



In 2010, Baywatch did not operate as a fisheries business in Alaska. It leased all of its fish processing equipment, including the Rollstock Machine and Pinbone Remover for which it received the tax credit, to Alaska General Seafoods, Inc. (AGS). In 2010, AGS did not use the qualifying equipment to process any salmon for sale. AGS did keep the qualifying equipment ready for use as backup at its Naknek facilities.<sup>3</sup> At the oral argument, Jack Miceli, the general manager of Baywatch, explained that equipment that is being kept ready as backup in a fish processing plant must be calibrated, sharpened, and otherwise prepared for use.<sup>4</sup> He noted that is particularly true of vacuum-packing machinery, which he described as “temperamental.”<sup>5</sup>

Before the fishing season began in 2011, Leader Creek Fisheries acquired the qualifying equipment from AGS. Leader Creek and AGS are affiliated companies with a common parent. During 2011, Leader Creek used the qualifying equipment to process salmon. In November 2011, Baywatch sold the qualifying equipment.

The Department of Revenue subsequently audited Baywatch. The Department determined that because the qualifying equipment was not used by Baywatch in 2010, the Department was required to recapture 75 percent of the tax credit Baywatch had received in 2008 and 2009. The Department assessed Baywatch with an additional tax owed for tax year 2010 of \$53,390.97. Baywatch’s first attempt to appeal the assessment was not timely. Baywatch then paid the assessment in full, and requested a refund. The Department denied the refund on January 12, 2012, and this appeal followed.

In this appeal, the parties agree that the dispute regarding the refund denial is purely a question of law. The parties agree on the facts, and submitted a joint stipulation of the facts regarding Baywatch’s ownership and use of the qualifying equipment. On September 16-17, 2013, the parties submitted cross-motions for summary adjudication.<sup>6</sup> Oral argument on the motions was held on September 20, 2013. Michael Barber represented the Department and Jack Miceli represented Baywatch.

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<sup>3</sup> *Id.*; Miceli statement. The Department agreed at oral argument that it would accept the additional statements of explanatory fact provided by Mr. Miceli during oral argument.

<sup>4</sup> Miceli statement.

<sup>5</sup> *Id.*

<sup>6</sup> Summary adjudication is appropriate when no material facts are in dispute and a party is entitled to a ruling as a matter of law. *In re Klawock Oceanside, Inc.*, OAH No. 10-0352-TAX at 2 (Office of Administrative Hearings 2012).

### III. Discussion

The State of Alaska imposes a tax on the activity of processing fish, called the “fisheries business tax.”<sup>7</sup> In 2003, the legislature adopted the “Salmon Product Development Credit, which allowed a qualifying fisheries business to deduct 50 percent of the cost of investment in qualifying equipment from its fisheries business tax liability.”<sup>8</sup> The purpose of the tax credit was to provide an incentive to the salmon industry to diversify into producing value-added salmon products.<sup>9</sup> The parties agree that Baywatch’s qualifying equipment was eligible for the credit in 2008 and 2009, when Baywatch itself used the equipment.

The dispute in this case is about the effect of Baywatch’s lease of the qualifying equipment to AGS in 2010. This effect is important because the credit includes a recapture provision under which a fisheries business would have to reimburse the state for some or all of the credit under certain conditions. If the action that triggered the recapture occurred in 2010, 75 percent of the credit would be recaptured.<sup>10</sup> If it occurred in 2011, 50 percent of the credit would be recaptured.<sup>11</sup> The recapture provision is triggered when, in a tax year, the equipment:

- “is disposed of by the taxpayer”;
- “ceases to be qualified investment property”; or
- “is removed from service in the state.”<sup>12</sup>

The division has determined that in tax year 2010, Baywatch’s qualifying equipment met all three of the triggering events—any one of which would be sufficient on its own to trigger the recapture provision. Baywatch, on the other hand, believes that none of the triggering events occurred until November 2011, when it sold the qualifying equipment.

#### **A. Did the qualifying equipment cease to be qualified investment property in 2010 when it was idle?**

In 2010, the qualifying equipment was not used to produce salmon products. The Department argues that the statute defining “qualified investment” requires that the equipment be

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<sup>7</sup> AS 43.75.015.

<sup>8</sup> AS 43.75.035.

<sup>9</sup> *See, e.g.*, Minutes, House Fisheries Committee (Feb. 26, 2003).

<sup>10</sup> AS 43.75.035(g)(2).

<sup>11</sup> AS 43.75.035(g)(3).

<sup>12</sup> AS 43.75.035(g).

“used” to produce value-added salmon products.<sup>13</sup> Equipment that is not used ceases to be qualified investment.

Baywatch does not disagree that the statute requires use, but argues that the equipment was employed on a stand-by basis in 2010 and then used in 2011 to actually produce value-added product. The nature of the industry, and the unpredictability of the salmon run, means that all fish processors must have some redundant equipment to be able to cope with both equipment breakdowns and sudden influxes of product. Standby equipment is not discarded equipment—it must be calibrated and tuned so that it is ready to use when needed. In Baywatch’s view, the increase recognizes “standby” as a legitimate use, so standby use should qualify for the tax credit.

This issue is similar to the issue addressed in *In re Klawock Oceanside, Inc.*<sup>14</sup> In *Klawock*, the taxpayer had purchased qualifying equipment, and performed some tests to ensure that the equipment would be ready for the upcoming year.<sup>15</sup> Because of an unexpected change in market conditions, however, the taxpayer was not able to use the equipment as intended in the first year of ownership.<sup>16</sup> The taxpayer argued that it should remain eligible for the tax credit. It asserted that disallowing the credit when market conditions caused the disuse would transfer all the market risk to the taxpayer, and create a disincentive to the purchase of new equipment. That disincentive would be contrary to the intent of the legislature to encourage investment.<sup>17</sup>

*Klawock* rejected the taxpayer’s argument, and held that the statute requires “the taxpayer to actually use the equipment to produce value added products.”<sup>18</sup> *Klawock* acknowledges that the decision could put taxpayers at a risk of loss due to the uncertainties of the fishing industry, but found no evidence that the legislature intended to insure against such a loss by allowing idle equipment to remain eligible for the tax credit.<sup>19</sup>

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<sup>13</sup> “Qualified investment” means “the investment cost in depreciable personal property with a useful life of three years or more to be used predominately to perform a processing, packaging, or product finishing function that is a significant component in producing value-added salmon products beyond gutting of the salmon.” AS 43.75.035(j)(3). Recapture is triggered when property “ceases to be qualified investment property.” AS 43.75.035(g).

<sup>14</sup> *In re Klawock*, OAH No. 10-0352-TAX.

<sup>15</sup> *Id.* at 1.

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 6.

<sup>18</sup> *Id.* at 7.

<sup>19</sup> *Id.*

The general rule is that tax credits are to be narrowly construed against the taxpayer.<sup>20</sup> *Klawock* held that the Salmon Product Development Credit should be construed narrowly.<sup>21</sup> Consistent with approach, here, Baywatch’s argument is somewhat weaker than that of the taxpayer in *Klawock*. If Baywatch needed redundant equipment, it could have avoided the loss of the credit by using the qualifying equipment to process value-added products, and then keeping older, non-qualifying equipment standby. That Baywatch did not have control of the equipment because it had leased it only makes the case for disallowance of the credit stronger—as *Klawock* held, to qualify for the credit, “the taxpayer [must] actually use the equipment.”<sup>22</sup>

Applying the holding of *Klawock* to the facts at issue here, the tax credit requires actual use of the equipment by the taxpayer to process value-added products. Idle equipment, even if it is prepped and ready for use, is not actually used. Because the qualifying equipment was no longer qualified investment in 2010, the Department’s denial of Baywatch’s request for a refund is affirmed.

**B. Was the qualifying equipment removed from service in the state in 2010?**

The Department also argues that the recapture provision was triggered because during the 2010 tax year, the qualifying equipment was removed from service in the state when it sat idle for an entire tax year. Baywatch disagrees, asserting that this triggering provision applies only to removal of equipment from the state by floating processors. Because the equipment remained in the state, in Baywatch’s view, it was not removed from service in the state for purposes of this provision.

Baywatch argues that this triggering provision does not say “removed from service.” It says “removed from service in this state.” Yet, if the legislature’s intent was only to reach removal from the state, the trigger would have said “removed from the state.” Here, either “removed from service” or “removed from the state” can trigger the recapture. Equipment that is

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<sup>20</sup> *State, Dep’t of Rev. v. OSG Bulk Ships, Inc.*, 961 P.2d 399, 409 (Alaska 1998); *C.f.*, e.g., *In re Renaissance Umiat, LLC*, OAH No. 10-268-TAX at 4 (Office of Admin. Hearings 2011).

<sup>21</sup> *In re Klawock*, OAH No. 10-0352-TAX at 4.

<sup>22</sup> *Id.* at 7.

idle for an entire tax year is removed from service.<sup>23</sup> Therefore, this trigger provides an alternative ground for affirming the Department's denial of Baywatch's request for a refund.<sup>24</sup>

#### **IV. Conclusion**

Baywatch's action of leasing the qualifying equipment in 2010 to a company that did not use the equipment to produce value added salmon products that year means that the equipment was removed from service in the state, and ceased to be a qualified investment. Therefore, the Department correctly determined that 75 percent of the Salmon Product Development Credit that Baywatch applied to its fisheries business tax in 2008 and 2009 should be recaptured. The Department's motion for summary adjudication is granted and its denial of Baywatch's request for a refund of the recaptured credit is affirmed.

Dated this 25<sup>th</sup> day of October, 2013.

By: Signed  
Stephen C. Slotnick  
Administrative Law Judge

#### **NOTICE**

This is the decision of the Administrative Law Judge under AS 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.<sup>25</sup>

A party may request reconsideration in accordance with AS 43.05.465(b) within 30 days of the date of service of this decision.

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.<sup>26</sup> 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.<sup>27</sup>

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<sup>23</sup> At oral argument the Department agreed that qualifying equipment that is used for only one day in a tax year would not be considered removed from service during the tax year.

<sup>24</sup> The Department also argues that Baywatch disposed of the equipment in 2010 when it leased the equipment to AGS. Given that the recapture provision is triggered by the fact that the taxpayer did not use the equipment in 2010, it is not necessary to reach the issue of whether a lease is a disposal.

<sup>25</sup> AS 43.05.465(f)(1).

<sup>26</sup> AS 43.05.470.

<sup>27</sup> AS 43.05.470(b).

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with AS 43.05.480 within 30 days after the date on which this decision becomes final.<sup>28</sup>

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

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<sup>28</sup> AS 43.05.465 set out the timelines for the decision becoming final.