THE TORTUOUS HISTORY OF SECTION 170 OF THE KENTUCKY CONSTITUTION: HAS THE KENTUCKY SUPREME COURT FINALLY AND CONCLUSIVELY DETERMINED ITS SCOPE?

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In its history, Kentucky's highest court has heard a multitude of important cases dealing with Kentucky tax matters, including many involving the Kentucky constitution. In March 2018, the Kentucky Supreme Court rendered one of the most significant tax cases in its history, this one concerning the scope of Section 170 of the Kentucky constitution. This Article examines whether the court's decision was correct in light of the language of the constitutional provision in question and relevant judicial precedent. It concludes that the court erred in deciding as it did, but that the decision is not likely to be overturned anytime soon.

I. INTRODUCTION

To quote Kentucky's highest court: "The cases that have been decided under Section 170 (§ 170) of the Constitution of Kentucky have at best lacked consistency."[1] In the most recent such case, *Commonwealth v. Interstate Gas Supply Co. ex rel. Tri-State Healthcare Laundry, Inc.* (*IGS*), the Kentucky Supreme Court held that § 170 applies only to ad valorem (property) taxes.[2] Given that its predecessors have often held otherwise, one has to ask whether *IGS* represents the ultimate say on the issue.

As adopted in 1891, § 170 provided in relevant part:

> There shall be exempt from taxation public property used for public purposes; places actually used for religious worship, with the grounds attached thereto and used and appurtenant to the house of worship, not exceeding one-half acre in cities or towns, and not exceeding two acres in the country; places of burial not held for private or corporate profit, institutions of purely public charity, and institutions of education not used

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[1] Dep't of Revenue v. Louisville Children's Theater, Inc., 565 S.W.2d 643, 645 (Ky. Ct. App. 1978).

[2] *See* Commonwealth v. Interstate Gas Supply, Inc. *ex rel.* Tri-State Healthcare Laundry, Inc., 554 S.W.3d 831 (Ky. 2018).

> or employed for gain by any person or corporation, and the income of which is devoted solely to the cause of education; public libraries, their endowments and the income of such property as is used exclusively for their maintenance; all parsonages or residences owned by any religious society, and occupied as a home, and for no other purpose, by the minister of any religion, with not exceeding one-half acre of ground in towns and cities and two acres of ground in the country appurtenant thereto; household goods and other personal property of a person with a family, not exceeding two hundred and fifty dollars in value; crops grown in the year in which the assessment is made, and in the hands of the producer; and all laws exempting or commuting property from taxation other than the property above mentioned shall be void.[3]

If one infers that the authors of § 170 purposely used semicolons to establish precisely the subjects of the exemption afforded by the provision, it is appropriate to categorize those subjects as follows: (1) public property used for public purposes; (2) places actually used for religious worship, with the grounds attached thereto and used and appurtenant to the house of worship;[4] (3) (a) places of burial not held for private or corporate profit, (b) institutions of purely public charity, and (c) institutions of education not used or employed for gain by any person or corporation, the income of which is devoted solely to the cause of education; (4) public libraries, their endowments and the income of such property as is used exclusively for their maintenance; (5) all parsonages or residences owned by any religious society, and occupied as a home, and for no other purpose, by the minister of any religion; (6) household goods and other personal property of a person with a family;[5] and (7) crops grown in the year in which the assessment is made, and in the hands of the producer.

Of these categories, the one that has created the most controversy over the years, and hence the one that has most often been considered by the courts, concerns the exemption granted to "institutions of purely public charity." As this Article details, the Kentucky courts have wavered over the years regarding the precise scope of § 170. The courts' vacillation can be attributed to various factors, including historic perceptions of what the drafters of § 170 intended, ongoing perceptions of what constitutes a "purely public charity," disputes over what taxes come within § 170's purview,

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[3] KY. CONST. § 170 (amended 1955).

[4] This exemption was removed in 1990. *See* 1990 Ky. Acts 307, ch. 227, § 1. As the revised provision is not relevant to this discussion, it is not reproduced here.

[5] This exemption was modified in 1954. *See* 1954 Ky. Acts 352–53, ch. 111, § 1. As the revised provision is not relevant to the discussion, it is not reproduced here. At the same time, the semicolon appearing after the phrase "to the cause of education" was changed to a comma, apparently inadvertently.

misapplication of the rules governing constitutional construction, and changes in Kentucky's tax schemes and statutes.

In considering the scope of § 170, it is important to be aware of certain rules of construction that apply in interpreting the constitution. For example, according to one rule, in construing one section of the constitution, it is appropriate to consider adjoining provisions covering the same subject matter.[6] This rule does not apply, however, where the meanings of the words of a particular constitutional provision are clear on their face.[7] Thus, under the plain meaning doctrine, unless § 170 is considered ambiguous—which no court has suggested—§ 170 must be construed according to its plain language and without reference to other provisions of the constitution or any other aids to construction. Of course, since § 170 concerns taxes, these rules are augmented by the oft-stated rule that taxing statutes are strictly construed against the party claiming exemption.[8] Kentucky's highest court has held, however, that the principle of strict construction may not be used to undermine the plain meaning doctrine.[9]

Both *IGS* and the principal case on which it relied, *Children's Psychiatric Hospital of Northern Kentucky, Inc. v. Revenue Cabinet* (*Children's Psych.*), failed to adhere to these fundamental principles of constitutional construction.[10] In this regard, both decisions, while purporting to construe § 170, overlooked a part of § 170 that leaves no doubt that the provision applies to more than property taxes. That is, § 170 specifically exempts "public libraries, their endowments and *the income of such property* as is used exclusively for their maintenance."[11] According to the plain language of this provision, the *income* of a public library, including the income generated by its endowments, is exempt from any taxes, including, necessarily, income taxes.[12] Thus, no matter how strictly one construes

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[6] *See* Grantz v. Grauman, 302 S.W.2d 364, 366 (Ky. 1957) (stating constitutional provisions dealing with the same subject matter should be considered together).

[7] *Id.* (where constitutional language leaves "no doubt of the intended meaning . . . courts may not employ rules of construction"). *See also* Fletcher v. Graham, 192 S.W.3d 350, 358 (Ky. 2006) (when interpreting a constitutional provision, the court's focus rests on the express language of the provision, the "cardinal rule" being that rules of construction may not be employed when the language of the provision is clear and unambiguous).

[8] *See, e.g.*, Hancock v. Prestonsburg Indus. Corp., 365 S.W.3d 199, 201 (Ky. 2012).

[9] King Drugs, Inc. v. Commonwealth, 250 S.W.3d 643, 645 (Ky. 2008).

[10] *See* Commonwealth v. Interstate Gas Supply, Inc. *ex rel.* Tri-State Healthcare Laundry, Inc., 554 S.W.3d 831, 839–40 (Ky. 2018); Children's Psychiatric Hosp., Inc. v. Revenue Cabinet, 989 S.W.2d 583, 585–86 (Ky. 1999).

[11] KY. CONST. § 170 (emphasis added).

[12] The concept of an income tax had to have been well known at the time § 170 was adopted. For example, Congress had enacted an income tax in 1861 to help fund the Union's efforts in the Civil War. The income tax was reenacted in 1862 and 1864, and was repealed in 1872. *See* Joseph A. Hill, *The Civil War Income Tax*, 8 Q. J. ECON. 416, 416, 422, 423 (1894).

§ 170, there can be no question that it provides that the income of a public library may not be taxed.[13] It necessarily follows that § 170 is not on its face limited to property taxes, and *Children's Psych.* and *IGS* erred in holding otherwise.

II. EARLY CASES SET SOME PARAMETERS

In the first case to construe § 170, *Trustees of Kentucky Female Orphan School v. City of Louisville* (*Kentucky Female Orphan School*), the court of appeals had to decide whether income-producing real estate located in Louisville owned by an organization that operated an orphanage in Midway was exempt from property taxes under § 170.[14] The evidence showed that the income derived from the property was used to enable the organization to carry on its activities.[15] After finding that the organization qualified as both an institution of purely public charity and as an institution of education, the court proceeded to consider the parameters of the public charity exemption, and concluded that "a proper construction of the language used in the section requires the exemption of the entire property of this institution wherever situated, and in whatever form its investments may be found."[16]

In a nutshell, *Kentucky Female Orphan School* stands for the proposition that § 170's exemption extends to a public charity's income-producing property, notwithstanding that the property is not used directly in furtherance of the institution's charitable activity. While *Kentucky Female Orphan School* would appear to give a broad grant of exemption to "institutions of purely public charity" and "institutions of education," it is worth noting that when *Kentucky Female Orphan School* was decided, substantially all of

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[13] In the only case that has construed this particular part of § 170, *City of Louisville v. Filson Club*, 295 S.W.2d 340 (Ky. 1956), a nonprofit membership corporation, formed for the purpose of collecting and preserving a library and museum of historic matter, sought a declaration that it and its property were exempt from taxation under § 170. The evidence showed that, in addition to owning real estate, the corporation derived income from various sources including membership dues. *Id.* at 341. The court of appeals affirmed the lower court's determination that § 170 exempted both the property and the income of the corporation. *Id.* at 342.

[14] Trs. of Ky. Female Orphan Sch. v. City of Louisville, 36 S.W. 922, 922 (Ky. 1896). It appears that the organization was formed by legislative act in 1847, and that act was amended in 1862 to provide that the organization's "property" located in Midway, Kentucky, would be exempt from all taxes "so long as it exists as a school of charity." *See id.* In *City of Newport v. Masonic Temple Ass'n*, 45 S.W. 881, 881 (Ky. 1898), an organization was formed by legislative act and granted an exemption from property and income taxes, so long as the organization was operated for "Masonic and charitable purposes." This case held that the exemption created by the legislative act was superseded by the adoption of the constitution. *Id.* at 882. Presumably, it was understood in *Kentucky Female Orphan School* that the organization could no longer rely on the statutory exemption it had been granted, thereby requiring it to seek refuge in § 170.

[15] *See Kentucky Female Orphan School*, 36 S.W. at 922.

[16] *Id.* at 925.

Kentucky's tax revenues came from property taxes.[17] Thus, when *Kentucky Female Orphan School* held that the "institution"—rather than simply its property that was used directly in furtherance of its exempt purpose—was exempt, it had little practical impact at the time beyond exemption from property taxes. Nevertheless, the case said what it said.

In 1903, the court of appeals was asked in *Commonwealth v. Young Men's Christian Association* (*YMCA*) to determine whether certain property owned by the YMCA was subject to taxation.[18] The property included a building, part of which was rented to non-YMCA members to raise revenue necessary to maintain the organization and part of which was used to conduct religious, charitable, and educational activities.[19] The organization owned additional property, including a vacant lot and other property that it held for sale.[20] The YMCA claimed the exemption on three grounds: that its property was used for religious worship; that it was an institution of purely public charity; and that it was an institution of education not used for gain by any person or corporation, the income of which was devoted solely to the cause of education.[21]

The court had little trouble concluding that the YMCA qualified as a religious institution, but noted that not all of its property was used for religious purposes, with the result that such property would be subject to taxation[22] if the YMCA did not qualify as either a public charity or an educational institution whose income was used exclusively for educational purposes.

The tax authority claimed that the YMCA did not qualify as a public charity, since its benevolence was limited to its dues-paying members, thereby rendering the organization a "private" charity.[23] Without directly

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[17] Kentucky did not levy an income tax after the constitution was adopted in 1891 until 1936. *See* 1936 Sp. Rev. Sess. Ky. Acts 81, ch. 4, § 14. Similarly, it did not levy a sales tax (called a "gross receipts tax") until 1934. *See* 1934 Sp. Sess. Ky. Acts 214–27, ch. 25, §§ 1–19. This tax, which was repealed in 1936, *see* 1936 Ky. Acts 320–21, ch. 101, § 1, was at issue in *City of Covington v. State Tax Comm'n*, 77 S.W.2d 386 (Ky. 1934), discussed *infra* at text accompanying note 41.

[18] Commonwealth v. Young Men's Christian Ass'n, 76 S.W. 522 (Ky. 1903).

[19] *Id.* at 522–23.

[20] *Id.* at 522.

[21] *Id.*

[22] *Id.* at 523. The § 170 exemption for religious institutions is specifically limited to "places actually used for religious worship." *Id.*

[23] *Id.* at 524. In cases decided in 1900 and 1901, the court of appeals held that an organization whose charitable benefits were limited to destitute widows and orphans of deceased organization members was a "private" rather than "public" charity for purposes of § 170, with the result that the organizations were denied exemption from taxation under § 170. *See* City of Newport v. Masonic Temple Ass'n, 56 S.W. 405, 407 (Ky. 1900); Widows' & Orphans' Home of Odd Fellows v. Bosworth, 65 S.W. 591, 592 (Ky. 1901). Just a few years later, the court of appeals retreated from the strict construction it had placed on "purely public charity" in these two cases, holding that, as long as an organization alleviates to some

responding to that argument, the court noted that, while the payment of dues provided the members with certain benefits, the members received no profits or dividends; that member dues represented only a small part of the YMCA's revenues; and, that many of its benefits were free to the public.[24] Finally, the court said that the fact that the YMCA required its members to pay dues "does not change its character as a public charity."[25] Based on the foregoing, the court concluded that the YMCA qualified as a purely public charity, including by virtue of its educational features, which it said it need not

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extent a burden that otherwise would be borne by the Commonwealth, the organization can qualify as a "public" charity. *See* Widows' & Orphans' Home of Odd Fellows v. Commonwealth, 103 S.W. 354, 358–59 (Ky. 1907). Many years later, the court of appeals appeared to narrow the meaning of "purely public charity" when it held that exemption from taxation under § 170 requires that two conditions be met: first, the institution itself must be a charity whose income must be used to further its charitable purpose; and, second, the institution's property must be used for a purely charitable purpose. Iroquois Post No. 229 v. City of Louisville, 309 S.W.2d 353, 354 (Ky. 1958). This holding would appear to contradict both *Kentucky Female Orphan School* and *YMCA*. *Iroquois Post No. 229* was followed by *Commonwealth v. Grand Lodge of Ky.* 459 S.W.2d 601, 602 (Ky. 1970). There, the tax authority denied an exemption to a Masonic lodge building on the ground that the building was not used for a purely charitable purpose as required by *Iroquois Post No. 229*. *Id.* The court of appeals held that, under *Iroquois Post No. 229*, property need not be used directly in charitable work, provided "that the ultimate effect of the use of the property is to accomplish the charitable purposes of the institution." *Id.* at 602. This reading would seem to align *Iroquois Post No. 229* with *Kentucky Female Orphan School* and *YMCA*. A 1974 case, *Commonwealth v. Isaac W. Bernheim Found., Inc.*, 505 S.W.2d 762 (Ky. 1974), went even further. There, a nonprofit organization owned a large nature preserve that was open to the public without charge. *See id.* at 763. It sought exemption as a purely public charity under § 170. *See id.* at 762. The taxing authority contested the exemption on the ground that the organization's activities, though charitable, were not of a character that fulfills basic human needs. *Id.* at 763. In finding for the organization, the court of appeals, seemingly ignoring the maxim that taxing statutes must be strictly construed against the party seeking exemption, said that "[n]o case has been called to our attention which requires that a charity have as its objective the fulfillment of basic human needs for food, clothing and shelter to qualify as a charity for purposes of tax exemption under [§ 170]." *Id.* at 763. The court followed by stating that "charity is broader than relief to the needy poor and includes activities which reasonably better the condition of mankind." *Id.* at 764 (citing District of Columbia v. Friendship House Ass'n, 198 F.2d 530 (D.C. Cir. 1952)). *Banahan v. Presbyterian Hous. Corp.*, 553 S.W.2d 48 (Ky. 1977), was decided just three years after *Bernheim*. That case involved a nonprofit corporation that was formed to provide low-income housing for the elderly and for handicapped persons. *Id.* at 49–50. The tax authority claimed that the corporation could not qualify as a purely public charity under *Iroquois Post No. 229*. *Id.* at 49. The supreme court, noting that all of the nonprofit corporation's income was used to provide low-income housing to a needy class of individuals, held that the corporation qualified as a purely public charity. *Id.* at 51–52. None of the cases summarized in this footnote dealt directly with the question of just what taxes come within the purview of § 170. Hence, these cases are summarized in this note rather than fully explicated in the text. Nevertheless, these cases demonstrate that the Kentucky courts have vacillated over the years in construing what can fairly be said is § 170's most important term.

[24] Commonwealth v. Young Men's Christian Ass'n, 76 S.W. 522, 524 (Ky. 1903).

[25] *Id.*

consider independently under the circumstances.[26] As a result, all of the property in question was deemed exempt.

III. THE FIRST NON-PROPERTY TAX CASE—*CORBIN YMCA*

Fifteen years after the *YMCA* case, the court of appeals was again asked to consider § 170's scope, this time in *Corbin Young Men's Christian Ass'n v. Commonwealth* (*Corbin YMCA*).[27] There, in the first case involving the application of § 170 to non-property taxes, the Corbin YMCA, which was stipulated as qualifying as a public charity within the meaning of § 170, was cited for failing to pay an occupational license fee in connection with its operation of a restaurant on its premises.[28] The Commonwealth asserted that the exemption granted to public charities by § 170 extended only to property taxes. In response, the court, without specifically mentioning the plain meaning doctrine, focused on the literal language of § 170, stating:

> Section 170 of the Constitution very plainly by its terms places quite different limitations upon the extent of exemption from taxation extended to different classes of organizations. It exempts all public 'property' used for public purposes. It exempts 'places,' limited in size, actually used for religious worship. It exempts 'places' of burial not held for private or corporate profit. It exempts 'institutions' of education not used for gain and the income of which is devoted solely to the cause of education. But it exempts 'institutions of purely public charity' without limitations of any kind, except by the descriptive terms employed; 'purely public charity' implying, of course, that the institution could not be used for gain, and that whatever income it enjoyed must be used solely for the cause of charity.[29]

Consistent with the decisions in *Kentucky Female Orphan School* and *YMCA*, the court opined that the language of § 170 demonstrated the drafters' intent to treat the subjects of § 170 differently.[30] After referring to the principle that statutes granting exemption from tax are to be strictly construed against the party seeking exemption,[31] the court concluded that, based on the express language of § 170, organizations that constitute "purely public

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[26] *Id.*

[27] Corbin Young Men's Christian Ass'n v. Commonwealth, 205 S.W. 388 (Ky. 1918).

[28] *Id.* at 388; *see also* Ky. Stat. § 4224, Carroll's Ky. Statutes 2121, 2126 (1915).

[29] *Corbin Young Men's Christian Ass'n*, 205 S.W. at 388 (internal quotation marks omitted). As in *Children's Psychiatric Hosp., Inc. v. Revenue Cabinet*, 989 S.W.2d 583 (Ky. 1999), and *Commonwealth v. Interstate Gas Supply, Inc. ex rel. Tri-State Healthcare Laundry, Inc.*, 554 S.W.3d 831 (Ky. 2018), the court did not mention that § 170 expressly exempts the income of public libraries.

[30] *Corbin Young Men's Christian Ass'n*, 205 S.W. at 389.

[31] *Id.*

charities" are exempt from all taxes, not just property taxes.[32] As a consequence, the organization was excused from paying the occupational license tax.[33]

As mentioned in discussing *Kentucky Female Orphan School*, other than license taxes on certain activities, such as the one in dispute in *Corbin YMCA*, there were no taxes other than property taxes in effect in Kentucky at the time *Corbin YMCA* was decided. Thus, while the *Corbin YMCA* court construed "institution of purely public charity" based upon § 170's literal language, the decision did not have much practical impact at the time. To the extent the various Kentucky tax authorities continued to adhere to *Corbin YMCA* as additional Kentucky taxes were added to the landscape, however, the case necessarily has had far-reaching impact.

IV. ADDITIONAL NON-PROPERTY TAX CASES

A. Gasoline Tax

Just a few years after *Corbin YMCA*, the court of appeals considered the extent to which § 170 applies to a municipality in *City of Louisville v. Cromwell* (*Cromwell*).[34] In that case, a city claimed that § 170 exempted it from a statutorily imposed gasoline tax.[35] The tax authority asserted that, insofar as it applies to municipalities, § 170 exempts only "public property used for public purposes," and thus applies only to property taxes.[36] The court agreed with the tax authority, holding that § 170 did not shield the city from the gasoline tax.[37] In so finding, the court observed that, unless the constitution provides otherwise, the General Assembly has power to levy taxes and grant exemptions from such taxes.[38] Thus, the gasoline tax was a proper exercise of that authority.

B. The 1934 Gross Receipts Tax

In 1934, the Kentucky General Assembly, perhaps in need of additional revenue as a consequence of the Great Depression, enacted a 3% gross receipts tax on the sale of certain commodities.[39] The statute specifically

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[32] *Id.* at 389–90.
[33] *Id.* at 390.
[34] City of Louisville v. Cromwell, 27 S.W.2d 377 (Ky. 1930).
[35] *Id.*
[36] *Id.* at 378–79.
[37] *Id.* at 382.
[38] *Id.* at 378–79.
[39] Gross Receipts Tax Law of 1934, ch. 25, § 3, 1934 Ky. Acts 218–19.

required the seller to collect the tax from the purchaser.[40] In *City of Covington v. State Tax Commission* (*City of Covington*), several municipalities, charitable institutions, and educational institutions brought suit claiming exemption from the tax under the language of the taxing statute as well as under § 170.[41] The statute exempted "every charitable and educational institution in the State of Kentucky and institutions thereof."[42] The trial court, and the court of appeals, rejected the municipalities' contention that they were "institutions of Kentucky."[43] As a result, sellers of the designated commodities to municipalities were required to collect the tax from the municipalities. After suggesting that sales to charitable and educational institutions would be exempt under § 170, the court concluded that sales to such organizations were exempt by virtue of the taxing statute itself.[44] The court also concluded, however, that nothing in § 170 or the taxing statute excused the charitable and educational institutions from collecting the sales tax on their sales of the specified commodities.[45] The latter finding was predicated on the court's determination that, in view of the fact that the statute required the seller to collect the tax from the purchaser, the legal incidence of the tax was on the purchaser rather than the seller.[46] Therefore, requiring a charitable or educational institution to act as a tax collector on its sales did not run afoul of § 170.

C. Motor Vehicle Usage Tax

In *Gray v. Methodist Episcopal Church, South, Widows & Orphans Home* (*Widows & Orphans Home*), a Kentucky nonprofit corporation operated an orphanage.[47] In order to transport the orphans, the organization purchased a motor vehicle.[48] The county clerk refused to register the vehicle or accept the registration fee on the ground that the organization had failed to pay a statutorily prescribed "motor vehicle usage" tax.[49] The organization claimed purely public charity status under § 170.[50] The lower court

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[40] Gross Receipts Tax Law of 1934, ch. 25, § 3, 1934 Ky. Acts 218.

[41] City of Covington v. State Tax Comm'n, 77 S.W.2d 386 (Ky. 1934).

[42] Gross Receipts Tax Law of 1934, ch. 25, § 5, 1934 Ky. Acts 219.

[43] *City of Covington*, 77 S.W.2d at 391.

[44] *Id.* at 390.

[45] *Id.* at 391.

[46] *Id.*

[47] Gray v. Methodist Episcopal Church, South, Widows & Orphans Home in State of Ky., 114 S.W.2d 1141 (Ky. 1938), *abrogated by* Commonwealth v. Interstate Gas Supply, Inc. *ex rel.* Tri-State Healthcare Laundry, Inc., 554 S.W.3d 831 (Ky. 2018).

[48] *Id.* at 1142.

[49] *Id.*

[50] *Id.*

concluded that the organization qualified as a purely public charity and, as such, was exempt from the motor vehicle usage tax, not under § 170 per se, but under an exemption included in the taxing statute itself.[51] The lower court also held that, as a purely public charity, the organization was exempt from paying the registration fee by virtue of § 170.[52]

Before the court of appeals, the county clerk conceded the organization's status as a purely public charity.[53] As a consequence, the statute that levied the motor vehicle usage tax expressly exempted the organization from the tax, so that issue was not before the court. The county clerk argued, however, that public charity status did not excuse the organization from paying the registration fee, the theory being that the registration fee was not a tax but a regulatory fee.[54] The organization claimed that § 170 exempted it from the registration fee as well as the motor vehicle usage tax.[55] Citing *Corbin YMCA* and *Kentucky Female Orphan School*, the court reaffirmed that institutions of purely public charity are exempt from all taxes. "In other words, the exemption was intended to extend further than an exemption of ad valorem or property, directly used by the institution in the operation of its charity."[56] Ultimately, however, the court, after citing the principle that exemption statutes are to be strictly construed against the party seeking exemption,[57] concluded that the registration fee was a regulatory fee rather than a tax within the purview of § 170.[58] Hence, the orphanage was held liable for the registration fee but not for the motor vehicle usage tax.

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[51] *Id.* at 1145 (citing Ky. Stat. § 4281i–3, Carroll's Ky. Statutes 2283 (1936)).

[52] *Id.* at 1142.

[53] *Id.*

[54] *Id.*

[55] *Id.*

[56] *Id.* at 1143. It should be noted that, as of the time of *Widows & Orphans Home*, Kentucky had enacted an income tax. *See* 1936 Sp. Rev. Sess. Ky. Acts 67–102, ch. 7, §§ 1–40. Hence, the principle enunciated in *Corbin Young Men's Christian Ass'n v. Commonwealth*, 205 S.W. 388 (Ky. 1918), that purely public charities are exempt from all taxes, had taken on greater significance by the time of *Widows & Orphans Home*. That being said, it bears noting that "religious, educational, charitable and other corporations not organized or conducted for pecuniary profit" were statutorily exempted from the income tax. *See* 1936 Sp. Rev. Sess. Ky. Acts 81, ch. 7, § 14. Hence, as of 1936, a "purely public charity" no longer needed to rely on § 170 to be exempt from tax on its income.

[57] *Widows & Orphans Home*, 114 S.W.2d at 1143.

[58] *Id.* at 1144. Despite the court's conclusion regarding the orphanage's liability for the registration fee, it is clear from the language of the opinion that, had the court considered the registration fee a tax, it would have held the organization exempt from the fee pursuant to § 170.

D. Gasoline Tax

The distinction between the subjects listed in § 170 was further noted in *Board of Education of Kenton County v. Talbott*.[59] There, the Board of Education purchased gasoline outside Kentucky for use in Kentucky.[60] The statute that imposed the gasoline excise tax did not exempt any person, public or private.[61] Thus, the sole issue was whether § 170 exempted the Board of Education from the tax.[62] Citing *Cromwell*, the court of appeals held that only the exemption for public property used for public purposes could apply to a board of education.[63] Since the tax in question was an excise tax rather than a property tax, § 170 did not excuse the Board of Education from paying the tax.

E. Sales and Use Tax

The next significant Kentucky tax case involving § 170, *Marcum v. City of Louisville Municipal Housing Commission* (*Marcum*),[64] dealt with the Kentucky sales and use tax that was adopted in 1960.[65] Very generally, the sales tax applies to sales of tangible personal property consummated in Kentucky,[66] while, the use tax applies to the "use" of property in Kentucky,[67] the purchase of which was not subject to Kentucky sales tax.[68]

At the time the new tax scheme was adopted, it included a provision, Kentucky Revised Statute (KRS) § 139.470(1), that provided, and substantially continues to provide:

> There shall be excluded from the computation of the amount of taxes imposed by this chapter:
> (1) Gross receipts from the sale of, and the storage, use or other consumption in this state of, tangible personal property the gross receipts from the sale of which, or the storage, use or consumption of which, this state is prohibited from taxing under the Constitution or laws of the United States, or under the Constitution of this state.[69]

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[59] Bd. of Educ. of Kenton Cty. v. Talbott, 151 S.W.2d 42 (Ky. 1941).

[60] *Id.* at 43.

[61] *Id.* (citing Acts of 1932, ch. 150, § 1, 1936 Sp. Rev. Sess. Ky. Acts 51).

[62] *Id.* at 45.

[63] *Id.*

[64] Marcum v. City of Louisville Mun. Hous. Comm'n, 374 S.W.2d 865 (Ky. 1963).

[65] 1960 Kentucky Acts 9-36, ch. 5, Art. I.

[66] *See* KY. REV. STAT. ANN. § 139.200(1)(a) (West 2010).

[67] *See id.* § 139.310(1).

[68] *See id.* § 139.500(1).

[69] *Id.* § 139.470(1). This statute was most certainly aimed at § 170. Most likely, given the state of the case law at that time, it was intended to grant sales and use tax exemptions to places of burial, purely

The Housing Commission sought a declaration that it was exempt from the sales and use tax on its purchases of utilities.[70] The tax authority agreed that the Housing Commission qualified as a purely public charity within the meaning of § 170, and the lower court held that the Housing Commission was exempt from the sales and use tax.[71]

When the matter was brought to the court of appeals, the court began with a consideration of the distinction between the sales tax and the use tax, as in effect during the relevant tax period. First, it noted that, when applicable, the use tax was required to be collected by the retailer from the purchaser,[72] while the statute imposing the sales tax merely authorized the retailer to collect the tax from the purchaser.[73] Based on this dichotomy, the court concluded that the legal incidence and the economic burden of the use tax fell on the purchaser, while the legal incidence of the sales tax fell on the retailer, even if the economic burden could be passed on to the purchaser.[74] The court also concluded that, since the legal incidence of the use tax was on the consumer, § 170 and KRS § 139.470(1) applied to exempt purely public charities from the use tax.[75] The tax authority agreed with this proposition.[76] As for the sales tax, however, the court determined that, since its legal incidence was on the retailer, neither § 170 nor KRS § 139.470(1) shielded a purely public charity from bearing the economic burden of the sales tax.[77] Consequently, since the Housing Commission had purchased the utilities in Kentucky, the court found no ground to exempt it from bearing the economic burden of the sales tax.

Though the court of appeals' decision can be justified on the basis of the express language of the sales and use tax statutes then in effect, the decision

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public charities, certain educational institutions, and public libraries. *Children's Psychiatric Hosp., Inc. v. Revenue Cabinet*, 989 S.W.2d 583 (Ky. 1999), and *Commonwealth v. Interstate Gas Supply, Inc. ex rel. Tri-State Healthcare Laundry, Inc.*, 554 S.W.3d 831 (Ky. 2018), virtually emasculate this exemption insofar as it relies on § 170 rather than the federal Constitution.

[70] Marcum v. City of Louisville Mun. Hous. Comm'n, 374 S.W.2d 865, 865 (Ky. 1963).

[71] *Id.* at 866.

[72] *See* KY. REV. STAT. ANN. § 139.340(1) (West 2010).

[73] See 1960 Ky. Acts 16, ch. 5, Art I, § 21, for KRS § 139.210(1) as in effect during the years in issue. In 1990, KRS § 139.210 was amended to require the retailer to collect the sales tax from the purchaser. *See* 1990 Ky. Acts 281, ch. 137, § 1.

[74] *Marcum*, 374 S.W.2d at 866.

[75] *Id.*

[76] *Id.* The opinion in *Commonwealth v. Interstate Gas Supply, Inc. ex rel. Tri-State Healthcare Laundry, Inc.*, 554 S.W.3d 831, 839 n.10 (Ky. 2018), mentions *Marcum* at footnote 10, and states that the court there "assumed" that § 170 exempts purely public charities from non-property taxes. In fact, the tax authority had conceded that position, leaving no reason for the court to address the issue.

[77] *Marcum*, 374 S.W.2d at 866. The sales tax that was enacted in 1960 should be compared with the gross receipts tax that was at issue in *City of Covington v. State Tax Comm'n*, 77 S.W.2d 386 (Ky. 1934). The tax at issue there was required by law to be collected from the purchaser. *Id.* at 387. Since the statute itself exempted charitable institutions, § 170 was not in issue. *Id.*

would appear to undermine the economic interests of Kentucky and its citizens. That is, based on the rationale of *Marcum*, a purely public charity is (or was under the law in effect at the time) better off making its purchases from non-Kentucky retailers, for which it would not be liable for use tax, to the obvious disadvantage of Kentucky retailers.

F. Motor Vehicle Usage Tax

A municipal corporation's claim of exemption from Kentucky's motor vehicle usage tax pursuant to § 170 was again at issue in *Thomas v. City of Elizabethtown* (*Thomas*).[78] At the time of the city's purchase, the governing statute exempted only vehicles sold to the United States or to the Commonwealth of Kentucky.[79] Previously, the statute had also specifically exempted cities and other political subdivisions.[80] So the question before the court of appeals was whether the city was exempt from Kentucky's motor vehicle usage tax, solely by virtue of § 170.[81] The court began its analysis by citing the well-established principle that statutes granting exemption from tax are strictly construed against the party claiming exemption.[82] It then turned its attention to the constitutional terms "public property" and "public purposes," and to the term "ad valorem."[83] The court quickly concluded that the vehicles in question were public property used for public purposes.[84] That left the question whether the motor vehicle usage tax is the equivalent of an ad valorem property tax. The court looked to the dictionary definition of "ad valorem":

> Literally, according to the value; used especially to designate a duty or charge laid upon goods at a certain rate per cent upon their value as stated in the invoice, in opposition to a specific sum upon a given quantity or number; to designate an assessment of taxes against property, etc.[85]

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[78] Thomas v. City of Elizabethtown, 403 S.W.2d 269 (Ky. 1965).

[79] *Id.* at 271 (citing KY. REV. STAT. ANN. § 138.470(1) (West 2010)).

[80] *Id.*; see also Ky. Stat. § 4281i-3, Carroll's Ky. Statutes 2283 (1936) (later codified at KRS § 138.470(1)), which had exempted motor vehicles sold to the United States, Kentucky, any city or political subdivision of Kentucky, or to any charitable, religious, or educational institution of Kentucky. In 1968, KRS § 138.470(1) was amended to exempt vehicles sold to the United States or to Kentucky or any of its political subdivisions, and KRS § 138.470(2) was amended to exempt motor vehicles sold to purely public charities and institutions of education not used or employed for gain by any person or corporation. *See* 1968 Ky. Acts 96, ch. 40, Part III, § 3.

[81] *See Thomas*, 403 S.W.2d at 271.

[82] *Id.* at 271.

[83] *Id.* at 271–72.

[84] *Id.*

[85] *Id.* at 272 (internal citations and quotation marks omitted).

According to the court, "[t]his definition fits the tax in question like a pocket fits a shirt."[86] Responding to the tax authority's argument that the motor vehicle usage tax is specifically imposed on the use of a motor vehicle in Kentucky rather than upon the vehicle itself, the court observed that "[t]he nature and character of the tax is measured by its features and not by the name given it by the Legislature."[87] The court concluded:

> It may be said there is no difference between the tax in question and the general sales tax, but as pointed out in *Marcum* . . . , the sales tax involves a transaction of purchase and sale, and is fixed upon the seller, whereas the use tax is not excised from or by reason of a transaction. Being a tax on the use and enjoyment of property, it is more akin to a tax on property itself, an ad valorem tax, than it is to a simple excise tax such as the sales tax . . . .[88]

Based on this questionable reading of *Marcum*, the court held that the motor vehicle usage tax did not apply to the city's use of the vehicles (despite clear legislative intent to the contrary).[89] To be sure, *Marcum* never hinted that Kentucky's use tax is the equivalent of a property tax. *Thomas*'s flawed analysis of the nature of the motor vehicle usage tax, along with its inaccurate reading of *Marcum*, mark it as one of Kentucky's worst tax decisions. At a minimum, the court's decision reflected an absolute disregard of the established principle that exemptions from taxation are strictly construed against the party seeking exemption.

G. Use Tax

In a case decided just three years after *Thomas*, the City of Elizabethtown was again before the court of appeals in a tax case, this time in *Commonwealth v. City of Elizabethtown* (*City of Elizabethtown*).[90] That case presented the question whether the city was liable for Kentucky use tax on items of equipment it had purchased outside Kentucky for use in Kentucky.[91] Both the board of tax appeals and the circuit court determined that the city was not liable for the tax.[92]

At the time of the purchases, KRS § 139.310 read as follows: "An excise tax is hereby imposed on the storage, use or other consumption in this state

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[86] *Id.* Whatever that means.

[87] *Id.*

[88] *Id.* The court erred in stating that the use tax is not imposed "by reason of a transaction." To the contrary, the taxable transaction is the storage, use, or other consumption of the property in Kentucky.

[89] *Id.* at 271.

[90] Commonwealth v. City of Elizabethtown, 435 S.W.2d 78 (Ky. 1968).

[91] *Id.* at 79.

[92] *Id.*

of tangible personal property purchased on or after July 1, 1960, for storage, use or other consumption in this state . . . ."[93] The city, citing the misguided decision in *Thomas*, claimed exemption from the tax under that part of § 170 that exempts "public property used for public purposes."[94] The city asserted that there was no practical difference between the motor vehicle usage tax at issue in *Thomas* and the use tax presently before the court.[95] The tax authority insisted that § 170 exempts cities from property taxes only, and that *Thomas* erred in equating the motor vehicle usage tax with a property tax.[96]

In addressing the issue, the court of appeals cited a dozen or so cases from other jurisdictions that had labeled their states' use tax an excise tax and not a property tax.[97] It followed by stating that "[i]t now appears that our classification of the tax as an ad valorem tax in [*Thomas*] was an unfortunate classification and should be corrected."[98] The court proceeded to consider whether the city was exempt from the use tax levied by KRS § 139.310 under that part of § 170 that exempts public property used for public purposes. After noting that the Kentucky courts had "uniformly"[99] held that that part of § 170 applies only to property taxes, the court continued:

> As the tax is not an ad valorem tax exempt under section 170 of the Constitution the only other logical basis to support its exemption would be if the incidence of the tax is so similar to an ad valorem tax that by virtue of this fact alone it would be brought under the protection of the Constitution. The tax, strictly speaking, is not upon the property per se. It is levied upon the transfer[100] presumably for its use, storage or consumption within this state. In theory it would appear from the statute that the tax is in reality a tax upon the right to use property upon which a sales tax has not been paid. Section 170 of the Constitution exempts the city from tax upon 'public property used for public purposes.' As this tax is a tax upon the use of the property it would seem that if the property is used for public purposes then the incidence of the tax is identical to that of any other ad valorem tax, therefore, even though it be, strictly speaking, an excise tax it would violate the exemption provided by the Constitution because it is in fact a tax upon the use of public property used for public purposes.

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[93] *Id.*

[94] *Id.*

[95] *Id.*

[96] *Id.*

[97] *Id.* at 79–80.

[98] *Id.* at 80.

[99] *Id.*

[100] Contrary to the court's statement, while KRS § 139.340(1) implies that the use tax is to be collected at the time of transfer, the use tax is levied not on the "transfer" of property but on its use, storage, or other consumption in Kentucky. *See* KY. REV. STAT. ANN. § 139.310 (West 2010). Of course, even if the use tax were triggered by a transfer, it would constitute an excise tax.

. . . .

> It is our opinion that the tax levied by KRS § 139.310 is an excise tax the incidence of which is so similar to that of an ad valorem tax as to render its enforcement against cities unconstitutional.[101]

City of Elizabethtown represents another low point in Kentucky tax jurisprudence. While the court of appeals in that case admitted the mistake it had made in *Thomas*, the *City of Elizabethtown* court showed no better understanding of the difference between a property tax (i.e., a tax on property, measured by its value) and an excise tax, which is universally recognized as a tax on a transaction (e.g., a "sale" or "use" of property). The court could have redeemed itself by simply overruling *Thomas*. Instead it ignored the long-standing principle of strict construction against exemption and stunningly found it appropriate to conclude that if a tax is sufficiently similar to a property tax, it should be treated like a property tax for purposes of § 170.[102] It should be noted that the same judge who had dissented in *Thomas* also dissented in *City of Elizabethtown*.[103]

H. Sales and Use Tax

The status of an organization as a "purely public charity" was again at issue in *Department of Revenue v. Central Medical Lab, Inc.* (*Central Medical Lab*).[104] In that case, a nonprofit corporation operated a laboratory testing facility for three nonprofit hospitals.[105] The lab and each of the hospitals qualified for exemption from federal income tax as charitable organizations described in I.R.C. § 501(c)(3).[106] The tax authority treated each hospital as a purely public charity, but declined to so treat the lab.[107] As a result, the lab could not avoid Kentucky sales and use tax on its purchases. The tax authority's determination was upheld by the board of tax appeals, but reversed by the circuit court.[108]

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[101] *City of Elizabethtown*, 435 S.W.2d at 80 (quotation marks in original).

[102] *Id.*

[103] *See id.* (Williams, J., dissenting); Thomas v. City of Elizabethtown, 403 S.W.2d 269, 272 (Ky. 1965) (Williams, J., dissenting).

[104] Dept. of Revenue v. Cent. Med. Lab, Inc., 555 S.W.2d 632 (Ky. Ct. App. 1977).

[105] *Id.* at 633.

[106] *Id.* The lab qualified for I.R.C. § 501(c)(3) status as a "cooperative hospital service organization" under I.R.C. § 501(e)(1).

[107] *Id.*

[108] *Id.*

On appeal, the court of appeals affirmed the judgment of the circuit court, thereby entitling the lab to "purely public charity" tax treatment.[109] The court noted that the lab had been formed solely to provide laboratory services to its three member hospitals; that the existence of the lab resulted in significant savings to the hospitals; and, that the services performed by the lab previously had to be performed by the hospitals in furtherance of their activities as purely public charities.[110] Citing KRS § 139.470(1), the court held that the lab qualified for exemption from the sales and use tax as an institution of purely public charity described in § 170.[111]

V. KRS § 139.495—CHARITIES GET THEIR OWN SALES AND USE TAX STATUTE

The litigation in *Central Medical Lab* commenced in late 1975. At that time, a purely public charity had to rely on KRS § 139.470(1) to claim exemption from Kentucky sales and use tax. That statute exempted a party from the sales and use tax if taxation was prevented by either the federal Constitution or the Kentucky constitution.[112] By the time the board of tax appeals issued its order in *Central Medical Lab*, the General Assembly had enacted KRS § 139.495.

At its enactment, KRS § 139.495 provided in relevant part:

> (1) The taxes imposed by this chapter shall apply to resident, nonprofit educational, charitable, and religious institutions as follows:
>
> (a) Tax does not apply to sales of tangible personal property or service to such institutions provided the property or service is to be used solely within the educational, charitable, or religious function.
>
> (b) Sales made by such institutions are taxable and the tax may be passed on to the customer as provided in KRS § 139.210.[113]

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[109] *Id.*

[110] *Id.*

[111] *Id.* at 634. *Central Medical Lab* contradicted *Marcum v. City of Louisville Mun. Hous. Comm'n*, 374 S.W.2d 865 (Ky. 1963), in effectively holding that the organization was exempt not only from Kentucky use tax but also from Kentucky sales tax.

[112] *See Cent. Med. Lab, Inc.*, 555 S.W.2d at 633–34. This is an important factor to consider in assessing the correctness of the decision in *Commonwealth v. Interstate Gas Supply, Inc. ex rel. Tri-State Healthcare Laundry, Inc.*, 554 S.W.3d 831 (Ky. 2018). In this regard, it should be noted that *Central Medical Lab* is not mentioned in *IGS*.

[113] 1976 Ky. Acts 156, ch. 77, Part III, § 2. At the same time, the legislature amended KRS § 139.470 to exempt from the sale and use tax: "(7) Gross receipts from sales to any cabinet, department, bureau, commission board, or other statutory or constitutional agency of the state and gross receipts from sales to counties, cities or special districts as defined in KRS § 65.005." *Id* at § 1(7). This exemption applies only to purchases of property or services for use solely in the governmental function. This exemption now

The General Assembly's motivation for the enactment of KRS § 139.495 is unknown. For example, was KRS § 139.495's addition to the sales and use tax law an attempt merely to clarify the application of Kentucky's sales and use tax to certain organizations described in § 170, and therefore, already exempted under KRS § 139.470(1)? If so, why not use § 170's language? Did the legislature intend by using the phrase "nonprofit educational, charitable, and religious institutions" to extend to such institutions an exemption the legislature thought was not otherwise afforded by KRS § 139.470(1) and § 170?[114] Was KRS § 139.495 added to overrule *Marcum*, which had concluded some twelve years earlier that charities are exempt from paying the use tax but not the sales tax?

A. Sales Tax on Sales of Admissions

Not long after KRS § 139.495 was enacted, the court of appeals decided *Louisville Children's Theater*.[115] As KRS § 139.495 was not mentioned in the decision, the case must have concerned tax years prior to 1976. The case dealt with the narrow issue of whether the organization should be excused from collecting sales tax on its sales of tickets to theater events, pursuant to KRS § 139.470(1) and § 170.[116] At the time of the case, KRS § 139.200(2)(c) defined "retail sale" to include the sale of admissions, and KRS § 139.200 imposed the tax on the retailer, while KRS § 139.210 authorized, but did not require, the retailer to collect the tax from the customer.[117] Thus, under the law in effect at that time, the legal incidence of the sales tax applicable to ticket sales was on the selling party. The trial court found that the organization qualified as both a public charity and as an educational institution under § 170, a decision that was affirmed by the court of appeals.[118] As a consequence, the theater was held to be exempt from sales tax on its sales of admissions.[119] In other words, *Louisville Children's*

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appears at KRS § 139.470(6).

[114] The rationale for adding KRS § 139.470(6) to exempt certain governmental entities from sales and use tax is clearer. Although Kentucky's highest court had found a way, in both *Thomas v. City of Elizabethtown*, 403 S.W.2d 269 (Ky. 1965), and *Commonwealth v. City of Elizabethtown*, 435 S.W.2d 78 (Ky. 1968), to exempt a governmental entity from an excise tax, the General Assembly may have been of the opinion that the validity of those cases would not last for long. Thus, it made perfect sense to add KRS § 139.470(6) to settle the issue. The motor vehicle usage tax law at issue in *Thomas* was amended in 1968 to add KRS § 138.470(1) to exempt motor vehicles sold to political subdivisions of Kentucky. *See* 1968 Ky. Acts 96, ch. 40, Part III, § 3.

[115] Dep't of Revenue v. Louisville Children's Theater, Inc., 565 S.W.2d 643 (Ky. Ct. App. 1978).

[116] *Id.* at 644.

[117] *See* 1968 Ky. Acts 86, ch. 40, Part I, § 4 (language of KRS § 139.200); 1960 Ky. Acts 16, ch. 5, Art. 1, § 21 (language of KRS § 139.210).

[118] *Louisville Children's Theater*, 565 S.W.2d at 643.

[119] *Id.* at 645. *Louisville Children's Theater* is mentioned at footnote 10 of *Commonwealth v. Interstate*

Theater held that, under the sales tax law in effect at the time (i.e., KRS § 139.470(1)), sales of admissions are not taxable when made by charitable or educational § 170 organizations.[120]

At the time *Louisville Children's Theater* was decided, KRS § 139.200 imposed the sales tax on the retailer, and KRS § 139.210 authorized the retailer to collect the tax from the purchaser. Thus, as was discussed by the court of appeals in *Marcum*, the statute in effect at the time of *Louisville Children's Theater* placed the legal incidence of the tax on the retailer. While the language of KRS § 139.200 and KRS § 139.210 permitted that determination, the decision had the effect of allowing the tax-exempt ticket seller to decide whether or not Kentucky should get any sales tax revenue on ticket sales that otherwise were taxable under the admissions statute.

B. Reconciling Marcum, Central Medical Lab, and Louisville Children's Theater

When one measures *Marcum*, *Central Medical Lab*, and *Louisville Children's Theater* side-by-side, the results are baffling. *Marcum* held that, under the law in effect at the time, a purely public charity was exempt under § 170 and pursuant to KRS § 139.470(1) from Kentucky use tax (since the legal incidence of the tax was on the purchaser/user) but not from Kentucky sales tax (since the legal incidence of the tax was on the seller, though it could be passed on to the purchaser).[121] In contrast, the *Central Medical Lab* court held that the organization in that case was exempt from both Kentucky sales and use tax under the exact same law, and specifically directed the tax authority to provide it with a tax exemption certificate.[122] That certificate could then be provided to both in-state and out-of-state retailers to avoid the payment of Kentucky sales and use taxes. *Louisville Children's Theater* dealt solely with whether the organization had to collect sales taxes on its admissions (the legal incidence of the sales tax being on the seller).[123] The decision raises the question, however, as to the manner in which the organization's purchases were to be treated for sales and use tax purposes. Presumably, though the decision excused the organization from collecting

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Gas Supply, Inc. ex rel. Tri-State Healthcare Laundry, Inc., 554 S.W.3d 831, 839 n.10 (Ky. 2018).

[120] *Louisville Children's Theater*, 565 S.W.2d at 647. The Kentucky Attorney General issued an opinion in 1980 stating, without discussion of any kind but citing § 170, KRS § 139.470(1), and KRS § 139.495, which was not before the court in *Louisville Children's Theater*, that Louisville Orchestra, Inc. was a purely public charity under § 170 and thus exempt from sales tax on its admissions. *See* Op. Att'y Gen. 80–598 (1980).

[121] Marcum v. City of Louisville Mun. Hous. Comm'n, 374 S.W.2d 865, 868 (Ky. 1963).

[122] Dept. of Revenue v. Cent. Med. Lab, Inc., 555 S.W.2d 632, 634 (Ky. Ct. App. 1977).

[123] *Louisville Children's Theater*, 565 S.W.2d at 644.

sales tax on its admissions, pursuant to *Marcum*, the organization would remain liable for sales tax on its Kentucky purchases but not for use tax on its purchases that were not subject to sales tax. Or perhaps it would be exempt from both sales and use tax under *Central Medical Lab*.

In sum: (1) the organization in *Marcum* was held exempt from Kentucky use tax but not Kentucky sales tax; (2) the organization in *Central Medical Lab* was held exempt from both Kentucky use tax and Kentucky sales tax; and (3) the organization in *Louisville Children's Theater* was held exempt from collecting sales tax on its sales of admissions, it being unclear whether *Marcum* or *Central Medical Lab* would govern the sales and use tax treatment of its purchases.

The seemingly irreconcilable teachings of these three cases may be the reason why the General Assembly amended KRS § 139.210(1) in 1990 to require the retailer to collect the sales tax from the purchaser.[124] This statutory change had the effect of shifting the legal incidence of the sales tax from the retailer to the purchaser, thereby putting the legal incidence of the sales tax and the use tax on the same plane. If one of the motivations for the change was to ensure that exempt organizations selling admissions would thereafter be required to collect the sales tax, the legislature may not have achieved its objective. This stems from the fact that, despite the change in KRS § 139.210, KRS § 139.495 was not changed in a corresponding manner. That is, while KRS § 139.210(1) was amended to provide that the sales tax "shall" be collected by the retailer, KRS § 139.495(2) continued simply to authorize, but not require, exempt organizations to collect the sales tax on their sales.[125] That disconnect continues today.[126] Perhaps that is why a regulation promulgated by the Kentucky Department of Revenue continues to proclaim that admissions sold by I.R.C. § 501(c)(3) organizations are exempt from sales tax.[127]

C. Health Care Provider Tax

In *Children's Psych.*, a group of hospitals challenged the validity of Kentucky's health care provider tax,[128] in part on the ground that the tax

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[124] *See* 1990 Ky. Acts 281, ch. 137, § 1.

[125] *See* KY. REV. STAT. ANN. § 139.495(2) (West 2010).

[126] *See id.* §139.495(8).

[127] *See* 103 KY. ADMIN. REGS. 28:010 § 6(3) (2019). Query why this part of the regulation was not deleted in light of *Children's Psychiatric Hosp., Inc. v. Revenue Cabinet*, 989 S.W.2d 583 (Ky. 1999). Most likely it will be withdrawn as a result of *Commonwealth v. Interstate Gas Supply, Inc. ex rel. Tri-State Healthcare Laundry, Inc.*, 554 S.W.3d 831 (Ky. 2018).

[128] *Children's Psychiatric Hosp.*, 989 S.W.2d at 584. The health care provider tax is levied pursuant to KRS §§ 142.301–.363. *See* KY. REV. STAT. ANN. §§ 142.301–.363 (West 2010). KRS 142.317 specifically exempts "charitable providers" from the tax. *Id.* § 142.317. That term is defined by KRS §

violates § 170.[129] The circuit court granted summary judgment to the tax authority. When the hospitals appealed to the court of appeals, that court granted the hospitals' motion to transfer the case to the supreme court to address the issue.

The supreme court began by quoting § 170 in its original form, following which the court, citing no authority, stated: "In looking at the adoption of Section 170 of our Constitution and realizing that as you go through the various Sections relating to taxation, Section 170 and related parts thereto is clearly designated to mean real property and not a carte blanche exemption of taxation."[130] In addition to its reading of § 170 and accompanying provisions of the constitution, the court cherry-picked statements made by the constitution's drafters in connection with its adoption.[131] When the hospitals pointed to the courts' long-standing interpretation of § 170 dating to *Corbin YMCA*, the court responded by stating that "[w]e believe that the *Corbin* decision was an aberration . . . ."[132] After addressing and rejecting the hospitals' other constitutional arguments, the court affirmed the circuit court's decision.[133]

142.301(2) to mean any provider that does not charge its patients for health care items or services, and does not seek or accept Medicare, Medicaid, or other financial support from the federal government or any state government. *Id.* § 142.301(2). Given the way modern day hospitals operate, virtually no hospital, including those exempt from federal income tax under I.R.C. § 501(c)(3), could qualify as a "charitable hospital" under that definition. Hence, since none of the hospitals in *Children's Psych.* qualified as a charitable provider, § 170 provided the only avenue for being exempted from the tax.

[129] *Children's Psychiatric Hosp.*, 989 S.W.2d at 584. The hospitals also argued that the health care provider tax violated § 59 of the constitution's proscription against special legislation; the equal protection and due process clauses of the federal and Kentucky constitutions; and § 51's requirement that any law enacted by the Kentucky legislature be limited to only one subject. *Id.* at 586–88.

[130] *Id.* at 585. This statement contradicted *Trs. of Ky. Female Orphan Sch. v. City of Louisville*, 36 S.W. 922, 922 (Ky. 1896); *Commonwealth v. Young Men's Christian Ass'n*, 76 S.W. 522 (Ky. 1903); *Corbin Young Men's Christian Ass'n v. Commonwealth*, 205 S.W. 388 (Ky. 1918); *Gray v. Methodist Episcopal Church, South, Widows & Orphans Home in State of Ky*, 114 S.W.2d 1141 (Ky. 1938); *Marcum v. City of Louisville Mun. Hous. Comm'n*, 374 S.W.2d 865 (Ky. 1963); *Dept. of Revenue v. Cent. Med. Lab, Inc.*, 555 S.W.2d 632 (Ky. Ct. App. 1977); and *Dep't of Revenue v. Louisville Children's Theater, Inc.*, 565 S.W.2d 643, 645 (Ky. Ct. App. 1978). In addition, in relying on constitutional provisions other than § 170, the court violated the plain-meaning doctrine. Also, the court overlooked the fact that § 170 specifically exempts the income of public libraries from taxation. *See Children's Psychiatric Hosp.*, 989 S.W.2d at 588 (citing KY. CONST. § 170 (amended 1955)).

[131] *Id.* at 585–86. In reviewing such statements, the court violated the plain-meaning doctrine.

[132] *Id.* at 586.

[133] *Id.* at 588. Health care provider taxes are used in part to fund Medicaid. Generally speaking, provider tax revenues collected by the state levying the tax are matched by the federal government to fund the state's Medicaid program. *See generally* 42 C.F.R. § 433.68 (2019). Thus, if § 170 were construed to prevent Kentucky from imposing its health care provider tax on purely public charities, Kentucky's federal Medicaid funds would be depleted significantly. This fact most likely served as a major if unspoken factor in the court's decision in *Children's Psych.* Unfortunately, the impetus for the decision—money—dealt a severe financial blow to Kentucky's purely public charities generally.

A dissenting opinion summarized the court's earliest decisions concerning the scope of § 170, including *Kentucky Female Orphan School* and *YMCA*, both property tax cases, and *Corbin YMCA*, a non-property tax case.[134] Responding to the majority's reference to *Corbin YMCA* as an "aberration," the dissenting opinion noted that "the principle announced in *Corbin YMCA* has been consistently reaffirmed in a number of later cases."[135] The dissent then summarized a few of the opinions to which it referred, including *Cromwell*, *Widows & Orphans Home*, *Presbyterian Orphans Home*, *Louisville Children's Theater*, and *Central Medical Lab*. Finally, the dissent noted that Kentucky voters had ratified six amendments to § 170 since 1955, none of which purported to affect the exemption for institutions of purely public charity.[136] The dissent then observed that "[t]he general rule is, when an amendment is made to a provision in a constitution to which a certain construction has been given, it will be presumed its unchanged portions have the same meaning formerly given it by legislative or judicial construction."[137] The dissent continued:

> Application of this principle to the history of Section 170 mandates a conclusion that not only is *Corbin YMCA* not an 'aberration,' its interpretation of the exemption for institutions of purely public charity has attained constitutional stature. If there is an 'aberration' in our interpretation of Section 170, it is the majority opinion in this case; for this is the first case ever to interpret Section 170 as not exempting institutions of purely public charity from a revenue-raising tax.[138]

As will be seen in the following paragraphs, *Children's Psych.* served as the principal if not sole grounds for the supreme court's decision in *IGS*.

D. Interstate Gas Supply

In *IGS*, Tri-State Healthcare Laundry, Inc. (Tri-State) regularly purchased natural gas from Interstate Gas Supply (Interstate), a non-Kentucky retailer.[139] Tri-State provided laundry services to a group of tax-

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[134] *Children's Psychiatric Hosp.*, 989 S.W.2d at 589–90 (Cooper, J., dissenting in part).

[135] *Id.* at 590.

[136] *Id.* at 591.

[137] *Id.* (quoting Hodgkin v. Ky. Chamber of Commerce, 264 S.W.2d 1014, 1016–17 (Ky. 1952)) (internal quotation marks omitted). *See also* Shamburger v. Duncan, 253 S.W.2d 388, 392 (Ky. 1952) (while not conclusive, legislative construction of a constitutional provision is persuasive where acquiesced in for many years).

[138] *Children's Psychiatric Hosp.*, 989 S.W.2d at 591 (Cooper, J., dissenting in part).

[139] Commonwealth v. Interstate Gas Supply, Inc. *ex rel.* Tri-State Healthcare Laundry, Inc., 554 S.W.3d 831, 832 (Ky. 2018).

exempt hospitals.[140] Because Tri-State could not qualify as an organization described in I.R.C. § 501(c)(3) during the years in issue,[141] it could not claim exemption from Kentucky sales and use tax under KRS § 139.495(1).[142] The facts showed, however, that the Kentucky Department of Revenue (KDOR) had, for many years, treated Tri-State as a purely public charity under § 170[143] (despite Tri-State's status as a for-profit corporation). Thus, Tri-State sought exemption under KRS § 139.470(1) and § 170.

Because Tri-State could not claim exemption under KRS § 139.495(1), Interstate collected Kentucky use tax on its sales to Tri-State pursuant to KRS § 139.390. In 2009, Interstate, at Tri-State's urging, asked the KDOR for a refund of Kentucky use taxes it had collected from Tri-State and remitted to the KDOR.[144] Interstate and Tri-State advanced two grounds for the refund claim. First, they asserted that, due to Tri-State's recognized status as a purely public charity, it was exempt from all taxes.[145] Second, citing *City of Elizabethtown*, they maintained that the use tax operates sufficiently like a property tax to bring it within the scope of § 170, even if § 170 applies only to property taxes.[146] Citing *Children's Psych.*, the KDOR rejected the refund claim.[147] The board of tax appeals, and then the circuit court, also rejected Interstate's refund claim, in each instance on the same grounds as the KDOR.[148] Interstate had better luck at the court of appeals. While that court concluded that § 170 applies only to property taxes per *Children's Psych.*, it also found, per *City of Elizabethtown*, that the use tax is sufficiently like a tax on property to exempt Tri-State from the use tax.[149]

The supreme court granted the KDOR's motion for discretionary review, and also agreed to reconsider *Children's Psych.*[150] Thus, the two issues before the court were: (1) whether Tri-State's status as a purely public charity entitled it to a use tax exemption under KRS § 139.470(1) and § 170 and (2) if not, whether the use tax is sufficiently akin to a property tax to exempt Tri-State from the use tax on that basis.[151] The court found against Tri-State on

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[140] *Id.*

[141] *Id.* According to the Kentucky Secretary of State, Tri-State was formed as a for-profit corporation on May 26, 1989. As such, it could not qualify as an I.R.C. § 501(c)(3) organization.

[142] *Id.* In 1978, KRS § 139.495(1) was amended to exempt purchases made by resident nonprofit educational, charitable, and religious institutions that hold federal I.R.C. § 501(c)(3) status. *See* 1978 Ky. Acts 762, ch. 258, § 2.

[143] *Interstate Gas Supply, Inc.*, 554 S.W.3d at 832.

[144] *Id.* at 833.

[145] *Id.* (including Kentucky use tax pursuant to KRS § 139.470(1)).

[146] *Id.*

[147] *Id.*

[148] *Id.*

[149] *Id.* at 833–34.

[150] *Id.* at 834.

[151] *See id.* at 833–34.

both issues.[152] There is little ground to quarrel with the court's decision on the second issue. For that reason, this Article does not discuss the court's analysis of that issue.[153] But the court's analysis, discussion, and conclusion regarding the first issue are entirely different matters.

The court's decision on the first issue really came down to whether it would blindly adhere to *Children's Psych.* The court began its opinion by quoting § 170 as it reads today, following which the court remarked that § 170 "on its face, is replete with references to property, both real and personal, including residences, places of burial and crops."[154] This comment is troubling when the court is purporting to construe the term "institutions of purely public charity." On the other hand, the court's comment only accentuates § 170's different classifications. Moreover, the court made no mention of the fact that the language of § 170 specifically exempts the income of public libraries. That surely would have led the court to the correct decision.

Next, the court, after mentioning §§ 171–175, stated, without citing any authority, that "[t]hrough the years, this Court and its predecessor have recognized that § 170 and other sections in that 'run' of constitutional provisions address only property (ad valorem) taxes."[155] Not having suggested that § 170 is in any way ambiguous, by referencing this "run," the court violated the rules of constitutional construction in looking at anything other than the plain language of § 170 to ascertain its meaning.

The court followed by suggesting that *Corbin YMCA* had "veered" from the view that § 170 concerns property taxes only.[156] Contrary to the court's statement, there was no suggestion in any case preceding *Corbin YMCA*—and the court certainly cited none—that § 170 concerns property taxes only.[157] The court did concede that the *Corbin YMCA* court "based [its] conclusion on its parsing of [§ 170]."[158] Given the lack of ambiguity in § 170, that is exactly what the *Corbin YMCA* court was supposed to do.

The court then noted that *Corbin YMCA*'s recognition of an exemption from all forms of taxation was "referenced in a handful of later cases without examination."[159] After mentioning *Cromwell* and *Widows & Orphans Home*,

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[152] *See id.* at 845.

[153] The court overruled *Commonwealth v. City of Elizabethtown*, 435 S.W.2d 78 (Ky. 1968). *See Interstate Gas Supply, Inc.*, 554 S.W.3d at 840–45.

[154] *Id.* at 837.

[155] *Id.*

[156] *Id.*

[157] Both *Trs. of Ky. Female Orphan Sch. v. City of Louisville*, 36 S.W. 922, 922 (Ky. 1896), and *Commonwealth v. Young Men's Christian Ass'n*, 76 S.W. 522, 524 (Ky. 1903), specifically held that the "institutions" involved in those cases were exempt from all taxes, not just property taxes.

[158] *Interstate Gas Supply, Inc.*, 554 S.W.3d at 837.

[159] *Id.* at 838.

the court remarked: "In fact, of the four post-*Corbin YMCA* cases from this Court's predecessor, only in [*Widows & Orphans Home*] did the Court actually apply the *Corbin YMCA* holding to relieve a public charity of a non-property tax."[160] This statement was accompanied by a footnote referencing *Central Medical Lab*, *Louisville Children's Theater*, and *Marcum*.[161]

Having marginalized the relevant cases, the court proceeded to rubber stamp *Children's Psych.* In doing so, the court pointed to an observation the *Children's Psych.* court had made near the conclusion of the majority's one-page opinion on the § 170 issue: "Clearly, Section 170 only exempts property tax according to the constitutional debates."[162] As *Children's Psych.* never suggested that § 170 is ambiguous, it was bound to interpret § 170 in accordance with its plain meaning and without resort to extrinsic aids. The *IGS* court's reliance on its predecessor's observation was equally inappropriate.

In sum, both *Children's Psych.* and *IGS* failed to apply established rules of constitutional construction in construing § 170. As a consequence, both failed to give due regard to the express terms of § 170. Neither paid any attention to the fact that the plain language of § 170 leaves no doubt that the drafters intended to classify the subjects of taxation. Nor did either take note of the fact that § 170 specifically exempts the income of public libraries from taxation. In addition, the court in each case ignored the host of cases holding that § 170 applies to non-property tax cases. As a consequence, the court was bound to come up with the wrong result in each case.

VI. CONCLUSION

For the reasons stated in this Article, *IGS* was wrong in concluding that § 170 applies only to property taxes. That being said, there are at least two reasons to think that the decision will not be disturbed anytime soon. First,

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[160] *Id.* at 839.

[161] *Id.* at 839 n.10. The only issue raised by the tax authority in *Central Medical Lab* was whether the lab was a purely public charity, it being conceded that, if it was, it was entitled to exemption from sales and use tax under § 170. Dept. of Revenue v. Cent. Med. Lab, Inc., 555 S.W.2d 632, 633 (Ky. Ct. App. 1977). Consequently, once the court determined that the lab so qualified, it had no reason to explore § 170's limits. *Id.* at 634. Similarly, in *Louisville Children's Theater*, the tax authority questioned whether the organization met the purely public charity standard, but agreed that, if it did, it was entitled to a sales tax exemption on its ticket sales pursuant to KRS § 139.470(1) and § 170. Dep't of Revenue v. Louisville Children's Theater, Inc., 565 S.W.2d 643, 644–45 (Ky. Ct. App. 1978). Finally, in *Marcum*, the tax authority agreed that the Housing Commission was a purely public charity, the only question being whether the Housing Commission was entitled to exemption from both the sales tax and the use tax under KRS § 139.470(1) and § 170. Marcum v. City of Louisville Mun. Hous. Comm'n, 374 S.W.2d 865, 866 (Ky. 1963).

[162] *Interstate Gas Supply, Inc.*, 554 S.W.3d at 839 (internal citations and quotation marks omitted).

the decision may not have that much impact on the Kentucky taxation of most charitable organizations operating in the state. This stems from the fact that the statutes that levy the most significant Kentucky taxes specifically exempt charitable organizations. For example, KRS § 139.495(1) exempts resident I.R.C. § 501(c)(3) educational, charitable, and religious organizations from Kentucky sales and use tax on their purchases.[163] Meanwhile, KRS § 141.040(1)(f) and (g), respectively, exempt organizations that are exempt from federal income tax under I.R.C. § 501 (including under I.R.C. § 501(c)(3)) and "religious, educational, charitable or like corporations" from the corporate income tax,[164] and KRS § 141.0401(6)(f) and (g), respectively, exempt such organizations from the tax on limited liability entities.[165] KRS § 138.470(2) exempts "institutions of purely public charity and institutions of education not used or employed for gain by any person or corporation" from the motor vehicle usage tax imposed by KRS § 138.460.[166] Thus, even if charitable organizations cannot rely on § 170 to claim exemption from the more significant non-property taxes, most will qualify for exemption under the tax statutes themselves.[167]

Of course, the health care provider tax[168] that was challenged in *Children's Psych.* is an exception, and that leads to the second reason that *IGS* is likely to stand for a while. While that tax includes an exemption for "charitable providers," that term's narrow statutory definition excludes all but the rarest of charitable hospitals.[169] Thus, even though most charitable hospitals are statutorily exempt from Kentucky income tax, limited liability entity tax, sales and use tax, and motor vehicle usage tax, they cannot escape the health care provider tax unless § 170 is construed to allow them to do so.

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[163] KY. REV. STAT. ANN. § 139.495(1) (West 2010). KRS § 139.470(9) grants the same exemption to non-resident nonprofits, but without limiting the exemption to I.R.C. § 501(c)(3) organizations. KY. REV. STAT. ANN. § 139.470(9) (West 2010).

[164] *Id.* §§ 141.040(1)(f)–(g). These provisions most likely exempt public libraries from income tax. If not, *IGS* may make the income of a public library taxable in direct contravention of the express language of § 170.

[165] *Id.* §§ 141.0401(6)(f)–(g).

[166] *Id.* § 138.470(2).

[167] One situation in which *IGS* could sting relates to the real estate transfer tax levied by KRS § 142.050(2), which by law is imposed on the grantor named in the deed. KY. REV. STAT. ANN. § 142.050(2) (West 2010). While KRS § 142.050(7) lists various situations in which the tax does not apply, transfers by charitable organizations are not listed. *See id.* § 142.050(7). Nevertheless, the Kentucky Attorney General has opined that the real estate transfer tax does not apply to transfers by charities, citing § 170. *See* Op. Att'y Gen. 82–484 (1982). In light of *Children's Psych.* and *IGS*, this ruling can no longer be relied upon.

[168] *See* KY. REV. STAT. ANN. §§ 142.301–.363 (West 2010).

[169] *See id.* § 142.301(2). This section defines charitable provider as any provider that does not charge its patients for health care items or services, and that does not seek or accept financial support from the federal government.

Given that Kentucky's annual provider tax revenues play a significant role in setting its annual federal Medicaid funding,[170] the provider tax may henceforth serve as the 800-pound gorilla in any future tax challenges under § 170.

This Article began by repeating something that Kentucky's highest court said many years ago: "The cases that have been decided under [§ 170] have at best lacked consistency."[171] It would be unfortunate if the construction placed on § 170 by *IGS* and its predecessor, *Children's Psych.*, is left standing, particularly for non-healthcare organizations for whom § 170 represents the most likely source of exemption from Kentucky taxation. Nevertheless, all things considered, it will take a very special situation to bring the question to the supreme court again. Even if that were to occur, given the underlying financial considerations, the supreme court will be strongly motivated to adhere to *IGS*.

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[170] *See* discussion *supra* notes 128, 133.

[171] Dep't of Revenue v. Louisville Children's Theater, Inc., 565 S.W.2d 643, 645 (Ky. Ct. App. 1978).