

BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of:)
)
 SNOPAC PRODUCTS, INC.) OAH Case No. 11-0362-TAX
)
2008 Salmon Product Development Tax)

DECISION AND ORDER

I. Introduction

This case is the tax appeal of Snopac Products, Inc. (Snopac) regarding 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 issued on August 25, 2011.

DOR correctly disallowed the contested tax credits because the disputed equipment that Snopac claimed the credit for during the 2008 tax year did not meet the requirements of Salmon Product Development Tax Credit under the proper, narrow construction of the statute authorizing that tax credit. The disputed credits were not for start-up capital investments in equipment, in direct contact with the fish, that performs an active role in the value-adding process that begins with the filleting machine.

II. Procedural Background

Snopac filed this appeal of DOR’s informal conference decision to the Office of Administrative Hearings (OAH). Administrative Law Judge Mark T. Handley for OAH was assigned to hear the appeal. Michael Barber, Assistant Attorney General, represented DOR. Snopac was represented by its president, Gregory B. Blakey. There was an evidentiary hearing DOR filed the agency record and exhibits. After a hearing DOR filed a post hearing brief.

III. Facts

DOR’s informal conference decision disallowed Snopac’s claim of Salmon Product Development Tax Credits totaling \$26,677.75 for the 2008 tax year. These claims were for new equipment that Snopac had purchased as part of its plan to produce high quality salmon fillets. There is no dispute that Snopac purchased this equipment with the intent to produce salmon products. There is also no dispute that Snopac would have qualified for the amount claimed if the equipment purchased qualified for the credit.

Snopac purchased equipment as part of its plan to produce salmon fillets in 2008. The types of equipment Snopac purchased that DOR did not allow a credit for included tote dumpers, repair kits, waste conveyors, collaring tables, knives, poly sleeve bin storage units, accumulation tables, and de-icers with flume. Snopac explained at the hearing that all of this equipment was used exclusively to produce salmon fillets. Snopac had an assembly line constructed to produce fillets. At the hearing Mr. Blakey explained how the equipment for which no credit was allowed fit into the processing of fillets. The description that follows is drawn from his testimony.¹

After the fish are gutted and have their heads removed, the fish are inspected and graded. Only the highest quality fish are put into the “trim line” for processing into fillets. First the selected fish are aged for 18 to 24 hours with ice in insulated totes, so that the pin bones can be removed. If the fish were not aged, the pin bones would break off in the fillets instead of being removed whole. The selected fish are iced to prevent further deterioration while the fish are aged.

The insulated totes full of aged and iced salmon are carried by a tote dumper to a de-icer. The de-icer is a ramp of metal bars. Gravity moves the fish down this ramp. The ice falls through the spaces between the bars. After de-icing the fish are taken to the collaring table. At the collaring table the collar of the salmon is removed.

The collar is a boney structure below the gills that is left on by the machine used in the heading and gutting process. The collar is initially left on the fish in order to prevent oxidization of the meat below the collar. Taking the collar off must be done by hand. The collar must be removed before the fish can be put through the fillet machine, because the fillet machine is not designed to cut through the big bones in the collar. The fish then are put through the filleting machine, which splits the fish.

The fillet machine splits the fish by removing the meat on both sides of the backbone, and it cuts out most of the rib bones. The remaining ribs bones in the meat are then trimmed off by workers whose area is called the active trim line. These workers also remove the fins of the fish.

Next to the conveyor belt that carries the fish through the active trim line where the workers are removing fins and rib bones is a waste conveyor. The trim line workers put the ribs and fins that they cut off on this waste conveyor. This waste conveyor goes the opposite

¹ Recording of Hearing - Testimony of Mr. Blakey

direction from the conveyor moving the fish through the trim-line. The waste conveyor was built into same unit as the trim-line conveyor belt. After the ribs and fins are removed on the trim line, the fillets go through a pin bone remover machine.

This machine does not remove all of the pin bones, so after the fillet goes through the machine it is inspected by hand and any remaining pin bones are removed. The fillet is cleaned up, placed in a poly bag and vacuum sealed.

The poly bags that will be put on the fillets are kept in a poly sleeve bin storage units. These poly bins are needed to hold the poly bags to put on the fillets as the fillets come down the conveyor at a rate of 30 fillets per minute. The poly sleeve bin storage units are fabricated from stainless steel with shelves to hold the poly bags next to the vacuum machine. The poly sleeve bin storage units must be made of stainless steel because they are located next to where the fish are being processed and they must be sanitized frequently. After vacuum sealing in the polybags, the fish are frozen.²

IV. Discussion

A. Disputed Tax Credits

The 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. 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. The equipment must be a capital investment with a useful life of at least three years.³

Specific types of equipment that may meet the requirements for the credit are specifically listed in the statute providing the credit. These types include equipment for filleting, skinning, portioning, mincing, forming, extruding, stuffing, injecting, mixing, marinating, preserving, drying, smoking, brining, packaging, blast freezing, or pin bone removal, as well as new parts to convert an existing can seamer to pop-top can production, conveyors specifically used in the value-adding process, and ice making machine.⁴

² Photos of one of Snopac's vacuum packing machines are found at Agency Record 98 & 100.

³ AS 43.75.035(a).

⁴ AS 43.75.035(i)(3)(A).

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. These types of equipment include vehicles, forklifts, conveyors not used in the value-adding process, cranes, pumps, or other equipment used to move salmon or salmon products, knives, gloves, tools, supplies and materials, equipment, other than ice making machines, that are not processing, packaging, or product finishing equipment, or other equipment only incidentally used in the value-adding process.⁵

The costs of the overhaul, retooling, or modification of new or existing property is also specifically disqualified from the credit.⁶

As can be seen from the specific inclusions and exclusions listed above, the credit is limited to investments in new equipment used specifically for value-added processing that that a processor would not make in support of the processor's existing gutting and freezing operations.

B. Taxpayer's Position

Snopac argues that the costs of the disputed types of equipment it purchased should qualify for the tax credit because the equipment was all part of the fillet line and it was all purchased and used predominantly to produce salmon fillets, and was not used process whole salmon into headed and gutted salmon.

Snopac argues that all of the disputed equipment is part of the fillet line as that term was used when DOR was informing the legislature what would be covered by the credits. Snopac describes the fillet processing as like an assembly line that begins after the headed and gutted salmon are sorted and those selected for filleting are place in insulated totes for aging. The assembly line ends when the fillets are vacuum sealed and frozen. Snopac argues that the disputed equipment types are integral parts of that assembly line and their purchase should qualify for the credit unless they are a type of equipment that is explicitly excluded from qualification.

C. DOR's Position

DOR argues that the equipment purchases that were determined not to qualify for the tax credit is equipment that does not perform a "processing, packaging, or product finishing function" and/or is incidental to these qualifying functions.

⁵ AS 43.75.035(i)(3)(B).

DOR argues that the types of equipment used in the filleting process that qualify for the credit are limited to those that are actually in contact with the fish when it is being made into fillets, and that that process does not start for the purpose of identifying qualifying equipment until the fish are being fed through the filleting machine. When equipment is not in contact with the fish during this process, but instead provides a support function such as the poly sleeve bin storage, DOR contends that it serves an incidental rather than a primary function in that process and therefore does not qualify for the credit.

D. Standard of Review

DOR's determination that the disputed equipment purchases do not qualify for the Salmon Product Development Tax Credit are based on DOR's interpretation of the law and are therefore subject of review based on the independent judgment of the administrative law judge.⁷

E. Interpretation of Tax Credit Provisions

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.⁸ 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.⁹

Although there is a general principle that ambiguities in tax statutes are to be resolved in favor of the taxpayer,¹⁰ the opposite rule applies with provisions creating exceptions or exemptions from the general tax treatment.¹¹ In *State, Department of Revenue v. OSG Bulk Ships, Inc.*,¹² 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."¹³

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*:

⁶ AS 43.75.035(i)(3)(B)(ii).

⁷ AS 43.05.435(2) requires the Administrative Law Judge resolve a question of law in an area where DOR is not legally vested with discretion through the exercise of the independent judgment of the administrative law judge.

⁸ *Native Village of Elim v. State*, 990 P.2d 1, 5 (Alaska 1999).

⁹ *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)).

¹⁰ *Union Oil Co. of Cal. v. Dep't of Revenue*, 560 P.2d 21, 25 (Alaska 1977).

¹¹ 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).

¹² 961 P.2d 399 (Alaska 1998).

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. [¹⁴]

This canon, requiring a narrow construction of tax credits, applies to all types of taxes including, the Fisheries Business tax.¹⁵

F. Narrow Construction of Salmon Product Development Tax Credit

DOR interpretation of the Salmon Product Development Tax Credit, as that credit applies to the dispute equipment purchases in this case, is a narrow construction of the scope of the credit. It is understandable that Snopac could read the statute and expect that some of the disputed items would qualify for the credit. However, both the language of the statute granting the credit, when read carefully as a whole, and the legislative history of that statute, support DOR's narrow construction of the credit.

As noted above, the language of the statute requires that in order for a piece of equipment to be a "qualified investment" it must be "used predominantly to perform an ice making, processing, packaging, or product finishing function." The use of the active verb "perform" implies that the equipment itself has an active rather than a passive role in processing the fish. Equipment that is itself passive in that process, for example, merely providing space for needed supplies, are outside the scope of the definition of "qualified investment," especially if that statute is read to give a narrow construction of the scope of what expenses are covered by the tax credit.

¹³ *Id.* at 409.

¹⁴ *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).

¹⁵ *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).

1. Ejusdem Generis

When interpreting a statute, the legal maxim “ejusdem generis” provides the common sense perspective that when a statute lists specific things in a class and also refers to the class in general terms, it can be inferred that the more general statements only apply to the types listed.¹⁶

Applying this maxim to the language of Salmon Product Development Tax Credit also supports a narrow reading of the scope of the credit. While the general “used predominantly” language in AS 43.75.035(j)(3), describing qualified investments could, as the taxpayer does, be read to include any equipment dedicated to the filleting process, the portion of the statute that lists specific types of equipment that do qualify for the tax credit shows that a more narrow scope is intended. The statute provides two lists of examples of types of equipment, one containing items that qualify and one containing items that do not. The types of equipment within each list share characteristics with each other that are not shared with the equipment in the other list. These shared characteristics are inconsistent with the broad reading of the scope of the tax credit argued by Snopac.

Under AS 43.75.035(j)(3)(A)(i), the first list of specific types of equipment that do qualify for the credit are all types of new equipment that have contact with the fish and have an active role in the filleting process that begins with the filleting machine. This first list includes equipment for filleting, skinning, portioning, mincing, forming, extruding, stuffing, injecting, mixing, marinating, preserving, drying, smoking, brining, packaging, blast freezing, or pin bone removal.

Three other types of equipment are then listed separately in their own sections (ii), (iii) and (iv). These separately listed items are not all new, do not all have an active role in, and are all not parts of the filleting process that begins with the filleting machine. These separately listed types of equipment are; (ii) new parts to convert an existing can seamer to pop-top can production conveyors specifically used in the value-adding process; (iii) ice making machines; and (iii) conveyors used specifically in the act of producing a value-added product.

The can seamer conversion is an exception to the requirement that equipment be new. The ice machines are part of the process that begins before the filleting machine. The separate section including conveyors specifically used in the value-adding process was added in separate legislation in order to clarify that this is an exception to the general rule that conveyors do not

qualify for the credit.¹⁷ These three types of equipment do not take away from the guidance provided by the first list that is limited to types of equipment that have contact with the fish and have an active role in the filleting process that begins with the filleting machine. Rather, these separately listed items are set out in a way that indicates that they are specific exceptions to the implied requirement that equipment must share the characteristics of the first list in order to qualify.

The part of the statute that lists specific types of new equipment that do not qualify for the tax credit also shows that a narrow scope is intended. This list includes vehicles, forklifts, conveyors not used in the value-adding process, cranes, pumps, or other equipment used to move salmon or salmon products, knives, gloves, tools, supplies and materials, equipment, other than ice making machines, that are not processing, packaging, or product finishing equipment, or other equipment only incidentally used in the value adding process. This list, found in AS 43.75.035(j)(3)(B)(i), of specific types of new equipment that do not qualify for the credit in the definition of qualifying “property” encompasses types of equipment that have contact with the fish in the filleting process that are used in the processing of fillets, but do not have a useful life of three years or do not have an active role to the process that begins with the filleting machines. Equipment that is used to transporting salmon but is not actually processing salmon, and equipment that is incidental to processing are also specifically excluded.

Legislative History

DOR testimony before the legislature on the bill that extended the Salmon Product Development Tax Credit to 2011, and added certain conveyors to the list of equipment that qualified for the credit, is consistent with the narrow construction of the scope of the credit that was applied to the disputed equipment in this case. When this bill, HB 321, was heard in the House Fisheries Committee, DOR explained its narrow construction of the credit, that is, that the credit is limited to equipment that actively performed the processing of the filleted salmon, and does not include equipment that filled a passive or secondary, or incidental role in processing, such as a table used in the filleting process even if that table was part of the fillet line. This explanation was given to show why the bill needed to specifically add the conveyor belt that

¹⁶ *Northern Alaska Env'tl. Ctr. v. State, Dept. of Natural Res.*, 2 P.3d 629, 636 (Alaska 2000).

¹⁷ See The discussion of the legislative history of HB 321 that follows.

move the salmon along the fillet line as an exception to this limitation in order to for that conveyor to qualify for the credit as the bill sponsor intended.¹⁸

DOR later explained in response to a question about the scope of the credit that DOR had some concern that the language of the bill should perhaps make it clearer that the credit did not extend to conveyors that were used to move salmon to the fillet processing line. There was then discussion by the committee, including discussion that the intent of the conveyor language was to make the conveyor that brought the salmon past the workers who are doing the fillet processing qualify for the credit, even though it was the workers rather than the conveyor that did the processing work. This discussion ended with conclusion that the words “specifically” and “in the act of producing,” in the language intended to give a credit for the conveyors that the fillet processing workers sit at, addressed DOR’s concern that the credit did not cover conveyors that move salmon to the fillet processing line.

Snopac’s understanding that DOR’s testimony before the committee implied that any part of what it views as the fillet line is covered by the credit is simply incorrect. DOR explained that only equipment that played an active role in the filleting process was covered and that, without specific language including it, even the conveyor would not be covered. DOR’s discussion regarding its intent to exclude conveyors and other equipment bring fish to processing also shows that DOR and the committee did not have the expectation that the language would cover equipment, other than the ice machines, used before the process that begins with the fillet machine.

The discussion in the House Fisheries Committee and DOR’s unchallenged explanation of its interpretation of the scope of the credit are consistent with the limiting the credit to equipment that performs an active role in the process that begins with the filleting machine. The same limitation is implied by the use of the active verb “perform” in the statutory requirement that qualified equipment must perform a processing function, as well as by the shared characteristics of the types of equipment that are specifically included and excluded.

G. The Disputed Equipment Does Not Qualify

As discussed below, given that this narrow construction of the scope of the credit is correct, none of types of equipment in dispute meets the requirements for the Salmon Product Development Tax Credit.

¹⁸ The relevant minutes of the House Fisheries Committee are found at Exhibit 2.c. at pages 46-48.

1. Knives

Snopac argued that the knives it claimed the credit for were exclusively used in fillet processing. There is no reason to doubt this, but as noted above, knives are among the types of equipment expressly listed in the statutes as disallowed. Moreover, this is not the type of equipment that is expected to last three years, and therefore would not normally be characterized as a capital investment.

2. Repair Kits

Similar to knives, repair kits would be used in overhauling equipment once it has been in service, and could not be characterized as an initial start-up capital investment for value-added processing.

3. Tote Dumper

At the hearing Snopac correctly agreed that the tote dumper is not a qualified investment.

4. De-icer with Flume

The deicer is a ramp made of metal bars that the iced and aged salmon slide down while the ice falls off. The deicer's function is primarily a transportation function. While ice is removed from aged salmon during that transportation so that the pin bone machine is more effective, the de-icer with flume is primarily a means of transporting the salmon to the collaring table. The de-icer with flume could be characterized as gravity conveyor that also separates ice from the fish before the filleting process begins. The separation function it performs is fairly passive. The ice just falls off the fish as they slide down the ramp. To the extent that the de-icer is a conveyor, it is a conveyor that transports the Salmon to the collaring table. This happens before the fish have are put through the filleting machine. Conveyors and other transportation equipment that bring salmon to the filleting process that begins with the filleting machine are not covered by the credit.

5. Collaring Table

The collaring table also serves a passive function that happens before the filleting process begins. Tables were specifically addressed in legislative discussions of this tax credit, with the general understanding being that they would not be covered.

6. Accumulation Table

The accumulation table holds the salmon before it is put through the filleting machine. It also serves a passive function in the filleting process.

7. Waste Conveyor

The waste conveyor does not have direct contact with the parts of the fish that are being processed into the value-added product. Rather, it carries away waste cut off of the fillet. Like conveyors that bring salmon to the line and those that take the salmon away after the process is complete, conveyors to take away waste products must be excluded.

8. Poly Sleeve Bin Storage

Poly sleeve bin storage units do not have direct contact with the fish during the processing nor do they play an active role in the processing of fillets.

V. Conclusion

DOR's Informal Conference Decision issued on August 25, 2011 is AFFIRMED.

DATED this 8th day of June 2012.

By: Signed _____
Mark T. Handley
Administrative Law Judge

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.¹⁹
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.²⁰
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.²¹
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.²²

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

¹⁹ Alaska Statute 43.05.465(f)(1).

²⁰ Alaska Statute 43.05.470.

²¹ Alaska Statute 43.05.470(b).

²² Alaska Statute 43.05.465 sets out the timelines for when this decision will become final.