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Court of Appeals Holds Income Tax Credit Properly Denied for Equipment Used To Generate, Transport and Flare Methane Gas in Landfill Operations

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In *Dept. of Revenue v. Bavarian Trucking Co., Inc., No. 2011-CA-002198-MR (May 24, 2013)* (Not To Be Published), the Court of Appeals (“Court”) held that the Appellees’ Bavarian Trucking Company, Inc., Waste in Place Trust, and Waste on Wheels Trust (collectively “BTC”) were not entitled to the recycling or composting equipment income tax credit under KRS 141.390 for the purchase of equipment used to generate, transport and burn landfill methane gas.

The Court noted that BTC collects garbage and transports it to its landfill for disposal. Methane gas is produced by the landfill operations, which is collected and transferred to an electrical plant owned by an unrelated company, where it is burned to generate electricity. BTC made equipment purchases and installations for use in its landfill operations of curbside garbage trucks and trash containers (collection equipment); bulldozers, tractors, excavators and other equipment for use at its landfill (landfill equipment), piping for general landfill use and to collect and transport methane and a flare to burn off excess build-up of methane. BTC applied for a \$3 million income tax credit pursuant to KRS 141.390, which the Department of Revenue (“Department”) denied in a Final Ruling letter.

BTC initially appealed the matter to the Kentucky Board of Tax Appeals (“Board”), which denied the tax credit for the collection equipment and granted the tax credit for the landfill equipment used for the methane generating process, piping and flare. Both parties appealed, and after a remand to the Board where it clarified that all landfill equipment was eligible for the tax credit, the Boone Circuit Court (“Circuit Court”) affirmed the Board’s amended order.

The Department appealed the Circuit Court’s holding that the landfill equipment, piping and flare qualified for the income tax credit. BTC argued that the Department did not adequately preserve the tax credit for the landfill equipment for appellate review. The Court held that the issue concerning the tax credit for the landfill equipment was properly preserved by the Department’s appeal of the Board’s rulings. BTC did not file a cross-appeal regarding the denial of the tax credit for the collection equipment.

The Court first indicated that tax credits, like tax exemptions, were disfavored in the law and should be strictly construed. It then indicated that its goal was to implement the intent of the General Assembly, and that it would rely on the plain language of the tax credit statute, KRS 141.390, which could not be ignored simply because another meaning might be considered to be a better policy.

The Court then reviewed the applicable tax credit statute, which defines recycling equipment as “any machinery or apparatus used exclusively to process postconsumer waste material and manufacturing machinery used exclusively to produce finished products composed of substantial postconsumer waste materials[.]” KRS 141.390(1)(b). The statute then defines postconsumer waste as a “product ... which has served its intended end use, and which has been separated from solid waste for purposes of collection, recycling, composting and disposition. . . [.]” KRS 141.390(1)(a).

The Court determined that BTC’s landfill equipment, piping and flare did not qualify as recycling equipment because BTC could not show that landfill methane gas was postconsumer waste, removing methane gas qualified as recycling or that its equipment was used exclusively to process postconsumer waste. Additionally, the Court determined that the equipment, piping and flare was not recycling equipment because collecting methane gas for combustion purposes was specifically excluded from the definition of recycling in KRS 224.01-010(22) (“Recycling ... does not include the incineration or combustion of materials for the recovery of energy.”).

The Court noted even if landfill methane gas qualified as postconsumer waste, BTC’s landfill equipment could not qualify for the tax credit because it did not use the equipment exclusively to process the methane but also to prepare and maintain its landfill. The Court rejected BTC’s argument that KRS 141.390’s “used exclusively” language should be interpreted the same as the KRS 139.170 language “used directly”, which allowed the application of the integrated plant theory for sales tax purposes. The Court held: “it would not be logical to interpret the statute to give them a tax credit for every aspect of landfill maintenance, rather than for just alterations needed to convert a methane system to energy collection.”

The Court also rejected BTC’s argument that its landfill equipment, piping and flare qualified as composting equipment, defined as “equipment used in a process by which biological decomposition of organic solid waste is carried out under controlled aerobic conditions, and which stabilizes the organic fraction into a material which can easily and safely be stored, handled, and used in an environmentally acceptable manner[.]” KRS 141.390(1)(c). The Court held that none of the equipment at issue qualified for the composting equipment tax credit because the methane was not produced under controlled aerobic conditions through composting and the process did not produce compost.

Finally, the Court held that legislative action in 2007 in enacting new incentive programs, including tax credits, to develop renewable energy and construct renewable energy facilities, made it clear that KRS 141.390 does not provide tax credits for the production of landfill methane gas for energy, citing KRS 154.27-020(1), (3)(d), (4)(e),(5) and KRS 154.20-415(1). The Court found it significant that the term “landfill methane gas” is specifically included in the 2007 legislative definitions for renewable energy and renewable energy facilities. KRS 154.27-010(26)(a); KRS 154.20-400(5).

As a result, the Court reversed and remanded the Circuit Court’s decision granting the tax credit for the landfill equipment, piping and flare, and affirmed the unchallenged portion of the decision regarding the collection equipment.