

BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of) OAH No. 10-0352-TAX
)
KLAWOCK OCEANSIDE, INC.)
)
<u>Salmon Product Development Tax</u>)
<u>Tax Years 2006 & 2007</u>)

ORDER GRANTING SUMMARY ADJUDICATION

I. Introduction

This case is the tax appeal of Klawock Oceanside, Inc. Klawock Oceanside is appealing the denial of its application of the Salmon Product Development Tax Credit by the Alaska Department of Revenue (DOR). The denial of this credit by DOR was upheld in an informal conference decision.

The parties filed briefing and participated in oral arguments on motions for summary adjudication. The Division’s motion is granted. Based on the undisputed facts, DOR correctly disallowed the contested tax credits because the equipment that Klawock Oceanside claimed the credit for was not used to perform a processing, packaging or product finishing function during 2006 and 2007 tax years.

II. Undisputed Facts

DOR’s informal conference decision disallowed Klawock Oceanside’s claim of Salmon Product Development Tax Credits. The disallowed claims totaled \$18,471.30 for the 2006 tax year and \$15,813.50 for the 2007 tax year. These claims were for new equipment that Klawock Oceanside had purchased as part of its plan to produce high quality salmon fillets. There is no dispute that Klawock Oceanside purchased this equipment with the intent to produce value added salmon products. There is also no dispute that Klawock Oceanside would have qualified for the Salmon Product Development Tax Credits if this equipment was used as Klawock Oceanside had planned for it to be used when it was purchased.

Klawock Oceanside purchased this equipment as part of its plan to produce high quality salmon fillets during the relevant tax years. This equipment included blast freezer baskets, liners, carts and a spray glazer. Klawock Oceanside ran some tests of this new equipment to ensure that it could produce high quality salmon fillets, but Klawock Oceanside was not able to use this equipment in accordance with its original plan because of an unexpected change in

market conditions. Klawock Oceanside still hopes to use this equipment for its intended purpose, but in the meantime it has been using for purposes that do not make the costs of the equipment qualify for the credit. Klawock Oceanside is concerned that it will not qualify for the credit when this equipment is used for its intended purpose because by the time the equipment is used to produce high quality salmon fillets, it will no longer be new equipment.

III. Discussion

Summary Judgment

Only when the parties genuinely dispute a material fact is it necessary to hold an evidentiary hearing.¹ The parties in this case have agreed that there are no material facts in dispute. DOR and Klawock Oceanside agree about the circumstance surrounding the purchase and subsequent use of the equipment that was the basis of the claimed credits. DOR does not dispute that Klawock Oceanside purchased this equipment with the intent to put it to a use that would have made the costs qualify for the credits. DOR does not dispute that unexpected market conditions made prevented Klawock Oceanside from using the equipment for its intended use. Klawock Oceanside does not dispute that equipment was not actually used for its intended purpose during the relevant tax years. The only disagreement between the parties is whether, given these undisputed facts, the costs of this equipment qualify for the credits.²

Disputed Tax Credits

As applied to the facts of this appeal Salmon Product Development Tax Credit grants a tax credit of 50% of the cost of qualified investments in new equipment placed in service during the tax year.³ Qualified investments are purchases of equipment to be used predominantly to perform an ice making, processing, packaging, or product finishing function. The function of the equipment invested in must be a significant component in producing value-added salmon products. This function must go beyond merely gutting of the salmon.⁴ The equipment must be a capital investment with a useful life of at least three years.

Specific types of equipment that may meet the requirements for the credit are specifically

¹ A fact is not “material” unless it would make a difference to the outcome. *Whaley v. State*, 438 P.2d 718, 720 (Alaska 1968).

² Parties’ Briefing on Motions for Summary Judgment.

³ AS 43.75.035(a).

⁴ AS 43.75.035(i)(3).

listed in the statute providing the credit.⁵ Examples of the types of equipment used in fish processing that do not qualify for the credit are also specifically listed in the statute providing the credit.⁶ The costs of the overhaul, retooling, or modification of new or existing property is also specifically disqualified from the credit.⁷ The specific inclusions and exclusions listed in the statute show that the credit is limited to investments in new equipment used specifically for value added processing that a processor would not make to support the processor's existing gutting and freezing operations.

Taxpayer's Position

Klawock Oceanside argues that the costs of the equipment it purchased should qualify for the tax credit because the equipment was purchased to be used predominantly to perform a processing, packaging or product finishing function. Klawock Oceanside's position is that the costs of equipment qualify for the credit even if the equipment is not actually used to produce value added products if the equipment was purchased for, and is capable of being used predominantly to perform, a processing, packaging or product finishing function.

Klawock Oceanside argues that its purchases met this test and should be allowed the credit even though the actual market conditions kept Klawock Oceanside from using the equipment as had planned. Klawock Oceanside maintains that the Salmon Product Development Tax Credit created in AS 43.75.035 is forward-looking, focused on creating an incentive for Alaska fish processors to make investments to produce value added products, and therefore should be read as allowing the credit for a good faith purchase of qualifying equipment, even if unexpected market conditions prevent a taxpayer from using the equipment to make value added salmon products.

Standard of Review

AS 43.05.435(2) & (3) establish the applicable standards of review for summary adjudication, requiring the administrative law judge to resolve a question of law through the exercise of the independent judgment of the administrative law judge and only to defer to the DOR in a matter where DOR has exercised legally vested discretion and DOR's exercise of that discretion had a reasonable basis. DOR has not requested deference on the basis of an exercise of discretionary

⁵ AS 43.75.035(i)(3)(A).

⁶ AS 43.75.035(i)(3)(B).

⁷ AS 43.75.035(i)(3)(B)(ii).

authority. DOR points out those courts in Alaska use their independent judgment on issues of pure statutory interpretation.⁸

Tax credits to be Narrowly Interpreted

Alaska statutes are interpreted according to reason, practicality, and common sense, taking into account the plain meaning and purpose of the law as well as the intent of the drafters.⁹ A sliding scale is applied to questions of statutory interpretation. The plainer the language of the statute, the more convincing contrary legislative history must be.¹⁰

Although there is a general principle that ambiguities in tax statutes are to be resolved in favor of the taxpayer,¹¹ the opposite rule applies with provisions creating exceptions or exemptions from the general tax treatment.¹² In *State, Department of Revenue v. OSG Bulk Ships, Inc.*,¹³ the Alaska Supreme Court upheld a narrow construction of a tax credit statute on the basis that it was “consistent with the following canon of construction: Exemptions are narrowly construed against the taxpayer.”¹⁴

This canon was explained in more detail by the Alaska Supreme Court in a property tax case, *Greater Anchorage Area Borough v. Sisters of Charity of House of Providence*:

All property is benefited by the security and protection furnished by the State, and it is only just and equitable that expenses incurred in the operation and maintenance of government should be fairly apportioned upon the property of all. An exemption from taxation releases property from this obligation to bear its share of the cost of government and serves to disturb to some extent, that equality in the distribution of this common burden upon all property which is the object and aim of every just system of taxation. While reasonable exemptions based upon various grounds of public policy are permissible, yet taxation is the general rule. . . . It is for this reason that statutes granting exemptions from taxation are strictly construed. A Taxpayer is not entitled to an exemption unless he shows that he comes within either the express words or the necessary implication of some statute conferring this privilege upon him. [¹⁵]

⁸ DOR Opposition Brief at page 2, citing *State v. OSG Bulk Ships*, 961 P.2d 399, 403 n.6 (Alaska 1998).

⁹ *Native Village of Elim v. State*, 990 P.2d 1, 5 (Alaska 1999).

¹⁰ *Alaskans For Efficient Gov't, Inc. v. Knowles*, 91 P.3d 273, 275 (Alaska 2004) (quoting *Ganz v. Alaska Airlines, Inc.*, 963 P.2d 1015, 1019 (Alaska 1998)).

¹¹ *Union Oil Co. of Cal. v. Dep't of Revenue*, 560 P.2d 21, 25 (Alaska 1977).

¹² E.g., 3A N. Singer, *Statutes and Statutory Construction* § 66.09 (5th ed. 1992); *Green Constr. Co. v. State, Dep't of Revenue*, 674 P.2d 260, 266 (Alaska 1983).

¹³ 961 P.2d 399 (Alaska 1998).

¹⁴ *Id.* at 409.

¹⁵ *Greater Anchorage Area Borough v. Sisters of Charity of House of Providence*, 553 P.2d 467, 469 (Alaska 1976), quoting *Animal Rescue League of Boston v. Bourne's Assessors*, 37 N.E.2d 1019, 1021 (Mass. 1941).

This canon, requiring a narrow construction of tax credits, applies to all types of taxes including, the Fisheries Business tax.¹⁶

Intended Use at Purchase

Klawock Oceanside correctly points out that some of the language in the statutes controlling the Salmon Product Development Tax Credit is forward-looking.

AS 43.75.035(i)(3) provides:

(3) "qualified investment" means the investment cost in depreciable tangible personal property with a useful life of three years or more to be used predominantly to produce value-added salmon products beyond gutting of the salmon; in this paragraph, "property" includes filleting, skinning, portioning, mincing, forming, extruding, stuffing, injecting, mixing, marinating, preserving, drying, smoking, brining, packaging, blast freezing, or pin bone removal equipment;

The definition of the term "qualified investment" includes the words "to be used predominantly" when describing the type of property a taxpayer may receive the credit for investing in.¹⁷ This forward looking language implicitly speaks both to the type of use that the property can be put to and the property's intended future use at the time of investment. Both must be predominantly for the production of value added products.

The forward-looking orientation of this description, however, is due to the timing of the "investment" in the sequence of events that must take place in order to qualify for the credit. That sequence is investment, then use, then filing a tax return and claiming the credit. It is this sequence that explains the forward-looking language in the statute rather than an implication that a credit will be awarded despite a failure to put the equipment to its intended qualifying use. This language does not provide implicit support for Klawock Oceanside's position that the credit is triggered by the taxpayer's intent in the purchase of the equipment rather than its actual use.

The forward looking orientation of the words "to be used" does not mean that the investment alone that triggers the credit. The statute requires that the property must be "first placed into service" during tax year.¹⁸ The words "first placed in service" are specifically defined in the statute as "the moment when property is first used for its intended purpose."

¹⁶ E.g., *Pledger v. Ethyl Corp.*, 771 S.W.2d 24, 25 (Ark. 1989) (in context of oil severance tax, "[a]ny tax exemption provision must be strictly construed against exemption, and to doubt is to deny the exemption."); *Secretary of Dep't of Revenue & Taxation v. Texas Gas Expl. Corp.*, 506 So. 2d 528, 530 (La. App. 1987); *Eagerton v. Terra Resources, Inc.*, 426 So. 2d 807, 808 (Ala. 1982); *Phillips Petroleum Co. v. Oklahoma Tax Comm'n*, 542 P.2d 1303, 1305 (Okla. 1975).

¹⁷ AS 43.75.035(i)(3).

New Pre-Approval Provision

Effective for tax years after those in dispute in this appeal, a taxpayer may submit a proposed investment to DOR for a preliminary determination of whether the equipment would qualify. Klawock Oceanside's argument that this new provision supports its view of the credit as broadly covering good faith investments in equipment for producing value added products is not convincing. The claimed credits were not for tax years when the new pre-approval provisions were in effect, and subsequent enactment of those provisions does not imply a legislative intent not to require that equipment be put to a qualifying use for the credit to apply.

In any event, the new statute does not trigger qualification for the credit at pre-approval or at the purchase of the property. The new pre-approval provisions do not allow a credit for a pre-approved purchase of equipment that is not put to its intended use during the tax year. These provisions only give a taxpayer an opportunity for assurance through pre-approval that a proposed investment is in a type of property that would qualify for the credit if it is purchased and put into service during the tax year for its intended purpose, which must be to predominantly produce value added products.¹⁹

Under the new pre-approval provisions, if the equipment the taxpayer plans to buy is not the right type of equipment (a forklift, for example), it will not be pre-approved and the taxpayer will then know not to claim or count on the credit. If it is the right kind of property (a pin bone remover, for example), it will be pre-approved, but under AS 43.75.035(a) it must be put into service during the tax year in order for the taxpayer to qualify for the credit. Being put in service means used for its intended purpose, and the intended purpose must be to predominantly produce value added products.

Equipment Type, Intended Use and Actual Use during Tax Year Required for Credit

Klawock Oceanside argues that this interpretation of the A.S. 43.75.035 is too narrow and eliminates those processors who purchased equipment, with the tax credit in mind, but were unable initially to use the equipment for its intended purpose because of market conditions, which introduces a risk to this type of investment which would run contrary to the legislation's sponsor's stated intent "to entice investment into the processing sector of the industry and to

¹⁸ AS 43.75.035(a) & AS 43.75.035(i) (1).

¹⁹ AS 43.75.035(i) in effect beginning in 2008. All other statutory cites refer to the 2006-2007 statutes.

make changes in terms of what products are being produced.”²⁰

The intent to provide an incentive to invest in equipment to produce value added products does not preclude a limitation on the tax credit that provides that incentive, requiring the taxpayer to actually use the equipment to produce value added products. While this limitation may in some cases result in a taxpayer bearing the full risk of loss on an investment that cannot economically be put to its intended qualifying use due to changing market conditions, there is no implication in the language of the statute or the legislative history cited by the taxpayer that the credit was intended to partially insure such a loss by applying to equipment that is not used for a qualifying purpose.

IV. Conclusion

DOR correctly denied the disputed tax credits. DOR’s motion for summary adjudication is GRANTED. DOR’s Informal Conference Decision issued on March 26, 2010 is AFFIRMED.

NOTICE

1. This is the hearing decision of the Administrative Law Judge under Alaska Statute 43.05.465(a). Unless reconsideration is ordered, this decision will become the final administrative decision 60 days from the date of service of this decision.²¹
2. A party may request reconsideration in accordance with Alaska Statute 43.05.465(b) within 30 days of the date of service of this decision.
3. When the decision becomes final, the decision and the record in this appeal become public records unless the Administrative Law Judge has issued a protective order requiring that specified parts of the record be kept confidential.²²
4. A party may file a motion for a protective order, showing good cause why specific information in the record should remain confidential, within 30 days of the date of service of this decision.²³
5. Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Statute 43.05.480 within 30 days of the date of this decision becomes final.²⁴

DATED this 1st day of October, 2012.

By: Signed _____
Mark T. Handley
Administrative Law Judge

[This document has been modified to conform to the technical standards for publication.]

²⁰ See Statement of Senator Ben Stevens, sponsor of HB 90 at Klawock’s exhibit A, page 3.

²¹ Alaska Statute 43.05.465(f)(1).

²² Alaska Statute 43.05.470.

²³ Alaska Statute 43.05.470(b).

²⁴ Alaska Statute 43.05.465 sets out the timelines for when this decision will become final.