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Commonwealth of Kentucky

Court of Appeals

NO. 2009-CA-001691-MR

DEPARTMENT OF REVENUE,
FINANCE AND ADMINISTRATION CABINET,
COMMONWEALTH OF KENTUCKY (THE
DEPARTMENT OF REVENUE) APPELLANT

v.

APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE PHILLIP J. SHEPHERD, JUDGE
ACTION NO. 09-CI-00305

COX INTERIOR, INC. APPELLEE

OPINION
AFFIRMING

** ** ** ** **

BEFORE: CAPERTON AND COMBS, JUDGES; LAMBERT,[1] SENIOR JUDGE.

CAPERTON, JUDGE: The Appellant, the Department of Revenue, Finance and Administration Cabinet, Commonwealth of Kentucky, appeals the August 27,

[1] Senior Judge Joseph E. Lambert sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and Kentucky Revised Statutes (KRS) 21.580.

2009, opinion and order of the Franklin Circuit Court, determining that the Appellee, Cox Interior, Inc., could receive a refund of its payment of an ad valorem tax assessment, despite its failure to protest that assessment prior to paying the taxes at issue. Having reviewed the record, the arguments of the parties, and the applicable law, we affirm.

In 2005, the Department of Revenue conducted a tangible personal property tax audit of Cox for the period from 2001 to 2004. At the conclusion of the audit, the Department issued tangible personal property tax bills to Cox in the amount of $151,943.51. In March of 2006, Cox paid the entire balance due, with interest, per the audit assessments. Approximately sixteen months thereafter, on July 10, 2007, Cox filed refund claims pursuant to KRS 134.590 to recover $44,717.00 in property taxes that Cox contends were erroneously paid because the Department of Revenue had incorrectly placed manufacturing machinery on the non-manufacturing schedule of the tangible return.

The Department of Revenue denied Cox's refund claims on procedural grounds on August 17, 2007. Specifically, the Department of Revenue found that, even though Cox filed its refund claims within two years of paying the audit liability, Cox's refund claims were nevertheless disallowed by KRS 134.590 because Cox paid the audit liability without protesting it first. Cox protested that denial on August 28, 2007, within the forty-five-day statutory period for filing a protest claim as set forth in KRS 131.110. On December 10, 2007, the Department of Revenue issued Final Ruling No. 2007-57, upholding the denial of Cox's refund

claims. This final ruling, in reliance upon the last sentence of KRS 134.590(2) and its counterpart in KRS 134.590(6), pointed out that Cox sought the refund of taxes paid on assessments that it had not first protested pursuant to KRS 131.110. Accordingly, the Department of Revenue determined that it had properly denied the claims.

Cox appealed the final ruling to the Kentucky Board of Tax Appeals (KBTA) on January 9, 2008. In its petition on appeal, Cox emphasized that its refund claims were filed within two years of payment, as required by KRS 134.590(2). It further asserted that Cox's failure to protest the original assessments made at the conclusion of the audit did not preclude Cox from filing a refund claim if it later discovered that it overpaid its property taxes. The petition further argued that Cox had protested the Department's denial of the refund claims in accordance with the third sentence of KRS 134.590(2).

On August 19, 2008, the Department filed a motion for summary disposition or judgment pursuant to 802 Kentucky Administrative Record (KAR) 1:010 Section 10. This motion was supported by the affidavit of Department of Revenue employee Montoiya Wheat. Wheat was a protest and review officer whose duties included the review of audits and issuance of notices of assessment pursuant to KRS 131.110. Wheat stated that she had personally reviewed Cox's audit and had sent Cox formal notices of assessment of tax due in accordance with KRS 131.110, 132.486, and 132.310. Accompanying the affidavit was a "fair and accurate copy" of the November 14, 2005, letter Wheat sent to Cox which was

accompanied by the auditor's narrative report, assessment notices, and supporting schedules. That letter stated as follows:

> In accordance with KRS 131.110, if you disagree with the audit results, a written protest, setting for [sic] the grounds upon which the protest is made, and identifying the specific adjustments protested, must be filed within forty-five (45) days from the notice date [on the formal Notices of Tax Due that would be forthcoming within five days].

Wheat's affidavit further established that Cox did not protest the tax assessments, but instead paid the tax assessed in full, with interest. Cox filed a response and its own motion for partial summary disposition on September 3, 2008. Therein, Cox reasserted its position that its protest of the Department's denial of its refund claims satisfied the last sentence of KRS 134.590(2). It also argued that this Court's decision in *Revenue Cabinet v. Castleton, Inc.*, 826 S.W.2d 334 (Ky.App. 1992), supported its position in this regard.

The KBTA issued Order No. K-20213 on February 5, 2009, concluding that Cox had timely filed its claim for a refund and, thereafter, timely filed its protest of Revenue's denial of its refund claims. It further found that Cox did not lose its ability to file for a refund under KRS 134.590 by paying the tax first. The KBTA found *Castleton* to be most analogous to the case before it and reasoned that the statute of limitations does not collapse on a refund merely because the taxpayer pays the tax assessed.

The Department of Revenue appealed the decision of the KBTA to the Franklin Circuit Court, which issued an opinion and order on August 27, 2009,

affirming the decision of KBTA. Like the KBTA, the circuit court found *Castleton* to be controlling. It further found that the interpretation of KRS 134.590 asserted by the Department created "a procedural minefield of obstacles" that would defeat the claims of taxpayers seeking to exercise their legitimate right to make refund claims, stating specifically that:

> Requiring a taxpayer to pay taxes under protest as a mandatory pre-condition of asserting a refund claim later simply erects unnecessary procedural obstacles to obtaining a refund. When a taxpayer protests the denial of a refund claim under the procedure of KRS 131.110, Revenue has a full and fair opportunity to address the merits of the refund claim. That is all the doctrine of exhaustion of remedies can or should require.[2]

It is from that opinion that the Department of Revenue now appeals to this Court. In addressing the issues raised by the parties, we note that when reviewing an appeal from an administrative decision, the standard of review regarding factual issues "is limited to determining whether the decision was erroneous as a matter of law." *McNutt Construction/First General Services v. Scott,* 40 S.W.3d 854, 860 (Ky. 2001). Indeed, "[J]udicial review of administrative action is concerned with the question of *arbitrariness* . . . . Unless action taken by an administrative agency is supported by substantial evidence it is arbitrary." *American Beauty Homes Corp. v. Louisville and Jefferson County Planning and Zoning Commission,* 379 S.W.2d 450, 456 (Ky. 1964). "Substantial evidence is defined as 'evidence of substance and relative consequence having the fitness to induce conviction in the minds of reasonable [persons].'" *Kentucky*

[2] *See* Franklin Circuit Court, Opinion and Order, p. 3.

Unemployment Ins. Com'n v. Landmark Community Newspapers of Kentucky, Inc., 91 S.W.3d 575, 579 (Ky. 2002).

Concerning the weight of the evidence, "the trier of facts is afforded great latitude in its evaluation of the evidence heard and the credibility of witnesses appearing before it." *Bowling v. Natural Resources and Environmental Protection Cabinet,* 891 S.W.2d 406, 409-10 (Ky.App. 1994). A reviewing court may not substitute its own judgment on a factual issue "unless the agency's decision is arbitrary and capricious." *McManus v. Kentucky Retirement Systems,* 124 S.W.3d 454, 458 (Ky.App. 2003). "[T]hree grounds of judicial review, (1) action in excess of granted powers, (2) lack of procedural due process, and (3) lack of substantial evidentiary support, effectually delineate [the] necessary and permissible scope [of review]." *American Beauty Homes Corp.* 379 S.W.2d at 456 (Ky. 1964).

Nevertheless, matters of statutory construction are subject to *de novo* review. "Statutory interpretation is a matter of law reserved for the courts, and this Court is not bound by the [Circuit Court's] interpretation . . . . " *Halls Hardwood Floor Co. v. Stapleton,* 16 S.W.3d 327, 330 (Ky.App. 2000). Under *de novo* review, a reviewing court affords no deference to the trial court's application of the law to the established facts. *Cinelli v. Ward,* 997 S.W.2d 474, 476 (Ky.App. 1998). Should an administrative body misconstrue the legal effect of the facts, courts are not bound to accept the legal conclusions of the administrative body. *Epsilon Trading Co. v. Revenue Cabinet,* 775 S.W.2d 937, 940 (Ky.App. 1989).

Further, we note that the provision at issue in this matter, KRS 134.590, provides, in pertinent part, as follows:

> (1) When the appropriate state government agency determines that a taxpayer has paid ad valorem taxes into the state treasury when no taxes were due or has paid under a statute held unconstitutional, the state government agency which administers the tax shall refund the money, or cause it to be refunded, to the person who paid the tax.
>
> (2) No state government agency shall authorize a refund unless each taxpayer individually applies for a refund within two (2) years from the date the taxpayer paid the tax. Each claim or application for a refund shall be in writing and state the specific grounds upon which it is based. Denials of refund claims or applications may be protested and appealed in accordance with KRS 131.110 and 131.340. No state government agency shall refund ad valorem taxes, except those unconstitutional, unless the taxpayer has properly followed the administrative remedy procedures established through the protest provisions of KRS 131.110, the appeal provisions of KRS 133.120, the correction provisions of KRS 133.110 and 133.130, or other administrative remedy procedures.

On appeal, the Department of Revenue argues that Cox was not entitled to an ad valorem tax refund under KRS 134.590, because it failed to protest the assessment of the taxes that were the object of the assessment. In making this argument, it focuses particularly on the word "has" in the last sentence of KRS 134.590(2). The Department of Revenue asserts that the use of the word "has" unmistakably requires the Department to ask itself when considering a refund claim: Has this taxpayer followed the provisions of KRS 131.110, which relate to the protest of tax assessments? The Department of Revenue argues that in

the matter *sub judice*, Cox did not protest the assessments issued to it as a result of the audit and that, accordingly, it could not later seek a refund.

In making this argument, the Department of Revenue asserts that the KBTA and the circuit court erred in their reliance on *Castleton*, in light of the history of KRS 134.590 and the difference in language between that provision and KRS 134.580, which was the provision analyzed in *Castleton*.

As the Department of Revenue correctly notes, *Castleton* involved a situation in which the taxpayer sought refund of a sales and use tax. Castleton paid part of the assessment without protest, and protested and appealed the balance of the assessment, achieving a reduction in tax liability. Approximately two years later, Castleton filed a claim seeking the refund of a portion of the unprotested amount it had paid. The Cabinet contended that Castleton had waived its legal right to pursue that refund because it had failed to protest the assessment of the tax for which it sought a refund. Therein, this Court held that the taxpayer did not have to follow procedures for filing a protest of a tax assessment in order to seek a refund, stating:

> Upon consideration of KRS 134.580 in light of KRS 131.110, we agree with the trial court's determination that the remedy for filing a claim for a refund of taxes pursuant to KRS 134.580 is not conditioned upon satisfaction of the procedural requirements provided in KRS 131.110 for filing a protest of a tax assessment.

Castleton, 826 S.W.2d at 337.

The Department of Revenue notes that in 1992, KRS 134.590 was amended to provide the specific connection between itself and KRS 131.110 that this Court found to be lacking between KRS 134.580 and KRS 131.110 in *Castleton*. Thus, the Department of Revenue argues that it is plain that no refund can be authorized by the Department unless the taxpayer has properly followed the applicable administrative remedy, including the protest and appeal of the assessment issued. The Department of Revenue argues that KRS 134.580 was not similarly amended, and that as KRS 134.580 and KRS 134.590 are the only two primary statutes governing tax refunds, the difference in language cannot be considered the result of inadvertence on the part of the General Assembly.

Cox disagrees, and argues that the *Castleton* decision clearly stands for the proposition that the taxpayer has the right to request a refund, provided that it is timely made, without regard to whether a protest was filed against the audit liability, and that such principle stands regardless of whether the refund claim relates to a sales tax or a property tax. Cox also argues that it is insignificant that KRS 134.590 references KRS 131.110, while KRS 134.580 does not, and that in any event, it has followed the administrative remedy procedures mandated by KRS 131.110.

Cox also disputes Revenue's assertion that the General Assembly effectively overruled *Castleton* by amending KRS 134.590 in 1992, and again in 2005. Cox instead asserts that the language added in 1992 merely requires that

taxpayers follow the appropriate administrative remedy procedures applicable to their refund claim, which it says it has done in this instance.

Cox further makes note of the "or other administrative remedy procedures" language at the end of KRS 134.590(2), which it asserts is an acknowledgement that a protest pursuant to KRS 131.110 is not the only administrative remedy procedure that may be applicable in a refund situation. Cox likewise argues that the 2005 amendment to KRS 134.590 does not support the interpretation argued by Revenue,[3] and that the clear and stated purpose of the 2005 bill was simply to make it clear that in a class action lawsuit to recover property taxes, each litigant had to file a refund claim with the Department of Revenue in order to receive a refund. Cox thus asserts that neither the 1992 nor the

[3] Specifically, Cox directs this Court to the recitals made to the 2005 bill (HB 498 GA) by the General Assembly, which state as follows:

> WHEREAS, the General Assembly has been made aware that technical nonsubstantive changes made to the tax refund statute, KRS 134.590, in 1996 are being interpreted by litigants and courts as making a substantive change that would allow the brining or maintenance of class actions for the recovery or refund of taxes against the Commonwealth and its political subdivisions and taxing districts; and
>
> WHEREAS, it appears to the General Assembly that similar interpretations are or have been advocated or adopted concerning other tax refund statutes, or that similar uncertainty exists with respect to other tax refund statutes; and
>
> WHEREAS, the General Assembly wishes to make it clear that each taxpayer must file an individual refund claim and that the filing of a class action lawsuit does not constitute a timely filing for each member of the class, and clarify other procedural requirements of the tax refund statutes . . . .

2005 amendments to KRS 134.590 support the Department of Revenue's assertion that the General Assembly has nullified *Castleton*.

Beyond asserting that *Castleton* is inapplicable to the matter *sub judice*, the Department of Revenue argues that the interpretation of the statute urged by Cox renders the last sentence of KRS 134.590(2) essentially meaningless. The Department of Revenue asserts that the General Assembly specifically intended for parties to protest allegedly erroneous assessments within a forty-five-day period, as mandated by KRS 131.110. Accordingly, it argues that the interpretation asserted by Cox, namely that parties have two years to request a refund and then to protest if the refund is denied, is contrary to the intent of the legislature in amending the statute. It further argues that the sensible and correct interpretation of the third sentence of KRS 134.590(2) is that it codifies the procedure for challenging refund claims denial that had previously been set forth in the Department's regulation, 103 KAR 1:010 §2. It also asserts that the last sentence, by its clear reference to KRS 131.110 (which expressly refers to assessments only) and to KRS 133.120 (which also pertains to assessments), makes clear that it pertains to the protest of an assessment and not the protest of a refund denial.

The Department of Revenue further argues that the interpretation of the statute urged by Cox is at odds with the tangible personal property ad valorem tax statutory scheme as a whole. Cox argued below that the Department of Revenue's position impermissibly shortens the two-year limitations period

prescribed in KRS 134.590(2) for filing refund claims to forty-five days, the time allowed for protesting an assessment under KRS 131.110. Cox restates that argument to this Court, asserting that the interpretation set forth by the Department of Revenue would have the effect of discouraging taxpayers from paying their taxes to avoid the risk of interest and penalties, and then pursuing a refund claim to retrieve the tax that is not owed.

The Department of Revenue argues, instead, that it was and is authorized, on a retroactive basis, to reopen assessments based upon a taxpayer's return, or to assess property that was omitted or not reported on tangible personal property tax returns. Further, it notes that taxpayers who disagree with assessments, or modifications to assessments, have the right to protest pursuant to KRS 131.110. Thus, the Department of Revenue argues that in the case of an assessment based solely upon an initial return, which is not modified, the taxpayer's protest and appeal rights would not be triggered. Instead, the taxpayer would receive his or her tax bill from the sheriff later in the year, and would have two years from the date of payment to obtain a refund if the taxpayer discovers that an error has been made.[4]

In addition, the Department of Revenue argues, the correction or exoneration procedures under KRS 133.110 and KRS 133.130 are not subject to any forty-five-day deadline and would be available to obtain a refund within the

[4] Citing to the Department's online "Frequently Asked Questions: Property Tax" available at http://revenue.ky.gov/FAQ/, page 8, in response to "**How do I amend a previously filed return? How long do I have?**" "[T]axpayer has 2 years from the date of payment to file [an] amended [tangible personal property tax] return which would result in a refund."

full two-year period. Apparently, the Department of Revenue argues that it is only in the specific situation at issue in the matter *sub judice* that a taxpayer must protest within forty-five days of receipt of the assessment and prior to paying the taxes. Thus, it appears that the primary distinction urged by the Department of Revenue is that the General Assembly intended to make a delineation between the refunds of property taxes paid in response to a tax bill issued by the sheriff as opposed to an assessment directly from the Department of Revenue.

In response, Cox asserts that a taxpayer should not forever waive the right to pursue a refund claim simply because the initial tax assessment was not protested. It argues that a refund claim is properly made so long as it is filed with the Department of Revenue within two years of the payment of the tax; and if the claim is denied, the denial is protested as provided in KRS 131.110. It argues that KRS 134.590(2) is effectively divided into two parts: the first of which provides the requirements of a proper refund claim, and the second provides the administrative remedy procedures in the event the refund claim is denied. It asserts that KRS 134.590 merely provides that the appropriate agency must issue a refund when it determines that the taxpayer paid property taxes that were not owed, and that it is absurd to suggest that the General Assembly intended to make a delineation between the refund of property taxes paid in response to a tax bill issued by the sheriff as opposed to the Department of Revenue.

Cox particularly draws this Court's attention to the final portion of KRS 134.590(2), which provides that "other administrative remedy procedures"

may be applicable, depending on the circumstances. Cox asserts that this is a clear acknowledgement that there are other administrative remedy procedures aside from the protest of an initial assessment pursuant to KRS 131.110, including the protest of a refund denial, which are applicable when warranted. Cox argues that it complied with the mandates of KRS 134.590 in the matter *sub judice* and was, accordingly, entitled to a refund.

Finally, the Department of Revenue asserts that the circuit court substituted its own public policy views in disregarding the "plain meaning" of the last sentence of KRS 134.590(2). Specifically, it takes issue with the court's statement that, "Requiring a taxpayer to pay taxes under protest as a mandatory pre-condition of asserting a refund claim later simply erects unnecessary procedural obstacles to obtaining a refund," and its additional statement that the taxpayer's protest of the denial of its refund claim is "all the doctrine of exhaustion of remedies can or should require."

The Department of Revenue argues that it was not the province of the court to discuss its opinions as to what legislative enactments should or should not require. It thus asserts that the court erred as a matter of law in failing to enforce a legitimate and salutary condition on the right to seek an ad valorem tax refund. It asserts that Cox was given an opportunity to protest and appeal its assessments, that it failed to do so, and that, accordingly, it cannot now obtain a refund under KRS 134.590.

In response, Cox asserts that it is the Department of Revenue's position which is contrary to public policy. It argues that it is against public policy to assert that taxpayers cannot retrieve erroneously paid taxes simply because the taxpayer received a bill from the Department of Revenue and not from the sheriff. In so arguing, it notes that the two-year statute of limitations applicable to property taxes is already half of the limitations period provided for most other taxes.[5]

Having reviewed the record, the aforementioned arguments of the parties, and the applicable law, we affirm. While the Department of Revenue asserts that our holding in *Castleton* is inapplicable to the matter *sub judice*, we cannot agree. Taxpayers have the right to determine their accurate tax liability, both before and after payment of the taxes assessed. While the Department of Revenue argues that the holding in *Castleton* is inapplicable because the refund claim was governed by a different refund statute from that at issue in the matter *sub judice*, we disagree.

The KBTA determined that *the same principle* that governed refunds under KRS 134.580 should apply to property tax refunds under KRS 134.590. We agree with the circuit court that KBTA's interpretation in that regard was reasonable, and we decline to disturb it herein. Although KRS 134.590 was amended subsequent to *Castleton* to condition an ad valorem tax refund on the exhaustion of administrative remedies, we do not find that such amendment alters the applicability of that holding herein. We are in agreement with both the KBTA

[5] *See* KRS 134.580, providing a four-year statute of limitations for other taxes.

and the circuit court that the interpretation asserted by the Department of Revenue would effectively require the exhaustion of two administrative remedies rather than one. As we have repeatedly held, we presume that the legislature did not intend an absurd result. *Workforce Development Cabinet v. Gaines*, 276 S.W.3d 789, 793 (Ky. 2008). Requiring a taxpayer to protest taxes prior to payment as a mandatory condition in order to later request a refund creates unnecessary and inefficient procedural obstacles for the taxpayer. We cannot presume that the legislature intended such a result.

Clearly, KRS 131.110 provides that a taxpayer who disagrees with an initial assessment has the right to protest the proposed increase before paying it within forty-five days. This does not, however, preclude those taxpayers who have already paid the tax from seeking a refund of those monies if they later discover that the amount assessed was in error. This Court is of the opinion that once the tax is paid, KRS 134.590 provides taxpayers with a two-year window to retrieve property taxes that were not owed.

We are in agreement with the interpretation asserted by Cox that the "or other administrative remedy procedures" language at the end of KRS 134.590(2) is an acknowledgement that a protest pursuant to KRS 131.110 is not the only administrative remedy procedure that may be applicable in a refund situation. Indeed, the disjunctive use of the word "or" which joins "other administrative remedy procedures," evidences, in the opinion of this Court, an intention that all prior references in the sentence are not to be treated as

conjunctive, or in steps, but in the disjunctive. This affords the taxpayer the option to use any one and maybe all of the administrative remedies available.[6]

All that KRS 134.590 requires is that taxpayers must exhaust their administrative remedies before a refund may be obtained. Cox did so in the matter *sub judice*. In reviewing the record, we note that it is undisputed that the refund claim submitted by Cox on July 10, 2007, was filed well within the two-year statute of limitations provided by KRS 134.590. It is further clear that the claim was submitted in writing, again per the requirements of the statute. It is equally clear that upon denial of the refund by the Department of Revenue, Cox protested that denial in accordance with KRS 131.110, and exhausted the administrative remedies available.

Having reviewed KRS 134.590 in detail, we simply cannot find language therein, or in any other property tax statute, which would support the position that the payment of a tax bill issued by the Department of Revenue nullifies the taxpayer's right to claim a refund if it is later learned that the tax was paid in error. We simply do not think that the General Assembly intended that the two-year property tax refund statute be limited to situations in which property taxes are paid to the sheriff and not to those which are paid in response to an assessment issued by the Department of Revenue.

[6] We note that the statute also states that "Denials of refund claims or applications may be protested and appealed in accordance with KRS 131.110 and 131.340." KRS 134.590(2). The use of the word "may" is usually found to be permissive, in contrast to the use of the word "shall," and while this issue was not argued to this Court, it may have some bearing on the interpretation of the statute.

As the circuit court correctly noted, our legislature has vested the KBTA with the authority to act as the final administrative decision-maker concerning interpretation of the Commonwealth's revenue statutes. In the matter *sub judice*, the KBTA, following a formal adjudication, found that Cox was entitled to pursue a refund. The circuit court, having reviewed that construction, found that it was neither arbitrary nor capricious, and that the KBTA applies the correct rule of law to the undisputed facts. While we review issues of statutory construction *de novo*, we are in agreement with the KBTA's construction of the pertinent statutory provisions, and decline to find otherwise herein.

Wherefore, for the foregoing reasons, we hereby affirm the August 27, 2009, Opinion and Order of the Franklin Circuit Court, and remand this case to the Department of Revenue with instructions to fully consider and make a determination upon the merits of Cox's refund claims.

LAMBERT, SENIOR JUDGE, CONCURS IN RESULT ONLY.

COMBS, JUDGE, CONCURS AND FILES SEPARATE OPINION.

COMBS, JUDGE, CONCURRING: I concur in full with the well reasoned majority opinion. I would simply note as a postscript that I deplore the Department's criticism of the public policy discussion in the opinion of the circuit court. The opinion was well founded on the law and eloquently articulated as to public policy concerns, which are most assuredly at the heart of all judicial writing. The criticism by the Department was an ill-founded distraction from the issue before us on appeal.

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