

**COMMONWEALTH OF KENTUCKY  
BOARD OF TAX APPEALS  
FILE NOS. K-10-R-35 and K-10-R-36**

**OHIO VALLEY ALUMINUM COMPANY, LLC**

**APPELLANT**

**ORDER NO. K-22086**

**COMMONWEALTH OF KENTUCKY,  
FINANCE AND ADMINISTRATION CABINET,  
DEPARTMENT OF REVENUE**

**APPELLEE**

The parties having briefed this matter in this consolidated case following an evidentiary hearing held before this Board on January 17, 2012, and the Board, being otherwise sufficiently advised, hereby enters the following Findings of Fact and Conclusions of Law.

**Background**

Appellant, Ohio Valley Aluminum Company, LLC, ("Ohio Valley") is in the business of manufacturing aluminum billets from raw and scrap aluminum at its plant located in Shelbyville, Kentucky. Ohio Valley seeks a refund of the utilities gross receipts license tax from the Shelby County schools and of the sales and use taxes paid during fiscal years ending March 31, 2008 and March 31, 2009. These refund amounts total \$861,679.00 plus applicable interest.

The Shelby County Board of Education levies the school tax, which is imposed upon up to 3% "of the gross receipts derived from the furnishing, within the district of utility services."

KRS 160.613 (1). There is, however, a partial exemption from the school tax as follows:

"gross receipts" shall not include amounts received for furnishing energy or energy-producing fuels, used in the course of manufacturing, processing, mining, or refining to the extent that the cost of energy or energy-producing fuels used exceeds three percent (3%) of the cost of production.

The companion sales and use tax law also allows a similar partial exemption for the consumption of energy or energy-producing fuels used in the course of manufacturing, processing, mining or refining, as well as any related transportation services billed to the user to the extent that the costs for this energy exceed three percent (3%) of the cost of production. See KRS 139.480(3).

Consumers who want to utilize these partial exemptions must apply for an energy direct pay authorization, whereby qualifying consumers pay an estimated tax each month directly to the Department of Revenue rather than to their energy provider, that takes into account the partial exemption. The consumer sets forth in an application its costs of production and costs related to energy and energy-producing fuels based upon costs incurred in the last completed fiscal or calendar year. 103 KAR 30:140.

The Department of Revenue denied Ohio Valley's application for an energy direct pay authorization and its refund requests. This denial was based upon the fact that Ohio Valley had not listed the cost of the raw or scrap aluminum when calculating its cost of production. In addition, the refunds for school tax for the periods 4/07 and 5/07 were denied as untimely under the two year statute of limitations for refunds of school tax. KRS 160.6156 (1).

Ohio Valley did not include the cost of the raw or scrap aluminum in its cost of production, because in 2007, the company had restructured and created OVACO, a wholly-owned subsidiary of Ohio Valley. According to the Appellant, OVACO was formed "for purposes of speculating/hedging, purchasing and ownership of aluminum scrap." (Appellant's brief, p.2). The ownership of all scrap metal and finished goods was transferred from Ohio Valley to OVACO. Ohio Valley also entered into a tolling agreement with OVACO whereby it processed the aluminum into billets for OVACO for a fee.

It is Ohio Valley's position that as a result of this restructuring, it became a toller and tollers, who perform services on a raw material or product owned by another for a fee, should

exclude the cost of materials it processes from the cost of production for purposes of the energy exemption. While the Department of Revenue's training materials agree with the statement that tollers do not include the cost of raw materials in their cost of production calculations, it is the Department of Revenue's position that Ohio Valley is not a true toller. The Department of Revenue argues that the relationship and operations between Ohio Valley and OVACO are not separate and distinct as is required by the caselaw for the cost of the aluminum to be separated from the rest of Ohio Valley's costs and allocated to OVACO.

### **Legal Authority**

The controlling taxation provisions do not define the term "cost of production." The regulation 103 KAR 30:140, however, does define cost of production as follows:

Section 1. Definitions. (1) "Cost of production" means the total of all costs, according to accepted accounting principles, incurred in manufacturing, mining, processing, or refining of tangible personal property computed on the basis of "plant facilities."

\*\*\*

(3) "Plant facilities" is defined in KRS 139.480(3).

Section 2. The list in this section shall serve as examples of accounts or classifications normally reflected in the computation of the cost of production:

(1) direct materials

KRS 139.480(3) defines "plant facilities" as follows:

Cost of production shall be computed on the basis of plant facilities which shall mean all permanent structures affixed to real property at one (1) location.

The Department of Revenue relies on Louisville Edible Oil Products v. Revenue Cabinet, 957 S.W.2d 272 (Ky. App. 1997) ("LEOP") wherein the Court stated, it is only if a

taxpayer has two discreet stages of production that it includes the cost of materials in the first stage and is not required to include the cost again in the second stage. The Court concluded that Louisville Edible Oil was involved in only one stage of production and could not exclude a portion of the production costs for the acquisition of the crude oil. Ohio Valley argues that the LEOP decision is not controlling, because it involved only one taxpayer and there was no tolling agreement. While the decision may not be on all fours with the facts of this case, it is instructive precedent as to when costs should be excluded from an operation for purposes of the exemption.

The Department also cites to Revenue Cabinet v. James Beam Distilling Co., 798 S.W2d 272 (Ky. 1997) wherein the Court concluded that Beam's production of whiskey in its distillery operation was a manufacturing operation separate and distinct from the bottling and warehousing operations and that it did not have to include the costs of unrelated operations in its costs of production for the whiskey production in its distillery operation. Once again, while the Beam decision does not involve two corporate entities, as in this case, it is instructive precedent on the question of the allocation of costs between distinct operations. Ohio Valley does not discuss the Beam decision in its brief.

Ohio Valley does not rely upon any Court of Appeals or Supreme Court cases, but rather cites to a 1993 decision of this Board and argues that this Board must conform with its own precedents. Regardless of what happened in that case, this Board is bound by the later published decisions of the Court of Appeals in LEOP, the Supreme Court in Beam, and the plain meaning of the controlling statutes and regulation. Under these authorities, this Board must decide, whether OVACO's operations are separate and distinct from those of Ohio Valley so that the cost of the raw materials can be allocated to OVACO or whether the Ohio Valley/ OVACO operations constitute one plant facility and a single operation for which the costs of production must be computed together under the controlling statute and regulation.

### **Findings of Fact**

1. The Ohio Valley plant is located in Shelbyville, Kentucky. At this plant, raw and scrap aluminum is melted down, cleaned and tested and then alloys are added as needed. Aluminum billets are then cast as per the customer's specifications as to size. (R. 9:43-9:47)
2. Ohio Valley casts aluminum into billets for extrusion customers. Extrusion customers purchase the aluminum billets to manufacture a wide variety of products such as windows, doors, automotive parts, truck trailers, church steeples and ladders. (R. 9:48-9:50)
3. OVACO LLC, a wholly-owned subsidiary of Ohio Valley, was formed in 2007. (R. 9:52)
4. Ohio Valley is the only member of OVACO, LLC (R. 10:08; Jt. Stip.App. Table Tab 30)
5. OVACO has no employees. (R. 10:21)
6. OVACO and Ohio Valley entered into a tolling agreement whereby Ohio Valley agrees to provide casting services for OVACO for a monthly fee. (Jt. Stip.App. Tab 19.)
7. The raw aluminum, which Ohio Valley makes into billets, is either purchased by and owned by OVACO or it is owned by the extrusion customer. If the aluminum is owned by the extrusion customer, OVACO has a separate tolling agreement with that customer whereby, it agrees to make the billets for the customer at the Shelbyville plant pursuant to OVACO's tolling agreement with Ohio Valley. (R. 10:57)
8. Ohio Valley provides services for OVACO pursuant to the Management Services Agreement (R. 10:59; Jt. Stip. App. Table Tab 30), which includes the following:

Accounting, treasury, tax, management information services, maintain all books and records, manage the accounts payable and receivable, prepare financial statements and reports and serve as agent for collection of all payments and authorized obligations.
9. Ohio Valley had no tolling agreements with any other entities during the period in question. (R. 10:52)
10. Ohio Valley has no other source of income other than the OVACO fee agreement and tolling agreement with OVACO (R. 10:52)

11. Both Ohio Valley's and OVACO's income is commingled in a bank account with other companies of Interlock Industries, Inc., Ohio Valley's parent. (R. 10:00)

### **Conclusions of Law**

In order to meet its burden of proof under Beam, Ohio Valley had to show that this aluminum casting operation, for which the partial energy exemption is sought, is a truly separate and complete operation from that of OVACO, and that Ohio Valley is not dependent on OVACO for the production of its completed aluminum billets. To the contrary, the proof in the case shows that there is not even another operation at the Shelbyville plant facility to which raw material costs could be allocated. OVACO, which exists on paper only, has no employees and it is actually Ohio Valley that handles all of the bookkeeping and the sales transactions with the extrusion customers and the purchasing of raw and scrap aluminum in the name of OVACO. As was the case in LEOP, the evidence shows that Ohio Valley is engaged in only one operation at the Shelbyville aluminum plant facility--it melts down raw and scrap aluminum and casts that aluminum into billets and it is dependent upon OVACO for the raw and scrap aluminum which it uses.

While Ohio Valley may have allocated the cost of the raw materials to OVACO on paper for speculating/hedging purposes, it cannot allocate the cost of the raw aluminum to OVACO, for purposes of calculating the cost of production for the statutory energy exemption, when there is only one plant facility and operation at the Shelbyville site within the meaning of the statute and regulation. As Kentucky courts have stated, "it is familiar law that it is the duty of courts to look to the substance rather than to the form of a transaction and the rule applies with equal force to matters of taxation." Revenue Cabinet v. Babcock & Wilcox Company, 203 S.W.3d 149, 156 (Ky. App. 2005) In this case, and for whatever reason, Ohio Valley is using OVACO as a conduit through which it can pass the raw and scrap aluminum, but it is Ohio Valley that needs and is using the raw aluminum to produce billets at the plant facility--without the aluminum,

there is no manufacturing or processing and no sales of aluminum billets.

Even though the taxpayer's wholly owned subsidiary owns the raw materials in question, those raw materials must be included in Ohio Valley's cost of production calculation, because those raw materials are associated with and necessary for the plant operation for which the exemption is sought. In cases where the extrusion customer does not own and provide the aluminum to Ohio Valley/OVACO to process as a toller, the aluminum becomes absolutely necessary for the production of a completed product at the Ohio Valley site and the costs associated with it, therefore, must be included in the cost of production calculation pursuant to 103 KAR 30:140, Section 1 (1). The question is not whether Ohio Valley owns the raw and scrap aluminum, but rather, is the raw and scrap aluminum in question necessary to that portion of the Ohio Valley operation for which the partial fuel exemption is sought and if it is, it must be included in the facility's cost of production calculation.

This Board finds and concludes that the Shelbyville plant, where Ohio Valley takes raw aluminum and makes billets to the specifications of its wholly owned subsidiary's customers, constitutes one plant facility and one operation. Accordingly, all costs associated with the production of these aluminum billets at this plant facility must be included in the calculation for the energy exemption, including the cost of the raw or scrap aluminum which is purchased in its wholly owned subsidiary's name for use by Ohio Valley at the plant.

The Department of Revenue's Final Ruling Nos. 2010-92 and 2010-93 are, therefore, upheld.

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 an 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 upon 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 KBTA 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: May 22, 2012**

**KENTUCKY BOARD OF TAX APPEALS  
FULL BOARD CONCURRING.**

**Cecil Dunn  
Chair**