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# Kentucky Court Holds Utility Franchise Subject to Highest State & Local Property Tax Rates

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The Kentucky Court of Appeals has affirmed the Kentucky Department of Revenue's (the "DOR") policy of classifying, for purposes of the public service company ("PSC") property tax, the total value of a utility's "franchise" as "tangible personal property" subject to tax at the highest state and local tax rates. In *Dayton Power & Light Co. v. Dept. of Revenue*, 2011-CA-001438 (Ky. Ct. App. Aug. 10, 2012), the question presented to the Court was whether the franchise value had to be allocated or spread across all classifications of the utility's property resulting in a reduction of the overall tax rate.

Dayton Power & Light Company ("DP&L") owned a 31% interest in a power generating facility in Boone County, Kentucky. DP&L paid property tax pursuant to KRS § 136.115, *et seq.* governing public service companies. Pursuant to KRS § 136.180, public service companies pay property tax on their "operating property". "Operating property" is defined at KRS § 136.115(2) as a company's tangible personal property plus its "franchise". For purposes of the PSC property tax, "franchise" is defined as:

> [T]he earning value ascribed to the capital of a domestic public service corporation by reason of its operation as a domestic public service corporation. It comprises the operating property and is assessed by the Revenue Cabinet by its fair cash value as a unit. In this case, the franchise is the earning value ascribed to Comcast's capital by reason of its operation as a cable television provider. Said another way, the value of the franchise is determined by subtracting the assessed value of the tangible operating property from the "capital stock," which is the "entire property, real and personal, tangible and intangible, assets on hand, and its franchise as well."[1]

On its 2006 tax return, DP&L identified five classes of property: (1) real estate, (2) tangible property, (3) manufacturing machinery, (4) pollution control equipment, and (5) business inventory. Tangible property is taxed at the state rate of $0.45/$100, business inventory at $0.05/$100 and both classes of property are taxed by local taxing jurisdictions.[2] Manufacturing machinery and pollution control equipment are taxed at $0.15/$100 and are exempt from local taxation.[3] DOR and DP&L agreed that the unit value of DP&L's operating

[1] *Revenue Cabinet v. Comcast Cablevision of the South*, 147 S.W.3d 743, 752 (Ky. App. 2003) (*quoting Henderson Bridge Co. v. Commonwealth*, 31 S.W. 486, 491 (Ky. 1895)).
[2] KRS § 132.020(1)(n) and (r) and KRS § 132.200.
[3] KRS § 132.020(i) and (k) and KRS § 132.200(4) and (8).

property for the 2006 tax year was $110,621,241; and, more specifically, agreed that the value of DP&L's franchise was $21,164,058.

Between 1999 and 2003, in the context of settlement negotiations, the DOR allowed DP&L to spread the value of its franchise among the classes of property it owned resulting in a lower tax rate and an exemption from local tax for part of the value of its franchise. With regard to the 2006 tax year, the DOR changed its position and insisted that the full value of DP&L's franchise be taxed as tangible personal property at full state and local tax rates. This resulted in higher taxes for DP&L because the franchise was subject to a higher tax rate and its entire value was subject to local taxation.

DP&L appealed to the Kentucky Board of Tax Appeals (the "Board"). The Board granted summary disposition for DP&L, ruling the DOR could not change its long-standing position without violating the doctrine of contemporaneous construction. According to the doctrine, an administrative agency that has interpreted an ambiguous statute may not change its long-standing interpretation. The DOR appealed the Board's ruling to the Franklin Circuit Court. The Franklin Circuit Court reversed the ruling of the Board holding that the DOR's past practices were incorrect and that its new method was correct under the statutes. DP&L appealed to the Court of Appeals.

The statutory language to be construed by the Court, KRS § 136.120(2)(c), requires the property of a public service company to be taxed at the "same rates" as non-public service companies. The Court concluded that DP&L's franchise value was within the catch-all provision of KRS § 132.020(1)(r) and, thus, subject to the $0.45/$100 tax rate. The Court found that none of the categories and rates in KRS § 132.020(1)(a) – (q) were applicable, and therefore, the catch-all provision applied. The Court also found that non-public service companies do not have taxable franchises and thus, there was no "same rate" to apply. Also, citing the 17 categories of property and rates in KRS § 132.020(1)(a)-(q) and KRS § 132.200, the Court held that had the legislature intended to tax the franchise at a lower rate or exempt it from local taxation, the legislature knew how to do so.

DP&L renewed its argument that the doctrine of contemporaneous construction prevented the DOR from changing its position on the taxation of the franchise. The Court found the doctrine inapplicable for two reasons. First, the statutes in question were not ambiguous, and second, DP&L had not proven the DOR's prior position to be a long-standing position. Also, the Court found that the present case was one in which the DOR was correcting a mistake and that it should not be locked into an incorrect application of the law.

DP&L is considering its options for appeal.