circuit court erred in affirming the Board's final order." The Court "also [agreed] with Kroger that the statement of value by Kroger's consultant in 2013 cannot be substantial evidence of its fair cash value as of January 1, 2015, two years later." The case was then ultimately remanded to the KBTA, which adopted the value of Kroger's expert.

TANGIBLE PERSONAL PROPERTY OR REAL PROPERTY?

An issue that often comes up in property tax (and in sales and use tax as well) is whether property is tangible personal property or real property. Marathon Pipe Line, LLC is a public service corporation (PSC) that owns or leases several thousand miles of pipeline throughout the United States including a 265-mile long tract of underground pipes stretching from Owensboro to a Catlettsburg refinery located in an activated Foreign Trade Zone (FTZ); tangible personal property located in an FTZ is taxed at a very favorable rate.

The KBTA held that the pipeline was tangible personal property and not real property, and the Franklin Circuit Court and Court of Appeals affirmed. *Department of Revenue v. Marathon Pipe Line, LLC*, 2021-CA-0626-MR (Ky. App. May 13, 2022) (not final). The rationale was that the pipeline was: not annexed to the realty as it is moveable; not adapted to the use or purpose of the land above it; and intended by the parties to be moved and not a permanent accession to the land. This case is not yet final.

OTHER TAX CASES WORTH WATCHING!

There are other tax cases winding their way through the Kentucky Board of Tax Appeals as well as the Circuit Courts and the Court of Appeals, including property tax cases involving value, a property tax case involving the religious institutions exemption, tax refund cases, and the sales tax exemption for food.

Taxpayers and taxing authorities always seem to find issue on which they disagree, even though the vast majority of the time, they are able to come to an agreement. While these cases highlight areas of disagreement, it is important to keep in mind that disagreement is often the exception the to rule. Regardless, taxpayers should be willing to fight when they are right!

This is a modified version of Mark A. Loyd's regular column, Tax in the Bluegrass, "Big Kentucky tax cases" which appeared in Issue 3, 2022 of the Kentucky CPA Journal.

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