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Kentucky Board of Tax Appeals Rules Pharmaceuticals Prescribed by Veterinarians Subject to Sales Tax

Erica L. Horn

In *Veterinary Pharmaceuticals East, Inc. v. Dept. of Revenue*, K10-R-12 (2/23/2012), the Kentucky Board of Tax Appeals (the “KBTA”) upheld the audit assessment of the Kentucky Department of Revenue (the “DOR”) finding that “legend drugs” sold by veterinarians to customers for use on cattle were not exempt from sales tax.

Veterinary Pharmaceuticals East, Inc. (“Appellant”) sold veterinary pharmaceuticals inside and outside Kentucky. The pharmaceuticals were identified as “legend drugs” requiring the prescription of a vet. The majority of the drugs were vaccines for cattle. Appellant did not collect sales tax from customers purchasing the drugs based upon oral advice from Mr. Losch, a representative of the Kentucky Board of Pharmacy, and an unnamed representative of the DOR.

Appellant argued that the legend drugs were exempt from sales tax because they constitute (a) farm chemicals used in the raising of livestock or poultry under KRS 139.480(8) and (b) feed for livestock pursuant to KRS 139.480(9). The DOR argued that such legend drugs did not fall within any exemption to the sales tax.

Exemptions under KRS 139.480

The KBTA ruled that the Appellant failed to prove the drugs were exempt under KRS 139.480(8) or (9). The Board, citing KRS 139.260, noted that the burden of proof fell upon the Appellant that the property satisfied the exemption. The Appellant failed to satisfy its burden because the only evidence presented was the testimony of the Appellant’s owner, stating that the drugs enhanced the growth of the cattle. No evidence was presented as to how growth was enhanced.

The Board rejected the cases cited by the Appellant in support of its argument, *Shadowland Farm v. Revenue Cabinet*, 779 S.W.2d 232 (Ky. App. 1989) and *Stonecreek Stud, Inc. v. Revenue Cabinet*, 746 S.W.2d 73 (Ky. App. 1987). At issue in *Shadowland Farm* and *Stoner Creek Stud* was whether feed, fertilizer, tractor parts and other items used in the horse breeding business were exempt from sales and use tax as feed, etc. for livestock pursuant to KRS 139.480(7) (now KRS 139.480(9)). In both cases, the Kentucky Court of Appeals noted that because the items were used for horses, and not livestock meant for human consumption, the items were not exempt. The Board noted that the court in those cases did not address the issue

presented by Appellant and in fact, the court in *Stoner Creek Stud* stated that the issue of the exemption for items meant to keep livestock healthy was better addressed in another context.

In determining what constitutes “feed” and “farm chemical”, the Board looked to the intent of the General Assembly as reflected in the statutory history. The Board cited to a regulation of the DOR, 103 KAR 30:091, which expressly states that medicines and vaccines for animals are not exempt from sales tax under KRS 139.480. Further, the Board noted that the General Assembly under KRS 139.472 has exempted “legend drugs” for use by humans, but chose not to extend the exemption to those for animals. The Board also looked at 103 KAR 26:090, which states that veterinarians are the consumers of the drugs used in their practice and must pay tax on those purchases; but if the drugs are supplied to a consumer for a separate charge, the veterinarians should collect the tax from the end consumer. The Board stated that the General Assembly had ample opportunity to exempt “legend drugs” for animal use but has chosen not to. Therefore, the drugs are not exempt under KRS 139.480(8) and (9).

Audit Sample

The Appellant also asserted that the use of sampling by the auditor (a common practice in Kentucky) resulted in an overstatement of the sales tax assessment. The Board found that there was no flaw in the methodology causing an overstatement. Again, the only evidence presented by Appellant was the testimony of the Appellant’s owner. The DOR, however, presented the testimony of a DOR representative and the protest resolution officer who had both reviewed the audit work papers and actual records of the Appellant and determined that gross receipts were substantially more than the Appellant claimed. Because the Appellant failed to meet its burden of proof, the Board found the tax assessment was not overstated.

Reliance on Advice

The final issue presented by the Appellant was whether the DOR was estopped from assessing the tax due to reliance by Appellant upon advice from the DOR and Kentucky Board of Pharmacy. Again, the only evidence presented by Appellant was the testimony of the Appellant’s owner that the Appellant had relied upon advice from the Board of Pharmacy and the DOR. Mr. Losch, the representative of the Board of Pharmacy, stated that he had never given any such advice to the Appellant regarding an exemption from the sales tax. The Board stated that even had Mr. Losch made such a statement, it is not the type of advice which could have been reasonably relied upon to estop the collection of the tax.

As to the oral statements of an unnamed representative of the DOR, the Board found that reliance on such advice did not constitute reasonable reliance. Pursuant to KRS 131.081(6), advice from the DOR must be written in order for reliance to be reasonable. Therefore, because the Appellant failed to prove reasonable reliance upon advice from the DOR or the Kentucky Board of Pharmacy, the DOR was not estopped from collecting the assessed tax.