COMMONWEALTH OF KENTUCKY
KENTUCKY BOARD OF TAX APPEALS
FILE NO. K11-R-03

PROGRESS METAL
RECLAMATION COMPANY **APPELLANT**

v. **ORDER NO. K-22015**

COMMONWEALTH OF KENTUCKY
FINACE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE **APPELLEE**

The Appellant and Appellee having briefed the matter following the evidentiary hearing held December 14, 2011, and the Board being otherwise sufficiently advised, the Board makes the following Findings of Fact and Conclusions of Law.

The taxpayer, Progress Metals Reclamation Company, does business as a recycler/manufacturer of scrap metal for the steel mills. (R. 9:46) The taxpayer appeals from the Department of Revenue's final ruling that a hammer pin is not an industrial tool pursuant to KRS 139.470(11) and is not, therefore, exempt from sales and use tax. The Department of Revenue further determined that the liquid oxygen used by the taxpayer in a cutting torch was considered to be an energy producing fuel and could not be exempted as an industrial supply. This audit covers the period from August '04 thru July '08. The amount at issue for hammer pins is $12,038.92 and the amount at issue for liquid oxygen is $30,535.55 and these claimed refund amounts are not in dispute. (R. 9:36-9:43).

HAMMER PIN

First, this Board must decide whether a hammer pin, which holds the hammer in place on

a rotor which turns and breaks up metal, is an "industrial tool " within the meaning of KRS 139.470(11)(2)(c) which provides as follows:

> Industrial Tools. This group is limited to hand tools such as jigs, dies, drills, cutters, rolls, reamers, chucks, saws, spray guns, etc. and to tools attached to a machine such as molds, grinding balls, grinding wheels, dies, bits, cutting blades, etc. (emphasis added)

The statute divides industrial tools into two categories--hand tools and tools attached to a machine. Testimony was presented that the main intent of the hammer pin is to hold the hammer in place on the rotor while it is turning and it is the hammer which breaks up the metal. (Record 9:47; 9:55). The taxpayer claims that the hammer pin serves as a "chuck" in this instance and since chucks are specifically listed and exempt in the first part of the statute, the hammer pin should also be exempt.

The term "chuck," however, is listed under the category of hand tools in the statute, so in order to be exempt, a "chuck" would first have to be found to be a hand tool. There was no evidence presented that a hammer pin is a hand-held device and in fact the taxpayer's witness Mr. Lance testified that the hammer pin "is not a hand tool." (R. 9:59) The Board finds that the hammer pin is not a hand tool within the plain meaning of the statute. Thus, if the hammer pin is to be exempt, it will have to be found to be a "tool attached to a machine."

It is clear that the hammer itself is the "tool attached to the machine" within the plain meaning of the statute. The testimony presented by the taxpayer was that the hammer pin is merely what attaches the hammer to the machine and that pin has to be replaced anywhere from every two weeks to a month. The taxpayer further testified that while the hammer pin may come into contact with the metal incidentally, it is the hammer that is intended to break the metal. (R. 9:49, 9:55)

As the Court noted in Mansbach Metal v. Commonwealth of Kentucky, Department of Revenue, 521 S.W.2d 85, 87, (Ky. 1975), there is a distinction in the statutory scheme between exempt items designed to be used up in the manufacturing process and non-exempt parts which

simply wear out. This Board concludes that the hammer pin is not an industrial tool itself within the plain meaning of the statute, but rather is a "repair, replacement or spare part" which simply wears out. KRS 139.470(11)(b) further provides as follows:

It shall be noted that in none of the three (3) categories is any exemption provided for repair, replacement, or spare parts. Repair, replacement or spare parts shall not be considered to be materials, supplies, or industrial tools directly used in manufacturing or industrial processing. "Repair, replacement, or spare parts" shall have the same meaning as set forth in KRS 139.170.

KRS 139.170(4) provides as follows:

"Repair, replacement, or spare parts" means any tangible personal property used to maintain, restore, mend or repair machinery or equipment."Repair, replacement, or spare parts" does not include machine oils, grease, or industrial tools.

The hammer pins, which are replaced every two weeks to a month, are clearly replacement parts used to "maintain, restore, mend or repair" the hammer within the plain meaning of the statute, and are, therefore, not exempt from taxation.

LIQUID OXYGEN

Second, the taxpayer claims that the bulk liquid oxygen that it uses is an exempt industrial supply. The taxpayer uses the oxygen in an oxy-fuel torch cutting process to cut the larger inventory items into smaller sizes, so they can be processed by a shredder or shears. (Ex. 6) It is the Department's position that the oxygen and acetylene are used as a gas mixture to create the cutting flame and the oxygen is only eligible for the specific energy and energy producing fuel exemption set forth in KRS 139.480(3), rather than the more general industrial supply exemption set forth in KRS 130.470 (11). The Department argues further that because the taxpayer failed to meet the statutory filing requirements for the energy producing fuel exemption, the oxygen is, therefore, taxable.

The Department of Revenue previously exempted liquid oxygen pursuant to the industrial supplies provision. In fact, it held this position from 1965 until 2004. Mr. Dobson, with the Department of Revenue, testified that there had been no change in the law that caused it to

change its longstanding position in 2004. (R. 10:31) The Department simply determined on its own that the components of the fuel mixture, which were used to fuel the cutting function, should be considered to be an energy producing fuel under the more specific statute and that it had not addressed such fuels properly in the past. It is the Department's position that the more specific energy producing fuel statute applies, rather than the general industrial supply statute. (R. 10:34)

The taxpayer argues that the doctrine of contemporaneous construction precludes the use of internal policy changes by administrators to reverse and overturn long-standing interpretations and for the Department to arbitrarily change its method of treating oxygen is a violation of the law. The Department of Revenue does not address this issue in its brief. Nor does the Department of Revenue argue that the oxygen is not an industrial supply within the meaning of that statute. It argues only that the more specific energy producing fuel statute should govern in this instance.

It is true that in harmonizing the conflict between two statutes that relate to the same subject, Kentucky follows the rule of statutory construction that the more specific statute controls over the more general statute. Light v. City of Louisville, 248 S.W.3d 559, 563 (Ky. 2008). Before this rule of statutory construction can be applied, however, it must be determined whether the two statutes in question relate to the same subject and, are in fact in conflict.

The taxpayer argues that the bulk oxygen it purchases is exempt pursuant to KRS 139.470(11)(a)(2)(b) which provides as follows:

2. Other tangible personal property which is directly used in the manufacturing or industrial processing. If the property has a useful life of less than one (1) year. Specifically, these items are categorized as follows:

b. Supplies. This category includes supplies such as lubricating and compounding oils, grease, machine waste, abrasives, chemicals, solvents, fluxes, anodes, filtering materials, fire brick, catalysts, dyes, refrigerants, explosives, etc. The supplies indicated above need not come in

direct contact with a manufactured product to be exempt. "Supplies" does not include repair, replacement, or spare parts of any kind. (emphasis added)

The Department of Revenue argues that the following statute, KRS 139.480(3), is a more specific statute that should govern:

All energy or energy-producing fuels used in the course of manufacturing, processing, mining or refining and any related distribution, transmission, and transportation services for this energy that are billed to the user.

The terms "energy or energy-producing fuels " are not defined in the statute and because the legislature has not made it clear that bulk liquid oxygen used in a blow torch is supposed to be considered an "energy producing fuel," the Board considers this provision to be ambiguous as it applies to liquid oxygen.

The term "tangible personal property," however, which is used in the industrial supply exemption, is specifically defined in the applicable version of KRS 139.010(22), to include such a gas.

"Tangible personal property" means personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses, regardless of the method of delivery, and includes natural, artificial, and mixed gas..." (emphasis added)

Liquid oxygen clearly falls within this definition of "tangible personal property," as that term is used in the industrial supply exemption. Contrary to the Department of Revenue's belief, this Board concludes that the industrial supply provision and the energy producing fuel provision are not in conflict and that the rule of statutory construction for specific over general provisions does not apply here.

Instead, it is the Board's conclusion that the doctrine of contemporaneous construction applies in this case. As the Supreme Court of Kentucky explained in GTE v. Revenue Cabinet, 889 S.W.2d 788, 792 (Ky. 1994):

The doctrine of contemporaneous construction means where an administrative agency has the responsibility of interpreting a statute that is in some manner ambiguous, the agency is restricted to any long-standing construction of the provisions of the statute it has made previously. The

term "taxpayer" is not defined and the ambiguity resulting there from requires application of the doctrine.

In this instance, the energy producing fuels provision is ambiguous in regard to its application to liquid oxygen, insofar that it does not define "energy producing fuels" to include such a gas. This Board concludes that under the doctrine of contemporaneous construction, the Department of Revenue is restricted, therefore, to its long-standing construction of the industrial supplies exemption as controlling in the exemption of liquid oxygen.

Furthermore, this Board concludes that the Department's exemption of liquid oxygen as an industrial supply from 1965 until 2004 was a correct interpretation. This Board finds that the oxygen by itself is not flammable and will not burn. When the oxygen is mixed with acetylene in the cutting torch, it is used up instantaneously as a part of the manufacturing process and should be exempt from tax, as is any other qualifying industrial supply. (R. 9:51)

Finally, because this Board has concluded that the Department of Revenue was restricted to its application of the industrial supplies exemption for liquid oxygen, we do not have to address the issue of whether the Department of Revenue is estopped from taxing this taxpayer based upon the erroneous written information that it received from the Department of Revenue. The taxpayer received a letter from the Department in 2005, even after it had changed its interpretation, wherein the oxygen was exempted from its audit as an industrial supply. (Ex. 6) While much was made of the erroneous Department of Revenue letter at the hearing, as a point of clarification, even if the taxpayer was given erroneous written information by the Department of Revenue in 2005, only the interest and penalty could have been waived and not the tax, as is provided for in KRS 131.081(6).

For the foregoing reasons, the Department of Revenue's final ruling as to the hammer pins is upheld and the ruling as to the liquid oxygen is reversed.

This is a final and appealable order. All final orders of this agency shall be subject to judicial review in accordance with the provisions of KRS Chapter 13B. A party shall institute an appeal by filing a petition in the Circuit Court of venue, as provided in the agency's enabling statutes, within thirty (30) days after the final order of the agency is mailed or delivered by personal service. If venue for appeal is not stated in the enabling statutes, a party may appeal to Franklin Circuit Court or the Circuit Court of the county in which the appealing party resides or operates a place of business. Copies of the petition shall be served by the petitioner upon the agency and all parties of record. The petition shall include the names and addresses of all parties to the proceeding and the agency involved, and a statement of the grounds on which the review is requested. The petition shall be accompanied by a copy of the final order.

A party may file a petition for judicial review only after the party has exhausted all administrative remedies available within the agency whose action is being challenged, and within any other agency authorized to exercise administrative review.

A petition for judicial review shall not automatically stay a final order pending the outcome of the review, unless:

(a) An automatic stay is provided by statute upon appeal or at any point in the administrative proceedings;

(b) A stay is permitted by the agency and granted upon request; or

(c) A stay is ordered by the Circuit Court of jurisdiction upon petition.

Within twenty (20) days after service of the petition of appeal, or within further time allowed by the Circuit Court, the Kentucky Board of Tax Appeals shall transmit to the reviewing

court the original or a certified copy of the official record of the proceeding under review in compliance with KRS 13B.140(3).

DATE OF ORDER
AND MAILING: April 18, 2012

KENTUCKY BOARD OF TAX APPEALS
FULL BOARD CONCURRING

Bill Hayes
Chair