BEFORE THE COURT OF TAX APPEALS
STATE OF KANSAS

IN THE MATTER OF THE APPEAL OF LAFARGE MIDWEST/MARTIN TRACTOR CO., INC. FROM AN ORDER OF THE DIVISION OF TAXATION ON ASSESSMENT OF SALES TAX	Docket No. 2006-8532-DT

ORDER DENYING THE KANSAS DEPARTMENT OF REVENUE'S MOTION FOR SUMMARY JUDGMENT

NOW the above-captioned matter comes on for consideration and decision by the Court of Tax Appeals of the State of Kansas. On May 15, 2008, oral arguments were heard on a motion for summary judgment filed by the Kansas Department of Revenue (the "Department"), which appeared by its attorney of record, Alice Leslie Rawlings. The taxpayer, LaFarge Corporation ("LaFarge"), appeared by its attorney of record, Gerald Capps.

I.

This is an appeal from a final written determination by the Department denying LaFarge's request for a refund of sales tax in the amount of $16,217.05, plus interest, paid on purchases of parts for Caterpillar loaders and haulers used by LaFarge in its cement manufacturing enterprise. LaFarge's refund request is based on the statute exempting repair and replacement parts for exempt machinery and equipment under K.S.A. 79-3606(kk)(1)(C).

This court has jurisdiction of the subject matter and the parties pursuant to K.S.A. 2008 Supp. 74-2438.

II.

The Department sets out in its summary judgment memorandum thirty (30) statements of fact which it asserts are uncontroverted. As evidentiary support the Department cites to its own notices and final written determinations as well as to statements contained in the prehearing order filed April 7, 2008. The Department also references an aerial photograph of the LaFarge facility and a DVD about cement manufacturing, in general, and LaFarge's Fredonia operation, in particular. The Department has come forward with no affidavits, deposition testimony,

answers to interrogatories, admissions or other evidence to support its factual assertions.

In its responsive memorandum, LaFarge disputes, or otherwise objects to, nine (9) of the Department's statements of fact, pointing to various assertions not supported by the record. LaFarge also offers two affidavits opposing the Department's assertions, one from the LaFarge plant manager and the other from the LaFarge controller.

III.

Summary judgment is appropriate where the pleadings, depositions, answers to interrogatories, and admissions on file, together with any 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. K.S.A. 60-256(c); *Mitzer v. State Department of SRS*, 891 P.2d 435 (Kan. 1995). Summary judgment is proper where the only questions presented are questions of law. *Holmes v. Unified School Dist. No. 259*, 46 P.3d 1158 (Kan. 2002).

An object of summary judgment is to test whether the parties have any real support for their version of the facts. *See Mays v. Ciba-Geigy Corp.*, 661 P.2d 348 (Kan. 1983). Summary judgment, nevertheless, is a drastic remedy. See *Herl v. State Bank of Parsons*, 403 P.2d 110 (1965). The movant has the strict burden of showing that there is both no genuine issue of material fact and that judgment as a matter of law is warranted. *See Saliba v. Union Pacific R.R. Co.*, 995 P.2d 1189 (1998).

IV.

An independent review of the record reveals that while the parties clearly disagree about how the record evidence should be interpreted and what legal conclusions should be drawn, there is no genuine dispute concerning the basic facts controlling resolution of the issues presented. There is no material disagreement concerning how the LaFarge operation is configured and operated, how ingredients are conveyed and combined to make concrete, or where the various activities are conducted on the premises.

Following is a neutral rendering of the record evidence. LaFarge manufactures cement at its manufacturing plant in Fredonia, Kansas. Its operation consists of various activities, all of which occur on contiguous property owned by LaFarge. The first step in the enterprise is to obtain limestone rock and other raw materials from a quarry on site using controlled explosives. Once blasted from the quarry face, loose raw materials are scooped from the quarry floor by loaders and

dumped into haulers. The haulers transport the materials over roads to crushing machines called hammermills, where the materials are crushed into pieces approximately the size of hard hats. These pieces are then conveyed from the hammermills to secondary crushers, where further reduction of the materials occurs. From there the materials are mixed with river water and fed into rotating ball mills, which combine the ingredients into fine slurry. The slurry is pumped into a network of blending and storage tanks and then sent to rotary kilns. During the kiln burning operation a substance called clinker is produced. The clinker is conveyed to finish mills, where gypsum is added. This mixture is then ground into a fine substance called cement. After the cement is tested and approved for sale, it is conveyed to storage silos for shipment throughout the United States.

V.

The exemption statute at issue, K.S.A. 79-3606(kk) (as amended in 2000 by House Bill 2011), is commonly referred to as the "integrated plant" statute because it codifies various aspects of a common law doctrine called the "integrated plant theory." This doctrine is used to assist in the determination of what processes, machinery and equipment within a plant operation are so directly involved in manufacturing that they should be accorded exemption status. The integrated plant theory first emerged in the case of *Niagara Mohawk Power Corp. v. Wanamaker*, 286 A.D. 446 (N.Y. 1955), where the court determined that coal and ash handling machines (cranes and dumpers) were an integral part of a steam electric generating plant.

In *Niagara Mohawk* the court held that the cranes and dumpers were necessary to the functioning of the plant as a whole, even though the handling equipment was not as directly, or actively, involved as the other plant equipment. Together, the court noted, all of the equipment formed a system to supply the power to make electricity. The court said that the "directness" of the activity was not the test; the true test was whether all parts of the plant contributed, continuously and vitally, to production and whether they were all integrated and harmonized.

The court explained the tax policy underlying the integrated plant theory as follows:

> One purpose of the sales and use tax resolutions is to reduce multiple taxation. The burden would be excessive if purchases for resale were taxed numerous times during the journey of goods to the ultimate consumer. The economic effect is no different where the tax is on raw materials or machines directly and exclusively used or consumed in production. *Id.* at 448.

The Kansas Court of Appeals summarized the integrated plant theory in 1999, stating that a sales and use tax exemption may be obtained for equipment and machinery that perform an "essential or indispensable function in the manufacturing process, regardless of whether a physical change is actually caused in raw materials." *See Water District No. 1*, 26 Kan. App. 2d at 374 (recognizing Kansas Supreme Court's adoption of "integrated plant theory" and rejecting more rigid "physical change" rule.)

The integrated plant doctrine in Kansas, as codified at K.S.A. 79-3606(kk), is comprised of seven subsections. Subsection (1) sets out the general parameters of the exemption, which include "all sales of machinery and equipment which are used in the state as an integral or essential part of an integrated production operation by a manufacturing or processing plant or facility." Subsection (2) defines the salient terms used in the exemption. Subsection (3) defines the types of equipment that qualify for exemption. Subsection (4) specifies additional machinery and equipment that qualify for exemption even though they would not otherwise qualify under the general terms of the statute. Subsection (5) specifies certain machinery and equipment that do not qualify for exemption. Subsection (6) delineates how machinery and equipment used both for production and non-production purposes should be treated under the statute. And subsection (7) directs the Department to adopt rules and regulations to implement the exemption.

VI.

The issue presented in the Department's motion for summary judgment is whether the Caterpillar loaders and haulers (and thus their repair and replacement parts) are exempt machinery and equipment under K.S.A. 79-3606(kk) in view of where the machinery and equipment is used at the premises. In the prehearing order, the parties state their respective positions as follows:

> "The Department and Taxpayer disagree as to where the excavation and manufacturing facilities, respectively, begin and end. The Department contends that the excavation operations are not a "manufacturing facility" and the loaders and haulers are not used in a manufacturing preparation activity. The Taxpayer contends that the loaders and haulers are used in a manufacturing process."

The Department's line of argument, as articulated in its summary judgment memorandum, can be distilled as follows:

1. LaFarge engages in two distinct business operations on its property. The first is a limestone excavation operation, which is conducted in and around the quarry. The second is a cement manufacturing operation, which begins with the crushing activities performed at the hammermill machines.

2. K.S.A. 79-3606(kk)(1)(C) exempts sales of parts for machinery and equipment only if the machinery and equipment is used as an integral or essential part of an integrated production operation by a manufacturing or processing plant or facility.

3. The LaFarge manufacturing plant operations begin at the hammermill machines because that is where the raw materials extracted from the quarry are fist crushed or otherwise processed.

4. The loaders and haulers are used in the quarry operation. They are not used primarily in the manufacturing operation at the plant.

5. Therefore, neither the loaders nor the haulers, nor their repair and replacement parts, are exempt from sales tax because the machinery and equipment is not used as part of an integrated production operation by a manufacturing or processing plant or facility, as required by K.S.A. 79-3606(kk)(1)(A).

The deficiency in the Department's line of argument is revealed upon careful examination of the relevant statutory provisions within the context of the overall legislative scheme expressed throughout K.S.A. 79-3606(kk).

VII.

As stated above, K.S.A. 79-3606(kk) (as amended in 2000 by House Bill 2011) exempts from sales tax all sales of machinery and equipment used in Kansas as an "integral or essential part of an integrated production operation by a manufacturing or processing plant or factility." *See* K.S.A. 79-3606(kk)(1)(A). The exemption also extends to certain installation, repair and maintenance parts and services for exempt machinery and equipment. *See* K.S.A. 79-3606(kk)(1)(B) and (C). The parties agree that if the loaders and haulers are in fact exempt machinery and equipment, then so too are their repair and replacement parts. Thus the question of whether the parts are exempt is subsumed by the quesiton of whether the machinery and equipment is exempt.

According to the Department, the machinery and equipment (*i.e.*, the loaders and haulers) are not exempt because they are used in an excavation operation and not as part of an integrated production operation by a manufacturing or processing

plant. The definition of "integrated production operation" is found at K.S.A. 79-3606(kk)(2)(A):

> "Integrated production operation" means an integrated series of operations engaged in at a manufacturing or processing plant or facility to process, transform or convert tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed.

The statute also provides that an integrated production operation shall include, among other things, "preproduction operations to handle, store and treat raw materials." *See* K.S.A. 79-3606(kk)(2)(A)(ii). Further, the statute specifies that "machinery and equipment shall be deemed to be used as an integral or essential part of an integrated production operation when used ... [t]o receive, transport, convey, handle, treat or store raw materials in preparation of its placement on the production line." *See* K.S.A. 79-3606(kk)(3)(A).

Based on the uncontroverted evidence presented, we decline to find as a matter of law that the loaders and haulers are not used as part of an integrated production operation, as that term is defined by K.S.A. 79-3606(kk)(2)(A). The record evidence shows that after the limestone and other materials are blasted from their natural state at the quarry, the loaders scoop the materials into the haulers and the haulers deliver the materials to the hammermill crushers. The Department has failed to show that the loaders and haulers are not used in "preproduction operations" to "receive, transport, convey, handle, treat or store raw materials in preparation of its placement on the production line." See K.S.A. 79-3606(kk)(2)(A)(ii) and K.S.A. 79-3606(kk)(3)(A).

VIII.

For purposes of this motion, the question thus becomes whether the uncontroverted evidence supports a finding, as a matter of law, that the loaders and haulers are not used "by a manufacturing or processing plant or facility." This requirement has been interpreted by our state's highest court to mean that the machinery and equipment in question must be used not only *by* the plant but also *at* the plant. *See In re Western Resources, Inc.*, 132 P.3d 950, 956 (Kan. 2006).

The term "plant" is defined at K.S.A. 79-3606(kk)(2)(C):

> "[M]anufacturing or processing plant or facitlity" means a single, fixed location owned or controlled by a manufacturing or processing business that consists of one or more structures or

> buildings in a contiguous area where integrated production operations are conducted to manufacture or process tangible personal property to be ultimately sold at retail.

The definition of "plant" under K.S.A. 79-3606(kk)(2)(C), has both physical and non-physical components. It is important to note here that the physical plant is different from the business that owns and operates the plant. The owner's business, unlike the plant premises, has a corporate existence outside and apart from the physical boundaries of the plant location. *See Western Resources*, 132 P.3d at 955.

The physical components of the definition of "plant" are that the premises must be a "single, fixed location." *See* K.S.A. 79-3606(kk)(2)(C). These words imply that the premises may not be comprised of multiple, separate locations and the location may not change from time to time. Also, as the Kansas Supreme Court has held, the physical boundaries of a plant location do not extend to machinery and equipment located on easements or rights-of-way. *See* 132 P.3d at 955 (holding transformers, substations, lines and poles located on easements miles away from electricity generating plant were not used at the plant.)

While the physical components of the definition of "plant" involve the geographic boundaries of the plant location, the non-physical components of the definition involve elements of ownership, control and business operation. The statute provides that the plant location must be "owned or controlled" by a "*manufacturing or processing business* consisting of one or more structures or buildings in a contiguous area where integrated production operations are conducted to manufacture or process tangible personal property to be ultimately sold at retail." *See* K.S.A. 79-3606(kk)(C) (emphasis provided).

The words "manufacturing or processing business" are defined in the next subsection, K.S.A. 79-3606(kk)(2)(D):

> "manufacturing or processing business" means a *business* that utilizes an integrated production operation to manufacture, process, fabricate, finish, or assemble items for wholesale and retail distribution as part of what is commonly regarded by the general public as an *industrial manufacturing or processing operation* or an agricultural commodity processing operation.
>
> (emphasis provided)

Also contained in the definition of "manufacturing or processing business" are illustrations of certain business operations deemed to be, and not to be, "industrial manufacturing or processing operation[s]." *See* K.S.A. 79-3606(kk)(2)(D)(i) and (ii).

Included among the business operations that are "industrial manufacturing or processing operation[s]" are enterprises such as metal, plastic, wood, and paper products fabrication and chemical and ready mix concrete production. Also included are operations at an oil and gas well, mine or other excavation site where the materials extracted are "cleaned, separated, crushed, ground, milled, screened, washed, or otherwise treated or prepared for its transmission to a refinery or before any other wholesale or retail distribution." *See* K.S.A. 79-3606(kk)(2)(D)(i).

Excluded from the definition of "industrial manufacturing or processing operation[s]" are "nonindustrial businesses whose operations are primarily retail and that produce or process tangible personal property as an incidental part of conducting the retail busines." *See* K.S.A. 79-3606(kk)(2)(D)(ii). Examples of such excluded businesses are certain retail food service businesses, cleaning businesses, and refurbishing and repair businesses. *See id.*

Based on a practical reading of the relevent provisions interpreted in harmony with the entire exemption statute, we find the arguments advanced by the Department in support of its summary judgment motion to be unsound. The interpretation urged by the Department requires a myopic view of the definitional provisions contained in K.S.A. 79-3606(kk)(D)(2).

The rule of statutory construction to which all other rules are subordinate is that the intent of the legislature as expressed through the text of the statute controls. See *State v. Scherzer*, 869 P.2d 729, 735 (1994). The canon of *pari materia* ("on the same subject") requires that statutes relating to the same subject matter or having the same general purposes are to be construed together in an attempt to reconcile differences and reach a sensible, rational result. *McVay v. Rich*, 859 P.2d 399, 403-404 (1993). Ordinary words are to be given their ordinary meanings. *State v. Royse*, 845 P.2d 44, 46 (1993).

At core, the Department's arguments hinge on K.S.A. 79-3606(kk)(2)(D)(i), an isolated provision within the subsection defining what is a "manufacturing or processing business." This portion of the definition sets out illustrations of the kinds of business operations that may qualify as a "manufacturing or processing business," provided, of course, the other requirements of subsection (2)(D) are also satisfied. One illustration is "excavation operations" where additional processing, such as crushing, occurs. The Department invokes this illustration to argue that because the loaders and haulers are primarily involved in removing and transporting raw materials from an excavation site where no additional processing occurs, the loaders and haulers are not used at the plant location. This argument conflates, and thus confuses, the physical and non-physical requirements found in the definition of "manufacturing or processing plant or facility."

When the relevant provisions of the statute are reconciled, it is clear that what is and what is not an "industrial manufacturing or processing operation" under 79-3606(kk)(2)(D) is only part of the broader question of whether a particular *business* that owns the plant location qualifies as a "manufacturing or processing business." This provision should not be read out of context as a definition governing where the physical, or geographic, lines of demarcation at a plant location should be drawn.

IX.

We find further support for our conclusions in various cases decided in other jurisdictions which have, like Kansas, adopted the "integrated plant theory."[1] See, for example, *Indiana Dep't of State Rev. v. Cavestone, Inc.*, 457 N.E.2d 520 (Ind. 1983), where it was held that transportation equipment used in a stone production process was exempt from sales tax because the stone product could be produced only if stones were transported from the quarry to the crusher.

Based on the uncontroverted evidence contained in the record, we find the Department has failed to prove as a matter of law that the loaders and haulers are not primarily used by (and at) the LaFarge plant. The evidence shows that both the quarry and cement manufacturing operations are conducted on adjacent property owned by LaFarge. There is no evidence that the loaders and haulers perform activities on property that may be characterized as anything but a single, fixed location. Nor is there any indication from the record that the loaders and haulers perform activities on rights-of-way or easements located on land not owned by LaFarge. The fact that the loaders and haulers may perform excavation-related activities on a portion of the LaFarge premises where no additional processing (such as crushing or grinding) occurs is not relevant to the determination of where the physical, or geographic, boundaries of the LaFarge plant should be drawn.

X.

During oral arguments, LaFarge's attorney suggested, though somewhat obliquely, that this court could deny the Department's motion and enter summary judgment in favor of LaFarge based on the evidence now contained in the record. This court is aware that in certain limited circumstances summary judgment may be issued without a formal motion, or even *sua sponte*. However, the Department

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[1] In a 2000 legislative hearing on House Bill 2011, Shirley Sicilian, general counsel to the Department, testified that the bill would move Kansas from a state that employs some characteristics of the integrated plant theory to a pure integrated plant theory state. Ms. Sicilian explained that the bill would place Kansas on similar footing with nearby states like Missouri, Colorado, Oklahoma, Indiana and Arkansas. *See* Minutes of Sen. Assessment and Taxation Committee, approved March 22, 2000.

clearly entered its objection to summary disposition in favor of LaFarge. We find the Department's objection to be justified under the circumstances.

Because LaFarge's refund request is predicated on an exemption claim, it is LaFarge's burden to bring itself clearly within the provisions of the exemption statute. *See Warren v. Fink*, 72 P.2d 968, 970 (Kan. 1937). All doubts concerning the exemption must be resolved against exemption and in favor of taxation. *See In re Derby Refining Co.*, 838 P.2d 354, 356-57 (Kan. Ct. App. 1992).

The Department's motion for summary judgment addresses only some of the many definitions and other variegated statutory requirements for exemption under K.S.A. 79-3606(kk). As set forth herein, the Department has failed to demonstrate that it is entitled to judgment as a matter of law based on the evidence and issues it presented in support of its summary judgment motion. Nevertheless, it is important to note that LaFarge has not yet articulated with affirmative evidentiary support all of the facts it contends bring the transactions at issue clearly within the exemption. The Department should not be foreclosed from learning of, and responding to, all elements of LaFarge's *prima facie* claim for exemption. *See, generally, MLK Inc. v. University of Kansas*, 940 P.2d 1158 (Kan. Ct. App. 1997).

IT IS THEREFORE ORDERED, for the reasons stated above, that the Department's motion for summary judgment is denied.

IT IS FURTHER ORDERED that judgment shall not be entered as a matter of law in favor LaFarge based on the evidence currently contained in the record.

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

S E A L

REBECCA W. CROTTY, JUDGE

ATTEST:

J. FRED KUBIK, JUDGE

TREVOR C. WOHLFORD, JUDGE PRO TEM

JOELENE R. ALLEN, SECRETARY

CERTIFICATE OF SERVICE

I, Joelene 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. 2006-8532-DT and any attachments thereto, was placed in the United States Mail, on this 4th day of June, 2009, addressed to:

Lafarge Midwest/Martin Tractor Co., Inc.
Lafarge North America
1400 S Cement Road
Fredonia, KS 66736-2068

Gerald Capps
Allen, Gibbs & Houlik
P.O. Box 817
Andover, KS 67002

and a copy was placed in capitol complex building mail, addressed to:

James Bartle
General Counsel
Legal Services Bureau
Department of Revenue
DSOB, 915 SW Harrison, 2nd Floor
Topeka, KS 66612

Alice L. Rawlings
Attorney
Legal Services Bureau
Department of Revenue
DSOB, 915 SW Harrison, 2nd Floor
Topeka, KS 66612

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

Joelene R. Allen

Joelene R. Allen, Secretary