JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2007-08-14-03 / NON-PRECEDENTIAL**
ID: **P-06-163-K**
DATE: **AUGUST 14, 2007**
DISPOSITION: **SUSTAINED**
TAX TYPE: **AD VALOREM / MANUFACTURERS EXEMPTION**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Protestant, PROTESTANT, is represented by ATTORNEY, Attorney at Law, LAW FIRM. The Ad Valorem Division of the Tax Commission ("Division") is represented by OTC ATTORNEY, Assistant General Counsel, Office of the General Counsel, Oklahoma Tax Commission.

STATEMENT OF THE CASE

Protestant's 2006 XM-R1 (XM1-2003 acquisition) and XM-R2 (XM2-2003 acquisition) applications for ad valorem tax exemption for its manufacturing facilities placed in service in 2004 were filed with the Division on May 24, 2006 and May 9, 2006, respectively. The applications were previously approved by the Assessor and Board of Equalization in and for COUNTY, State of Oklahoma.

By letters dated July 13, 2006, as amended by letters dated July 14, 2006, the Division notified Protestant that the applications were denied. Protestant timely protested the letters of denial by letter dated September 1, 2006.

On September 6, 2006, the Division's file was referred to the Office of the Administrative Law Judges ("ALJ'S Office") for further proceedings consistent with the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure before the Oklahoma Tax Commission[2]. The case was docketed as Case No. P-06-163-K and assigned to ALJ, Administrative Law Judge.[3]

A pre-hearing conference was scheduled in this cause for October 24, 2006, by *Prehearing Conference Notice* issued September 21, 2006.[4] The pre-hearing conference was held as scheduled. Pursuant to the conference, a *Prehearing Conference Order and Notice of Alternative Hearing Date* was issued setting forth the procedures by which the protest would be submitted for decision.[5]

A joint *Stipulation* was filed by the parties on November 28, 2006. As a result of this filing, the alternative hearing date was cancelled by letter dated December 5, 2006. *Protestant's Brief in*

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[1] 68 O.S. 2001, § 201 et seq.

[2] Rules 710:1-5-20 through 710:1-5-47 of the *Oklahoma Administrative Code* ("*OAC*").

[3] *OAC*, 710:1-5-22(b).

[4] *OAC*, 710:1-5-28(a).

[5] *OAC*, 710:1-5-28(b) and 710:1-5-38.

Chief was filed January 3, 2007. The *Response Brief of Ad Valorem Division, Oklahoma Tax Commission* was filed on January 22, 2007. The *Reply Brief of PROTESTANT* was filed on January 31, 2007. The record was closed and the protest was submitted for decision on February 1, 2007.[6]

FINDINGS OF FACT

Upon review of the file and records, including the Stipulation and the briefs, the undersigned finds:

The parties stipulate to the following:

1. In 2000, the Environmental Protection Agency ("EPA") enacted regulations mandating that oil refineries across the nation install equipment to lower the sulfur content of gasoline and diesel fuel ("mandated desulphurization equipment") by 2006.

2. In May, 1998, the Oklahoma Legislature adopted HJR 1096, calling for a legislative referendum election on a proposal to exempt pollution abatement equipment from ad valorem taxation. The measure, State Question 683, failed to obtain the requisite approval at the general election of November 3, 1998. In 2000[7], the Oklahoma Legislature enacted legislation addressing the valuation of mandated desulphurization equipment for purposes of ad valorem taxation. The legislation was codified at 68 O.S. § 2817(E), 2817.3 of the Ad Valorem Tax Code. Although the legislation was initially limited to small refineries, it was amended in 2003 to cover all refineries.

3. 68 O.S. § 2817(E) provided that the value of investment in property used exclusively by an oil refinery to lower the sulphur content of gasoline and diesel fuel "[s]hall not be included in the capitalization used in the determination of fair market value of such oil refinery <u>if such property would qualify as exempt property pursuant to § 2902 of this title</u>, whether or not an application for such exemption is made by an otherwise qualifying manufacturing concern owning property. . . ." (Emphasis original.) (For purposes of simplification, the effect of § 2817(E) will be referred to as the "valuation exclusion.").

4. 68 O.S. § 2817.3 provided the procedure by which an oil refinery could apply for the valuation exclusion. The OTC also enacted rules to implement the exclusion. OAC 710:10-13-1 et seq. Sections 2817.3(A), (B) directed the applicant to submit information to the Executive Director of the Department of Environmental Quality ("DEQ") detailing the environmental benefits, estimated cost and purpose for installation of the mandated desulphurization equipment. Section 2817.3(C) directed DEQ to make a determination that the mandated desulphurization equipment was "used wholly for the desulphurization of gasoline or diesel fuel. . ." and to send a letter to the applicant stating the proportion of the installation that qualified. Section 2817.3(E) required the applicant to provide a copy of the DEQ determination letter to the county assessor or the Director of the Ad Valorem Division of the OTC. Section 2817.3(E) further stated:

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[6] *OAC*, 710:1-5-39(a).

[7] The provisions in question were actually enacted in 2002, by Laws 2002, c. 345, § 1, eff. Jan. 1, 2003.

> The county assessor or the Director of the Ad Valorem Division of the Tax Commission *shall accept* the copy of the letter from the Executive Director as *conclusive evidence* that the facility, device or method is used wholly for the desulphurization of gasoline or diesel fuel. The county assessor or the Director of the Ad Valorem Division of the Tax Commission shall further determine if the property for which the exclusion is sought is qualified as provided in subsection E of Section 2817 of this title.

5. 68 O.S. § 2902, which is referenced in § 2817(E), implements the five (5) year ad valorem tax exemption for new, acquired or expanded manufacturing facilities authorized under Art. X, § 6B of the Oklahoma Constitution.

6. Section 2902(D) was amended, effective May 19, 2004, to allow a taxpayer who had failed to claim an exemption the opportunity to file a claim for an additional year, within two (2) years of the end of the original five (5) year period. Effective July 1, 2005, § 2902(D) was amended, to state that its provisions would apply to any applications that were due on or after March 15, 2003. This version of § 2902(D), which remained in effect until June 7, 2006, states as follows:

> D. The five-year period of exemption. . .shall begin on January 1 following the initial qualifying use of the property in the manufacturing process. If a taxpayer fails to file or timely file an initial application or any subsequent application for any year in which it was otherwise qualified, the taxpayer may file an application for an additional year within two (2) years of the end of the original five-year period. Any such failure to file or timely file shall not disqualify a taxpayer for any future year exemption to which the taxpayer would have been entitled under this section had there been no failure to file or timely file. The provisions of this subsection shall apply to any taxpayer who failed to file or timely file an application that was due on March 15, 2003 or later.

7. On March 5, 2004, [Protestant] filed an application with the DEQ requesting a determination that mandated desulphurization equipment installed at the CITY Refinery in 2003 was eligible for the desulphurization valuation exclusion under § 2817 in tax year 2004. On March 8, 2004, the DEQ issued a determination letter that $70,698,784.00 of [Protestant's] investment qualified under the § 2817 valuation exclusion. The § 2817 valuation exclusion was ultimately set at $95,917,501.00, by the COUNTY Assessor. The DEQ also determined that $30,055,996.00 of investment was for "enhancements" which did not qualify under § 2817.

8. On March 11, 2004, [Protestant] timely filed an application pursuant to § 2902(E) for a five (5) year manufacturing exemption in the amount of $30,055,996.00 covering the desulphurization "enhancements." The application states that the assets were acquired in 2003 and the facility became operational in 2004, thus making 2004 the first year (XM-1) the facility was eligible for the exemption. The application demonstrated satisfaction of § 2902 manufacturing, investment and payroll criteria, and was approved by the COUNTY Assessor on March 23, 2004. The exemption was thereafter approved by the OTC.

9. On March 11, 2005, [Protestant] timely filed a § 2902 manufacturing exemption application for year two (XM-2) on the desulphurization "enhancements." An amended application in the amount of $33,381,530.00 was filed on May 4, 2005. This application, as amended, was approved by the assessor and the OTC and the manufacturing exemption was granted.

10. An organization called "Save Ad Valorem Funding for Students" (hereafter "*SAVE*"), filed suit for a declaratory judgment that the statutory valuation exclusion was unconstitutional. The District Court found the statutes constitutional. The Oklahoma Court of Civil Appeals reversed and remanded on December 23, 2005, holding that the statutes were unconstitutional. [Protestant] and the other defendants appealed the Court of Appeal's decision in *SAVE* by filing a petition for certiorari with the Oklahoma Supreme Court. The petition for certiorari was pending at year end 2005.

11. On April 17, 2006, the Supreme Court denied petitions for certiorari filed by [Protestant] and other defendants in *SAVE*. The Supreme Court also ordered that the Court of Appeal's opinion in *SAVE* be released for publication. Neither the Court of Appeal's opinion in *SAVE*, nor the Supreme Court's order denying certiorari, specifically discuss whether the opinion is to be given prospective or retroactive effect.

12. Following entry of the Supreme Court order in *SAVE*, on May 2, 2006, [Protestant] filed a manufacturer's exemption application on the $95,917,500.00 investment in mandated desulphurization equipment, previously covered by the § 2817 valuation exclusion for the 2005 tax year. [Protestant] advised that 2005 was year two (XM-2) of the five (5) year exemption period. This application was approved by the assessor and the Board and forwarded to the OTC.

13. On May 10, 2006, the COUNTY Assessor issued a "Notice of Change in Assessed Value" for the 2004 tax year. The assessor increased the fair cash value of the "formerly excluded personal property" from zero to $95,917,500.00. This is the dollar amount of [Protestant's] investment in mandated desulphurization equipment that was previously approved under the § 2817 valuation exclusion for 2004. [Protestant] timely filed a protest of the "Notice of Change in Assessed Value" with the assessor, but no hearing has been held.

14. On May 15, 2006, in response to the assessor's Notice of Change in Assessed Value, [Protestant] filed a manufacturer's exemption application with the assessor in the amount of $95,917,500.00 for the 2004 tax year. This application covered the assets previously subject to the § 2817 valuation exclusion in 2004. This application was approved by the assessor and the Board and forwarded to the OTC.

15. The five (5) year manufacturing exemption applications for 2004 and 2005 in the amount of $95,917,500.00 were denied by the OTC by letters dated July 13th, as amended July 14, 2006. In its letters of denial, the OTC simply states that the "acquisitions were previously exempt under Title 68 § 2817.3."

ISSUE AND CONTENTIONS

The issue presented for decision is whether the opinion of the Court of Civil Appeals in ***Save Ad Valorem Funding for Students v. Oklahoma Department of Environmental Quality, et al.***, 2006 OK CIV APP 53, 135 P.3d 823 ("*Save*") is to be applied prospectively or retroactively?

Protestant contends that notwithstanding whether the *Save* opinion is applied prospectively or retroactively, it is not liable for any ad valorem taxes on the mandated desulphurization equipment for the 2004 or 2005 tax years because either the equipment remains "excluded" from the capitalization used in the determination of fair market value of the refinery under § 2817(E) or the equipment is "exempt" as manufacturing facilities under § 2902. Protestant argues that the equipment at issue is exempt under § 2902 for the 2004 and 2005 tax years since it is undisputed that it timely complied with the requirements of § 2902(E) and (D) by filing the XM-R1 and XM-R2 applications and it is undisputed that the applications show compliance with the investment and payroll requirements of § 2902. In the alternative, Protestant argues or does not take exception with the Division's proposition that the *Save* opinion should be applied prospectively and thus, the equipment at issue would remain "exclude" from the fair market value of the refinery during the 2004 and 2005 tax years.

The Division contends that it properly denied Protestant's applications. In support of this contention, the Division argues that the under the criteria for determining whether a judicial decision should be applied prospectively or retroactively, the Save opinion should be applied prospectively and therefore, Protestant's manufacturing exemption applications on the mandated desulphurization equipment are unnecessary and extraneous as the equipment remains exempt from ad valorem taxes in accordance with the valuation exclusion of § 2817(E).

CONCLUSIONS OF LAW

1. The Tax Commission is vested with jurisdiction of the parties and subject matter of this proceeding. 68 O.S. 2001, § 207(c) and *OAC*, 710:10-7-15.

2. "All property in this state, whether real or personal, except that which is specifically exempted by law or which is relieved of ad valorem taxation by reason of the payment of an in lieu tax, is subject to ad valorem taxation." 68 O.S. 2001, § 2804.[8] See, ***Save***, *supra* at ¶ 7, citing *In Re Gross Production Tax of Wolverine Oil Co.*, 1915 OK 792, 154 P. 362. In 2002, the Oklahoma Legislature amended § 2817[9] of the Ad Valorem Tax Code ("Code")[10] by adding a new subsection E which provided:

[8] Added by Laws 1988, c. 162, § 4, effective January 1, 1992 which replaced 68 O.S. 1981, § 2404 that was repealed by Laws 1988, c. 162, § 165.

[9] Provides for the valuation and assessment of property (real and personal) either by the fair cash value method or use value method.

[10] 68 O.S. 2001, § 2801 et seq.

> The value of investment in property used exclusively by a small oil refinery, as defined in [§ 2817.3 of the Code], that is used wholly as a facility, device or method for the desulphurization of gasoline or diesel fuel shall not be included in the capitalization used in the determination of fair market value of a small oil refinery.[11]

3. On November 10, 2004[12], "Save Ad Valorem Funding for Students (SAVE), an unincorporated association," with an "alleged" membership comprised of "more than 300 school districts, the Oklahoma Council for Oklahoma School Administration, the Oklahoma State School Boards Association, and the Organization of Rural Oklahoma Schools" sued "the Oklahoma Department of Environmental Quality (DEQ), the COUNTY Assessor (Assessor), the Oklahoma Tax Commission (OTC), the State Board of Equalization (SBOE), and PROTESTANT(Refinery), seeking a declaratory judgment that 68 O.S. Supp. 2004 §§ 2817(E) and 2817.3 [were] in conflict with the Oklahoma Constitution." ***Save***, *supra*. at ¶¶ 1 and 2. The District Court of Oklahoma County, the Honorable JUDGE, Judge, granted the motions to dismiss of Refinery and SBOE based on its findings the challenged statutes, 68 O.S. Supp. 2004, §§ 2817(E) and 2817.3, were constitutional and SAVE appealed. *Id.*, at ¶¶ 4 and 5. The Court of Civil Appeals of Oklahoma, Division No. 3, "reversed and remanded with instructions to enter judgment in favor of SAVE", "holding the statutes violate the Oklahoma Constitution, Article 5, § 50, and Article 10, § 8, because they create an ad valorem tax exemption and allow tangible personal property to be assessed for ad valorem taxation at less than ten percent of its value without the voters' approval." *Id.*, at ¶¶ 1 and 14. By Order dated April 17, 2006, the Supreme Court of Oklahoma denied certiorari and approved for publication the decision of the Court of Civil Appeals of Oklahoma, Division No. 3. *Id.*

4. In response to the ***Save*** opinion, Protestant on May 2, 2006, filed a manufacturer's exemption application (XM-R2) for the 2005 tax year with the COUNTY Assessor on the $95,917,500.00 investment in mandated desulphurization equipment previously subject to the valuation exclusion of § 2817(E). The XM-R2 application was approved by the COUNTY Assessor and Board of Equalization and forwarded to the Tax Commission. Also in response to the ***Save*** opinion, the COUNTY Assessor on May 10, 2006, issued a "Notice of Change in Assessed Value" for the 2004 tax year which Notice increased the fair cash value of the property previously subject to the valuation exclusion from zero to $95,917,500.00. Protestant not only protested the Notice timely, but on May 15, 2006, in response to the Notice, filed a manufacturer's exemption application (XM-R1) for the 2004 tax year on the investment in mandated desulphurization equipment previously subject to the valuation exclusion of § 2817(E). The XM-R1 application was

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[11] Laws 2002, c. 345, § 1, eff. Jan. 1, 2003. Amended by Laws 2003, c. 431, § 2, eff. Jan. 1, 2004, to provide:

> The value of investment in property used exclusively by an oil refinery that is used wholly as a facility, device or method for the desulphurization of gasoline or diesel fuel as defined in Section 2817.3 of this title shall not be included in the capitalization used in the determination of fair market value of such oil refinery if such property would qualify as exempt property pursuant to Section 2902 of this title, whether or not an application for such exemption is made by an otherwise qualifying manufacturing concern owning the property described by Section 2817.3 of this title.

[12] District Court of Oklahoma County Case No. CJ-2004-9232. *See*, www.oscn.net.

approved by the COUNTY Assessor and Board of Equalization and forwarded to the Tax Commission. No hearing was held on Protestant's protest to the "Notice of Change in Assessed Value" for the 2004 tax year. The five (5) year manufacturing exemption applications for tax years 2004 (XM-R1) and 2005 (XM-R2) in the amounts of $95,917, 500.00 were denied by the Division by letters dated July 13th, as amended July 14, 2006. Protestant timely protested the letters of denial by letter dated September 1, 2006.

5. The provisions of § 227.1 of the Uniform Tax Procedure Code[13] are not applicable to this proceeding. *See*, 68 O.S. 2001, § 227.1(B).

6. The general rule is that a decision of a court will be given retrospective application. ***Kay Electric Cooperative v. Oklahoma Tax Commission***, 1991 OK 76, 815 P.2d 175, 177. The Supreme Court is not prohibited nor compelled to give judicial decisions retrospective operation; judicial policy determines whether, and to what extent, a new rule will operate retroactively. ***McDaneld v. Lynn Hickey Dodge, Inc.***, 1999 OK 30, 979 P.2d 252; ***Globe Life and Accident Insurance Co. v. Oklahoma Tax Commission***, 1996 OK 39, 913 P.2d 1322; ***Resolution Trust Corp. v. Grant***, 1995 OK 68, 901 P.2d 807. The Supreme Court may give prospective operation to its decisions when necessary to avoid disruption and to allow a period of adjustment. ***Aple Auto Cash Express, Inc. of Oklahoma v. Oklahoma Department of Consumer Credit***, 2003 OK 89, 78 P.3d 1231. When a statute pronounced invalid by the court calls for a compulsory discharge of statutory duties by public officials who rely on the presumptive validity of statutes, the court may give its pronouncement purely prospective effect. ***Fent v. Contingency Review Board***, 2007 OK 27, ___ P.3d ___; ***Ethics Commission of State of Oklahoma v. Cullison***, 1993 OK 37, 850 P.2d 1069.

In determining whether to give prospective operation to its decision, the Supreme Court considers: (1) the purpose of the new rule announced by the Court; (2) the extent of reliance on old doctrines; and (3) the burden likely to be imposed on administering legal process due to additional litigation or curative actions. ***Aple Auto Cash***, *supra* at ¶ 20. The Supreme Court has also held: "[t]he three factors for determining if a decision should be given only prospective application are:

> First, the decision to be applied nonretroactively must establish a new principle of law; either by overruling clear past precedent on which litigants may have relied or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, it has been stressed that 'we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation.' Finally, we have weighed the inequity imposed by retroactive application, for 'where a decision of this Court could produce substantial inequitable results if applied retroactively.'

[13] 68 O.S. 2001, § 201 et seq.

Kay Electric, *supra* at 177. The criteria which should be examined in considering an argument against the retroactive application of a newly announced judicial rule are novelty of the rule, the purpose of the rule and whether it will be furthered by retroactive application, and the possibilities of inequities. ***Cox v. Brockway, Inc. (N.Y.)***, 1985 OK 80, 708 P.2d 1085, 1088; ***Mendus v. Morgan & Associates, P.C.***, 1999 OK CIV APP 137, ¶ 37, 994 P.2d 83.

7. Based on the criteria formulated by the United States Supreme Court in ***Chevron Oil Company v. Huson***[14] as adopted and expounded upon by the Courts of Oklahoma, there are sufficient grounds to conclude that the ***Save*** opinion was not intended to be applied prospectively only. First, although the Court struck down §§ 2817(E) and 2817.3 as unconstitutional, the decision neither established a new principle of law, nor was the ruling novel. Cf., ***Globe Life***, *supra* (where the Supreme Court determined that magnetic tapes represented intangible personal property) and ***Schulte Oil Co. Inc., v. Oklahoma Tax Commission***, 1994 OK 103, 882 P.2d 65 (where the Court determined that remanufacturing constituted manufacturing). The Court of Appeals in ***Save*** cited provisions of the Oklahoma Constitution and several decisions as precedence for its conclusion on each point of law. Further, the Court did not characterize its decision as one of first impression. See, ***Mendus***, *supra*.

Second, unlike ***State v. Ford***, 1967 OK 186, 434 P.2d 934 (decision cited by the Division where the exemption had been on the books and followed for more than fifty (50) years) or ***Harry R. Carlile Trust v. Cotton Petroleum Corp.,*** 1986 OK 16, 732 P.2d 438 (long standing statutory policy), the statutes in question were in relative terms new and the attack against them was contemporaneous with their enactment.

Third, the statutes in question were enacted to exclude from the valuation of a refinery mandated desulphurization equipment which the Court of Civil Appeals noted at ¶ 13 such exclusion was neither limited in duration nor was reimbursement for lost revenues provided to schools and others. Additionally the Court noted at footnote 2 that the issue of amending the Oklahoma Constitution to exclude pollution control property from ad valorem taxation was put to a vote of the people and the measure failed. The Court's decision and the purpose behind the lawsuit in ***Save*** will only be furthered by the retroactive application of the opinion inasmuch as the schools and others will at least receive reimbursement of the ad valorem taxes under Article 10, § 6B of the Oklahoma Constitution and § 2902.

Fourth, the possibility of inequity to refineries from the retroactive application of the decision is cured by the provisions of the exemption for new, expanded or acquired manufacturing facilities. As the Court by dicta stated in ***Save*** at ¶ 13 "nothing in this opinion prevents an eligible refinery from obtaining the exemption provided by Art. 10, § 6B." However, substantial inequity would attend to the schools if the decision was not applied retroactively as they would lose two (2) years of revenue which in this case is ad valorem taxes on $95,917,500.00. With respect to Protestant, a party to the ***Save*** decision, under the "pipeline doctrine" parties to a case are generally bound by the decision notwithstanding whether the decision is applied retrospectively or prospectively. See, ***City of Oklahoma City v. State ex rel. Oklahoma Department of Labor***, 1995

[14] 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971).

OK 107, 918 P.2d 26; ***Oklahoma Independent Petroleum Association v. Youngker***, 1988 OK 146, 769 P.2d 109.

Finally, as represented by the facts of this protest, Protestant in response to the ***Save*** opinion applied for a manufacturing exemption on the mandated desulphurization equipment which applications were approved by the COUNTY Assessor and Board of Equalization after; at least with respect to the 2004 tax year, a "Notice of Change in Assessed Value" was issued against Protestant. The Division denied the applications and notified the COUNTY Assessor to place the property on the tax rolls. The Division's denial led to this litigation and if it is decided that the protest should be denied, additional litigation is more than likely to ensue despite the fact that no one disputes Protestant is otherwise eligible for and entitled to the manufacturing exemption on the mandated desulphurization equipment.

8. Protestant's protest to the denial of its 2004 (XM-R1) and 2005 (XM-R2) manufacturing exemption applications on the mandated desulphurization equipment should be and the same is hereby sustained.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is ORDERED that the protest of Protestant, PROTESTANT, be sustained.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.