BEFORE THE BOARD OF TAX APPEALS OF THE STATE OF KANSAS

IN THE MATTER OF THE APPEAL OF GENESIS HEALTH CLUB/AKINS PRINTING – ET AL., FROM AN ORDER OF THE DIVISION OF TAXATION ON ASSESSMENT OF SALES/USE TAX

Docket No. 2005-62-DT

IN THE MATTER OF THE APPEAL OF GENESIS HEALTH CLUB/WESTAR ENERGY, ET AL., FROM AN ORDER OF THE DIVISION OF TAXATION ON ASSESSMENT OF SALES/USE TAX

Docket No. 2003-9597-DT thru 2003-9614-DT

ORDER ON THE KANSAS DEPARTMENT OF REVENUE'S MOTION FOR SUMMARY JUDGMENT AND GENESIS' CROSS-MOTION FOR SUMMARY JUDGMENT

COMES NOW this cause before the Kansas State Board of Tax Appeals (the "Board") on motion for summary judgment filed by the Kansas Department of Revenue (the "Department") on October 30, 2006, and on cross motion for summary judgment filed by Genesis, *et al.*, on November 17, 2006. Having considered the motions and all supporting memoranda and evidence filed therewith, and the applicable law, it is hereby

ORDERED AND ADJUDGED that, for the reasons set forth hereinafter, the Department's motion for summary judgment is granted and Genesis' cross-motion for summary judgment is denied for the reasons set forth hereunder.

The subject matter of these appeals is described as follows:

2003-09597-DT	REV.S DOCKET NO. 03-0209
2003-09598-DT	REV.S DOCKET NO. 03-0210
2003-09599-DT	REV.S DOCKET NO. 03-0211
2003-09600-DT	REV.S DOCKET NO. 03-0212
2003-09601-DT	REV.S DOCKET NO. 03-0213
2003-09602-DT	REV.S DOCKET NO. 03-0563
2003-09603-DT	REV.S DOCKET NO. 03-0564
2003-09604-DT	REV.S DOCKET NO. 03-0565
2003-09605-DT	REV.S DOCKET NO. 03-0566
2003-09606-DT	REV.S DOCKET NO. 03-0567
2003-09607-DT	REV.S DOCKET NO. 03-0568
2003-09608-DT	REV.S DOCKET NO. 03-0569
2003-09609-DT	REV.S DOCKET NO. 03-0570
2003-09610-DT	REV.S DOCKET NO. 03-0571

2003-09611-DT	REV.S DOCKET NO. 03-0572
2003-09612-DT	REV.S DOCKET NO. 03-0573
2003-09613-DT	REV.S DOCKET NO. 03-0574
2003-09614-DT	REV.S DOCKET NO. 03-0575
2005-00062-DT	REV.S DOCKET NO. 03-0743
	REV.S DOCKET NO. 03-0756
	REV.S DOCKET NO. 03-0757
	REV.S DOCKET NO. 03-0758
	REV.S DOCKET NO. 03-1229
	REV.S DOCKET NO. 03-1230
	REV.S DOCKET NO. 03-1231
	REV.S DOCKET NO. 03-1232
	REV.S DOCKET NO. 03-1234
	REV.S DOCKET NO. 03-1236

I.
Uncontroverted Facts

The Department's memorandum lists 137 facts upon which it relies for its motion. Genesis does not controvert the facts as set forth in the Department's memorandum and it provides in its responsive memorandum 31 additional facts. The Department alleged many of Genesis' additional facts consisted of legal argument, conclusory statements, and statements of law. In turn, Genesis alleged the Department's controversions were not properly supported by sufficient evidence. Upon review of Genesis' additional statements of fact and the Department's controversions thereof, the Board finds that both contain substantial argument, legal conclusions, factually unsupported assertions, or other non-factual statements. The Board finds the material facts, however, to be uncontroverted.

A summary of the material facts is as follows. Genesis is a private, for-profit health club with four locations in Wichita, Kansas. Genesis sells memberships that allow either an all-inclusive or limited access to the various locations and their respective services. The memberships entitle the member to access Genesis' facilities as well as take part in some services, depending on the membership class. Some services require an additional pre-paid fee. Members are not charged more based on their actual use of the facilities. To obtain access to a location and its facilities, members either present a membership card or Genesis' staff will search its records for their name. All members have equal rights to the use of facilities during business hours. Members are subject to several rules Genesis imposes at its facilities.

Genesis' facilities may include weight training equipment, exercise machines, one or more swimming pools, tennis courts, racquetball courts, volleyball courts, basketball courts, a dry sauna, a wet steam room, locker rooms with showers, tanning rooms with tanning beds, meeting rooms, a lounge, a concession stand, a kitchen, a laundry room, a daycare, group fitness rooms, staff offices, and off-limits storage or machinery areas. Genesis does not provide refunds if facilities are unavailable to members due to reasons such as mechanical failure. Access to exercise machines during heavy use periods is on a

first-come, first served basis, and members may not have access to a machine during such periods.

During business hours, most lights at the facilities are turned on. The owner and staff program the lighting control panels, and members cannot control the lighting. The pools are heated on a continual basis, and the saunas and steam rooms are kept at a preset temperature. Some exercise machines, and televisions in front of exercise machines, require electric power. Members may manually turn on the whirlpool jets, the sauna lights, and the steam room lights. Genesis controls the air temperature at each location, and members do not have access to the thermostats. Genesis is required to follow the City of Wichita's regulations regarding the pools and tanning beds.

Genesis mails a quarterly newsletter to members, provided at no additional cost as part of their membership. If a member does not receive a copy, the member may receive a replacement copy. The newsletters are also set out in the lobby areas of at least 2 Genesis locations for members or their guests to pick up.

Genesis uses several different chemicals to kill organisms in the pool water, to avoid foaming in the whirlpool, and to maintain the pH balance of the pool water. The large pools are only filled up with water annually. Genesis uses water primarily for the showers, as well as for laundry and water fountains. Genesis uses natural gas to heat the water for showers and to heat the facilities during cold weather, and such natural gas is used up instantaneously.

Some members do not use Genesis' showers, and some do. Some members may not use Genesis' towels or may bring their own, while the majority of members do use the towels. Members may not take towels from Genesis' facilities, are not charged extra for excess towel usage, and do not receive a dues discount if they do not use the towels. The towels are discarded after six months. Genesis uses laundry detergent to wash the towels. Laundry detergent is used up instantaneously. Genesis also purchased a sprinkler inspection.

For the time period in question (November 1999 to August 2002), Genesis charged, collected and remitted Kansas Retailers' Sales Tax on all monthly dues and charges for those services subject to Kansas sales tax. On December 2, 2002, Genesis filed refund claims, which the Department denied. On August 14, 2003, Genesis filed the instant appeals with the Board.

Genesis seeks exemption pursuant to K.S.A. 79-3606(m) and (n) for nine items used in its health club facilities: 1) electricity; 2) natural gas; 3) water; 4) pool chemicals; 5) laundry detergent; 6) hand and bath towels; 7) soap and shampoo; 8) newsletters; and 9) a sprinkler inspection.

This Board heard oral arguments on the parties' summary judgment motions on February 8, 2007. Genesis filed a motion for a protective order on November 6, 2006, but withdrew the motion on the record during oral arguments.

II.
Analysis

The standard of review for summary judgment is well known:

> "Summary judgment is appropriate when the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. The trial court is required to resolve all facts and inferences which may reasonably be drawn from the evidence in favor of the party against whom the ruling is sought. When opposing a motion for summary judgment, an adverse party must come forward with evidence to establish a dispute as to a material fact. In order to preclude summary judgment, the facts subject to the dispute must be material to the conclusive issues in the case. [Internal quotations and citation omitted.]" *Nungesser v. Bryant*, 153 P.3d 1277, 1288, 283 Kan. 550 (2007). See K.S.A. 60-256(c).

In the instant case, the parties largely agree as to the material facts of the case and assert that the matter is ready for summary judgment. The Board finds there is no genuine issue as to any material fact as set forth by both parties in their respective memoranda. As such, the Board finds these motions to be ripe for summary judgment.

From the outset it should be noted that in Kansas, taxation is the rule and exemption is the exception. *Assembly of God v. Sangster*, 178 Kan. 678, 680, 290 P.2d 1057 (1955). The burden of establishing an exemption from taxation rests with the party claiming exemption. *Director of Taxation v. Kansas Krude Oil Reclaiming Co.*, 236 Kan. 450, 454, 691 P.2d 1303 (1984). Tax exemption statutes are to be construed strictly in favor of imposing the tax and against allowing the exemption for an applicant who does not clearly qualify. *Br. of Sedgwick Co. Comm'rs v. Action Rent to Own, Inc.*, 266 Kan. 293, 301, 969 P.2d 844 (1998).

K.S.A. 2006 Supp. 79-3606(m) and (n) provide, in relevant part, that exempt sales include:

> "(m) all sales of tangible personal property which become an ingredient or component part of tangible personal property or services produced, manufactured or compounded for ultimate sale at retail within or without the state of Kansas[...].
>
> "(n) all sales of tangible personal property which is consumed in the production, manufacture, processing, mining, drilling, refining or compounding of tangible personal property, the treating of by-products or wastes derived from any such production process, the providing of services or the irrigation of crops for ultimate sale at retail within or without the state of Kansas[...]."

K.S.A. 2006 Supp. 79-3602(p) defines an "ingredient or component part" as "tangible personal property which is necessary or essential to, and which is actually used in and becomes an integral and material part of tangible personal property or services produced, manufactured or compounded for sale by the producer, manufacturer or compounder in its regular course of business."

K.S.A. 2006 Supp. 79-3602(dd) defines "property which is consumed," in relevant part, as "tangible personal property which is essential or necessary to and which is used in the actual process of and consumed, depleted or dissipated within one year in . . . (2) the providing of services [...]." Electricity, gas, and water are examples of tangible personal property that qualify as "property which is consumed." See K.S.A. 79-3602(dd)(B).

In *Southwestern Bell Tel. Co. v. State Commissioner of Revenue & Taxation*, 168 Kan. 227, 212 P.2d 363 (1949), the applicant Southwestern Bell sought an exemption from compensating tax on equipment it purchased to use in providing its telephone service to its customers. Similar to Genesis' arguments in this case, Southwestern Bell argued that the property in question, including telephones installed in customers' premises, instruments, poles, and wires, "is used and enters into the processing of and becomes an ingredient of the service it furnishes." *Southwestern Bell*, 168 Kan. at 232. The Kansas Supreme Court discussed the issues as follows:

> "There is one basic principle about our sales tax act. It is that the ultimate consumer should pay the tax and no article should have to carry more than one sales tax. The intention was that in the various steps between a loaf of bread and the wheatfield the person who bought the wheat from the farmer should not pay a sales tax nor the mill that bought it from the elevator man nor the jobber who bought the flour from the mill nor the baker who bought the flour from the jobber. To prevent such a result as nearly as possible, G.S.1947 Supp. 79-3602(k) was enacted. It had to be so. It should be noted that for each step from the wheatfield to the bakery the title to the wheat and flour passed. It was bought each time with the idea of the title passing and there being a resale. This is not true of the property in question here. When the telephone company buys a pole and sets it in the ground the pole belongs to it and the title does not pass to anyone of the telephone company's service. When the baker buys a new oven or the shoemaker a new machine or the shirtmaker a new sewing machine, he pays a sales tax on these purchases because they are the ultimate consumers, the title has come to rest, no further transfer of title is contemplated." *Southwestern Bell*, 168 Kan. at 233.

The Court denied Southwestern Bell's request for an exemption, stating: "Here it seems clear that the property in question is finally used by [Southwestern Bell]." *Southwestern Bell*, 168 Kan. at 235. Accord, *Appeal of AT&T Technologies, Inc.*, 242 Kan. 554, 749 P.2d 1033 (1988).

Genesis argues *Southwestern Bell* and similar case law cited by the Department are irrelevant to this case, as they dealt with purchases of equipment used to provide taxable services. On the contrary, the Board finds that, as in the case at hand, the central issue in *Southwestern Bell* was whether the applicant or the applicant's customers were the final owner and user of tangible personal property purchased by the applicant to provide its taxable service to such customers. Accordingly, the Board finds that *Southwestern Bell* controls.

The taxable service Genesis sells is the entitlement to the use of its facilities for recreation. See K.S.A. 79-3603(n). Genesis seeks exemption for tangible personal property it asserts it utilizes in providing this service. The Board finds that the tangible personal property at issue is not an ingredient or component part of the entitlement to use Genesis' recreational facilities under the clear and unambiguous language of K.S.A. 79-3606(m) and 79-3602(p). The Board further finds that the tangible personal property at issue is not consumed in providing the entitlement to use Genesis' facilities for recreation under the clear and unambiguous language of K.S.A. 79-3606(n) and K.S.A. 79-3602(dd). The Board concludes that Genesis' ownership and use of the tangible personal property at issue may be necessary to enable Genesis to furnish its service to its customers, but Genesis is the ultimate consumer of such property under the meaning of the statute, because the property does not become a part of the service provided and title to the property does not pass to the customer. See *AT&T Technologies*, 242 Kan. at 560; *Southwestern Bell*, 168 Kan. at 233. In other words, the tangible personal property is sold to Genesis, who does not resell the property to its members, but rather sells them the entitlement to use its facilities for recreation. See *Warren v. Fink*, 146 Kan. 716, Syl. ¶5, 72 P.2d 968 (1937). As to the sprinkler inspection in particular, the Board finds that this purchase does not constitute a purchase of "tangible personal property." See K.S.A. 2006 Supp. 79-3602(pp).

Moreover, K.A.R. 92-19-22b(d)(1) specifically denies an exemption for utilities and supplies used in buildings where "sports, games and other recreational activities," including "physical fitness services," are conducted. See K.A.R. 92-19-22b(a). The regulation provides, in relevant part, as follows:

> "(d)(1) An exemption for gas, fuel, or electricity shall not be allowed if the gas, fuel, or electricity is utilized for heating, cooling, or lighting a building or business premises where sports, games, or recreational activities are conducted. An exemption shall not be allowed for water, cleaning supplies, toilet supplies, sanitary supplies, and other consumables and supplies used to furnish and maintain a building or business premises so that the business premises or building is fit for public occupancy as a place where sports, games, or recreational activities are conducted."

The Board finds that the regulation speaks for itself: that Genesis' purchases of gas and electricity utilized to heat, cool, or light its facilities, as well as its purchases of water, cleaning, sanitary, or toilet supplies or other consumables used to provide a recreational facility fit for public occupancy, are taxable.

> "Administrative regulations have the force and effect of law. K.S.A. 77-425[.] [Citation omitted]. Administrative regulations, moreover, are presumed to be valid, and one who attacks them has the burden of showing their invalidity. [Citation omitted.] Rules or regulations of an administrative agency, to be valid, must be within the statutory authority conferred upon the agency." *Pemco, Inc. v. Kansas Dept. of Revenue*, 258 Kan. 717, 720, 907 P.2d 863 (1995).

The Board finds that K.A.R. 92-19-22b is consistent with the Department's statutory grant of authority conferred by K.S.A. 2001 Supp. 79-3618 and should be accorded reasonable deference.

Genesis incidentally argues that the Department violated its equal protection rights under the United States and Kansas Constitutions. Genesis argues it received less favorable treatment from the Department's than other service providers such as hotels. This Board is not vested with the authority to decide the constitutionality of a statute or administrative regulation. *Zarda v. State*, 250 Kan. 364, Syl. ¶ 3, 826 P.2d 1365, *cert. denied* 504 U.S. 973, 112 S. Ct. 2941, 119 L. Ed. 2d 566 (1992). The Board may determine, however, whether the Department violated Genesis' constitutional rights. See, e.g., *In re Sprint Communications Co., L.P.*, 278 Kan. 690, 700-01, 101 P.3d 1239 (2004).

> "If similarly situated taxpayers receive disparate treatment, the one receiving the less favorable treatment may have been denied equal protection of the law even if the taxpayer receiving the less favorable tax is taxed according to the law. [Citation omitted.] However, the taxpayer seeking to establish a violation of the Equal Protection Clause must demonstrate that his or her treatment is the result of a 'deliberately adopted system' which results in intentional systematic unequal treatment. [Citation omitted.]" *Sprint*, 278 Kan. at 701 (quoting *In re Tax Appeal of City of Wichita*, 274 Kan. 915, 920, 59 P.3d 336 [2002]).

The Kansas Supreme Court has stated the following rules with regard to the consideration of an equal protection claim:

> "A statute is presumed constitutional and all doubts must be resolved in favor of its validity. If there is any reasonable way to construe a statute as constitutionally valid, the court must do so. A statute must clearly violate the constitution before it may be struck down. This court not only has the authority, but also the duty, to construe a statute in such a manner that it is constitutional if the same can be done within the apparent intent of the legislature in passing the statute.
>
> "Equal protection is implicated when a statute treats 'arguably indistinguishable' classes of people differently....
>
> "The rational basis standard (sometimes referred to as the reasonable basis test)

> applies to laws which result in some economic inequality. Under this standard, a law is constitutional, despite some unequal classification of citizens, if the classification bears a reasonable relationship to a valid legislative objective.
>
> "The reasonable basis test is violated only if the statutory classification rests on grounds wholly irrelevant to the achievement of the State's legitimate objective. The state legislature is presumed to have acted within its constitutional power, even if the statute results in some inequality. Under the reasonable basis test, a statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it.
>
> "A plaintiff asserting the unconstitutionality of a statute under the rational basis standard has the burden to negate every conceivable basis which might support the classification.
>
> "In taxation, even more than in other fields, legislatures possess the greatest freedom in classification." *Sprint*, 278 Kan. at 701 (internal quotations and citations omitted).

Genesis argues that, "[b]y acknowledging in numerous public pronouncements that all taxable service providers may utilize [K.S.A. 79-3606(m) and (n)] and denying that Genesis is entitled to any of the exemptions, the KDOR appears to be deliberately, and without any rational basis, treating Genesis differently than all other taxable service providers." Genesis argues hotels and health clubs are virtually identical; that health clubs are like a hotel room, only larger. It argues both entities have customers who have ingress and egress rights to real property owned by the entity, and both hotels and health clubs must purchase utilities and sanitary supplies to provide their respective service to their customers.

The Department counters that Genesis' equal protection claims fail because it is not the equivalent of a hotel. The Department primarily relies on the fact that hotels, and not health clubs, transfer title to certain items of personal property to the consumer. It also argues that hotel guests and health club members have dissimilar sets of rights to the respective premises, and cites various statutory provisions to show that hotels and health clubs are viewed very differently by the legislature.

The Board finds that many of the service providers Genesis cites as having received the exemptions at issue, such as an auto body repair shop, welding shop, hotels and motels, pet groomers, and laundries provide wholly different services than Genesis, which offers customers the entitlement to use its facilities for recreation. See K.S.A. 79-3603.

For example, hotels provide the service of "renting of rooms," unlike Genesis or other taxable providers of the service of entitlements to use their facilities for recreation. See K.S.A. 79-3603(g). In K.A.R. 92-19-24, the Department specifically instructs that certain tangible personal property of hotels is exempt and certain other property is not. The regulation clearly states that even hotels are not entitled to exemptions for some of

the property for which Genesis seeks exemptions, including: towels; electricity, gas, fuel and water consumed in common areas, including swimming pools; laundry services; and water, solvents and other cleaning materials used by the hotel to clean or maintain guest rooms, swimming pools, and other areas of the hotel. See K.A.R. 92-19-24(b), (e), (f), and (g). Nevertheless, Genesis argues the Department unconstitutionally treats Genesis unequally because hotels' purchases of utilities and disposable toiletries that guests use in individual "sleeping rooms" are exempt. See K.A.R. 92-19-24(b) and (e).

As the Department argues, the renting of rooms is a service distinguishable from entitling customers to use facilities for recreation. Primarily, a renter of a hotel room enjoys considerable rights over the room. These rights include the individual's right to personal, 24-hour discretionary control over air conditioning, heating, lighting and appliances, water, and individually packaged toiletries. Conversely, at Genesis' facilities, the individuals who have purchased the entitlement to use the facility for recreation during business hours have no personal control over the facilities' level of lighting, air temperature, water use, soap use, etc. In other words, the individual members are not the final consumer of the property. The Board also notes that Genesis has not cited any for-profit health club or other provider of recreational services that has qualified for exemption under the statutes at issue.

Genesis has failed to show it is similarly situated to hotels or other service providers that the Department has determined qualify for the exemptions at issue. Moreover, Genesis has failed to negate every conceivable basis that might support the Department's classification differentiating between hotels and providers of recreational activities services. The Board concludes that Genesis has failed to meet its burden of establishing an equal protection violation. See *Sprint*, 278 Kan. at 701-02.

Finally, Genesis raises an equitable estoppel argument, which it correctly concludes this Board has no power to hear or decide. See *Sage v. Williams*, 23 Kan. App. 2d 624, 628, 933 P.2d 775 (1997).

III.
Conclusion

In view of the uncontroverted facts, the Board finds no genuine dispute that Genesis uses the electricity, water, natural gas, pool chemicals, newsletters, laundry detergent, towels, and soap to enable Genesis to maintain its health club facility in order to provide its service to its members. Such use of tangible personal property is taxable under Kansas law. The Board finds that Genesis has failed to satisfy its burden of establishing its entitlement to exemption from retail sales tax under K.S.A. 79-3606(m) and K.S.A. 79-3606(n) for the tangible personal property at issue.

Any party to this appeal who is aggrieved by this decision may file a written petition for reconsideration with this Board as provided in K.S.A. 77-529, and amendments thereto. 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 Board's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for

reconsideration shall be mailed to: Secretary, Board of Tax Appeals, DSOB Suite 451, 915 SW Harrison St., Topeka, KS 66612-1505. *A copy of the petition, together with all accompanying documents submitted, shall be mailed to all parties at the same time the petition is mailed to the Board. Failure to notify the opposing party shall render any subsequent order voidable.* The written petition must be received by the Board within fifteen (15) days of the certification date of this order (allowing an additional three days for mailing pursuant to statute if the Board serves the order by mail). If at 5:00 pm on the last day of the specified period the Board has not received a written petition for reconsideration, this order will become a final order from which no further appeal is available.

IT IS SO ORDERED

THE BOARD OF TAX APPEALS

SEAL

REBECCA W. CROTTY, CHAIRPERSON

ATTEST:

J. FRED KUBIK, MEMBER

BRUCE F. LARKIN, MEMBER

JOELENE R. ALLEN, SECRETARY

JAY VAN BLARICUM, ATTORNEY

CERTIFICATION

I, Joelene R. Allen, Secretary of the Board of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of the order in Docket Nos. 2005-62-DT *et al.* and any attachments thereto, was placed in the United States Mail, on this 24th day of October, 2007, addressed to:

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

Joelene R. Allen, Secretary