

**BEFORE THE COURT OF TAX APPEALS
STATE OF KANSAS**

IN THE MATTER OF THE
APPLICATION OF MCPHERSON
DRILLING FOR EXEMPTION FROM
AD VALOREM TAXATION IN
MONTGOMERY COUNTY, KANSAS

Docket No. 2009-156-TX

ORDER

Now the above-captioned matter comes on for consideration and decision by the Court of Tax Appeals of the State of Kansas. An evidentiary hearing was conducted July 15, 2009. The taxpayer, McPherson Drilling, appeared by Ronald and Nancy McPherson. The county appeared by its attorney of record, Paul Kritz. Appearing as witnesses for the county were Kathy Craig of the Montgomery County Appraiser's office and Lynn Kent of the Department of Revenue, Property Valuation Division (PVD).

This court has jurisdiction of the subject matter and the parties pursuant to K.S.A. 2008 Supp. 79-213.

The subject matter of this tax exemption application is described as follows:

Certain tangible personal property described as three 2006 Gefco drilling rigs and one 2007 Schramm drilling rig located as of January 1, 2007, in Cherryvale, Montgomery County, Kansas.

The applicant requests exemption from *ad valorem* taxation pursuant to K.S.A. 2008 Supp. 79-223 *First*. That statute exempts certain "commercial and industrial machinery and equipment" acquired after June 30, 2006.

The applicant originally requested exemption for all four drilling rigs listed in the written application; however, at the hearing the applicant acknowledged that two of the four rigs described in the written application were purchased before June 30, 2006. The applicant therefore abandoned its exemption request in respect to the two rigs acquired before the effective date of the exemption statute.

The applicant states in its written submission that the subject drilling rigs are used for "drilling oil and gas wells." The applicant contends the two rigs acquired after the effective date of K.S.A. 2008 Supp. 79-223 should be exempt

under that statute because the rigs fall within the common definition of the term “commercial and industrial machinery and equipment.” The applicant offers no additional arguments or legal authorities to support the exemption.

The county appraiser states in its written submission that it does not dispute the facts as stated by the applicant. Still, based on the undisputed facts, the county recommends that the exemption be denied.

At the hearing, county witness Kathy Craig testified that drilling rigs are not exempted by the county appraiser, explaining that such equipment has a long history of being rendered as “schedule 2 itemized equipment.” County witness Lynn Kent, who specializes in oil and gas valuation for PVD, testified that drilling rigs have, since 1965, been classified and taxed in Kansas as part of the mineral leasehold. The county offered no legal authority or argument to support its denial of the exemption.

From the outset we note that all property in this state that is not expressly exempt is taxable. *See* K.S.A. 79-101. The fundamental rule in Kansas is that tax exemption statutes shall be construed strictly in favor of taxation and against exemption and the burden of establishing exemption from taxation rests with the applicant. *See In re Application of Central Kansas E.N.T. Associates, P.A.*, 275 Kan. 893, 897, 69 P.3d 595 (2003); *Director of Taxation v. Kansas Krude Oil Reclaiming Co.*, 236 Kan. 450, 454, 691 P.2d 1303 (1984); *see also Manhattan Masonic Temple Ass’n v. Rhodes*, 132 Kan. 646, 296 P. 734 (1931). Uniformity and fairness in property taxation depends just as much on uniform application of exemption law as uniformity in taxation. *See Topeka Cemetary Ass’n v. Schnellbacher*, 218 Kan. 39, 43, 542 P.2d 278 (1975).

Upon review of the record evidence, including the verified written submissions and oral testimony, this court finds no material factual dispute. The dispute in this case is solely a question of law: Does the term “commercial and industrial machinery and equipment” as used in K.S.A. 2008 Supp. 79-223(d)(2) extend exemption status to the subject drilling rigs?

K.S.A. 2008 Supp. 79-223(d)(2) defines “commercial and industrial machinery and equipment” as “property classified for property tax purposes within subclass (5) of class 2 of section 1 of article 11 of the constitution of the state of Kansas.” Thus, in order to determine whether the subject drilling rigs are exempt, we must look to the classifications identified in article 11 of our state’s constitution.

Article 11, section 1(a) provides in pertinent part as follows:

Class 2 shall consist of tangible personal property. Such tangible personal property shall be further classified into six subclasses, shall be defined by law for the purpose of subclassification and assessed uniformly as to subclass at the following percentages of value:

- (1) Mobile homes used for residential purposes: 11 1/2%
- (2) Mineral leasehold interests except oil leasehold interests the average daily production from which is five barrels or less, and natural gas leasehold interests the average daily production from which is 100 mcf or less, which shall be assessed at 25% : 30%
- (3) Public utility tangible personal property including inventories thereof, except railroad personal property including inventories thereof, which shall be assessed at the average rate all other commercial and industrial property is assessed: 33%
- (4) All categories of motor vehicles not defined and specifically valued and taxed pursuant to law enacted prior to January 1, 1985: 30%
- (5) Commercial and industrial machinery and equipment which, if its economic life is seven years or more, shall be valued at its retail cost when new less seven-year straight-line depreciation, or which, if its economic life is less than seven years, shall be valued at its retail cost when new less straight-line depreciation over its economic life, except that, the value so obtained for such property, notwithstanding its economic life and as long as such property is being used, shall not be less than 20% of the retail cost when new of such property: 25%
- (6) All other tangible personal property not otherwise specifically classified: 30%

The classification and subclassification provisions under article 11 are expressed in broad terms and, like most constitutional provisions, are not without ambiguity. For example, subclass (2) of class 2 is identified as "mineral leasehold interests." In Kansas, mineral leasehold interests are intangible personal property. *See Ingram v. Ingram*, 214 Kan. 415, 419, 521 P.2d 254 (1974). Yet subclass (2) is listed under class 2 property, and class 2 property is identified as *tangible* personal property. Thus, under a literal interpretation subclass (2) would be rendered incongruous with its general class 2 designation. Further, we note that subclass (5), identified generally as "commercial and industrial machinery and equipment," is so broadly drawn that it could conceivably embrace tangible personal property within any of the other five subclasses of class 2 property.

This court recognizes the rule of interpretation instructing that the intent of the legislature controls if the intent can be ascertained from the plain language of

the statute. See *State ex rel. Stovall v. Meneley*, 271 Kan. 355, 378, 22 P.3d 124 (2001). We also recognize that, when interpreting a statutory provision, ordinary words are to be given their ordinary meanings. See *State v. Stallings*, 284 Kan. 741, 742, 163 P.3d 1232 (2007). Still, in cases where the ordinary meaning of codified language leads to an unreasonable or impracticable interpretation, it is appropriate to apply more flexible rules of interpretation. This is particularly true where, as here, the provision in question is a constitutional provision.

The rules governing interpretation of constitutional provisions differ from those governing ordinary statutory provisions. Constitutions are organic laws and, as such, provide a general framework for governance. It has long been held that the polestar in the construction of constitutional provisions is the intention of the makers and adopters. *Hunt v. Eddy*, 150 Kan. 1, 90 P.2d 747 (1939). When interpreting constitutional provisions, a court must adopt a construction that takes into account the attendant circumstances. See *id.* The meaning of a constitutional provision must be “gathered from both the *letter* and the *spirit* of the document.” *Id.* (emphasis original).

Based on settled rules of constitutional interpretation, we find it appropriate here to interpret the constitutional provisions in question in keeping with the surrounding facts and circumstances that gave rise to the provision’s enactment. See *In re Cent. Illinois Public Services Co.*, 276 Kan. 612, 612, 78 P.3d 419 (2003). It would be improper for this court to ignore the historical context of article 11 in favor of a rigid, technical construction of the text. See *Hunt*, 150 Kan. at 1 (Constitutional provisions should be construed so as to give them “effective operation and suppress the mischief at which [they] are aimed.”)

As noted above, in enacting K.S.A. 2008 Supp. 79-223(d)(2), the legislature chose to define “commercial and industrial machinery and equipment” by referencing the Kansas constitution, specifically subclass (5) of class 2 of section 1 of article 11. No additional definitional guidance is provided. Article 11 was amended in 1986 by means of House Concurrent Resolution 5018, which passed by a large margin of the voting electorate. This initiative created the property classification scheme that exists today.¹

Article 11 classifies property as either real property or tangible personal property and divides each classification into various subclasses. The 1986 amendment was enacted in conjunction with statewide reappraisal. At the time, a commission called the Kansas Tax Review Commission was formed to advise the legislature on exigent property tax issues. After performing an extensive study of

¹ Article 11 was amended again in 1992, but that amendment left the fundamental classification structure intact, changing only the rates of assessment applicable to the various subclasses.

tax statistics, the Commission concluded that statewide reappraisal was indeed appropriate because property was not being taxed uniformly and equally throughout the state. *See* Kansas Tax Review Commission, *Final Report and Recommendations*, P-5 (1985). Further, the Commission concluded that additional changes in the law were necessary to mitigate the shifts in tax burden among the various classes of property that would inevitably result from reappraisal. *See id.* at P-6. According to the Commission report, “[C]hanges in the distribution of the tax burden occasioned by reappraisal were likely to be of such magnitude that they are best addressed through a comprehensive, straightforward classification system.” *See id.* at P-9. The Commission explained: “[C]lassification offers the best opportunity to introduce certain tax policy and economic considerations into the distribution of the property tax burden and to avoid sanctioning a property tax distribution developed through historical accident.” *See id.*

No legislative history has been presented in this case to suggest that the Kansas legislature ever intended to substantively redefine the criteria used by taxing authorities to classify property for purposes of *ad valorem* taxation. In fact, the Kansas Tax Review Commission’s final report suggests the opposite – that the amendment’s purpose was to mitigate the anticipated disproportionate effects of reappraisal on *existing* classes of property throughout the state.

In addition to the historical evidence found in the Kansas Tax Review Commission’s final report, it also is useful to review the regulatory framework governing property taxation at the time the 1986 constitutional amendment was enacted. In particular, we note that since 1917, Kansas law has provided for oil and gas leases and wells and “all casing tubing or other material therein, and all other equipment and material used in operating” the wells to be assessed and taxed as personal property. Also, notably, at the time the amendment was enacted, county appraisers were delegated – as they are today – wide-ranging duties and authority, including the duty to subclassify all taxable and exempt real and personal property “in a manner prescribed by the director of the division of property valuation.” *See* K.S.A. 2008 Supp. 79-1459(e); *see also* K.S.A. 79-1402 (granting director of property valuation general supervision over the system of taxation throughout the state).

According to county witness Lynn Kent of PVD, the *Kansas Oil and Gas Appraisal Guide*, published under the authority of the director of property valuation, instructs that drilling rigs such as the subject property are to be valued as part of the oil and gas leasehold interest. Ms. Kent also testified that drilling rigs have been classified and taxed in this manner since 1965. The applicant has come forward with no evidence to dispute Ms. Kent’s testimony.

Finally, we note that, in conjunction with enacting K.S.A. 2008 Supp. 79-223, the legislature enacted K.S.A. 2008 Supp. 79-224. That provision exempts from

property tax certain telecommunications machinery and equipment, as well as railroad machinery equipment as defined under subclass (3) of class 2 of section 1 of article 11 of the Kansas Constitution. The rule *expressio unius* instructs that the inclusion of one thing implies the exclusion of another. *In re W.H.*, 274 Kan. 813, 815, 57 P.3d 1 (2002). Here it should be noted that, in addition to exempting all subclass 5 industrial and commercial machinery and equipment pursuant to K.S.A. 2008 Supp. 79-223, the legislature also chose to exempt, pursuant to K.S.A. 2008 Supp. 79-224, certain subclass 3 machinery and equipment. This court must therefore assume that if the legislature had intended to exempt machinery and equipment included in any other subclass of tangible personal property, it would have done so explicitly by statute. The inclusion of subclass 5 and subclass 3 machinery and equipment within the exemption implies the exclusion of subclass 2 (oil and gas) machinery and equipment.

The applicant has the burden of proof and may prevail only if the subject property clearly qualifies for exemption. Tax exemption statutes must be strictly construed in favor of taxation. The applicant has provided no evidence or authority to show that the subject drilling rigs were intended to be covered under the 2006 legislation exempting certain commercial, industrial, telecommunications and railroad machinery equipment. The applicant has failed to satisfy its burden.

IT IS THEREFORE ORDERED that the application for exemption from ad valorem taxation is denied.

Any party to this action who is aggrieved by this decision may file a written petition for reconsideration with this Court as provided in K.S.A. 2008 Supp. 77-529. The written petition for reconsideration shall set forth specifically and in adequate detail the particular and specific respects in which it is alleged that the Court's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for reconsideration shall be mailed to: Secretary, Court of Tax Appeals, Docking State Office Building, Suite 451, 915 SW Harrison St., Topeka, KS 66612-1505. A copy of the petition, together with any accompanying documents, shall be mailed to all parties at the same time the petition is mailed to the Court. Failure to notify the opposing party shall render any subsequent order voidable. The written petition must be received by the Court within fifteen (15) days of the certification date of this order (allowing an additional three days for mailing pursuant to statute). If at 5:00 pm on the last day of the specified period the Court has not received a written petition for reconsideration of this order, no further appeal will be available.

IT IS SO ORDERED



THE KANSAS COURT OF TAX APPEALS

Bruce F. Larkin

BRUCE F. LARKIN, CHIEF JUDGE

Fred Kubik

FRED KUBIK, JUDGE

Trevor C. Wohlford

TREVOR C. WOHLFORD, JUDGE PRO TEM

Joelene R. Allen

JOELENE R. ALLEN, SECRETARY

CERTIFICATE OF SERVICE

I, Joeline R. Allen, Secretary of the Court of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of this order in Docket No. 2009-156-TX, and any attachments thereto, was placed in the United States Mail, on this 20th day of August, 2009, addressed to:

Ronald McPherson
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IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka, Kansas.


Joeline R. Allen, Secretary