How State Pollution Control Tax Exemptions Can Help Businesses Transition Under New Biden Environmental Reform

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While approximately 100 environmental rules and policies were rolled back or altered during the economy-focused Trump Administration, President Biden has made clear his intent to reinstate many of the Obama-era environmental protections that were weakened or eliminated over the last four years. In his first hours in office, President Biden, via Executive Order, ordered the Environmental Protection Agency (EPA) to review several of its rules and regulations. This is in addition to other environmental efforts, such as recommitting the United States to the Paris Climate Agreement. With a primary focus of reducing greenhouse gas emissions and other various air, water, and ground pollutants, many industries should expect heightened requirements and environmental compliance scrutiny over the course of the Biden Administration.

As some businesses may be contemplating purchasing new equipment or changing their existing business model in the wake of new or heightened environmental regulation, it is important to note that several states provide tax exemptions for various pollution control equipment that may ease this transition.

In Kentucky, until 2018, the state offered both a sales tax exemption for the purchase of pollution control equipment, as well as an income tax benefit; however, both were eliminated during the sweeping 2018 state tax reform legislation. Today, Kentucky still provides a significant property tax benefit for equipment that is used for the primary purpose of "pollution control." KRS 132.200(8) provides that tangible personal property that is certified as a "pollution control facility" is exempt from all local tax (*i.e.*, county, city, school) and is subject only to Kentucky's state-level tax at a reduced rate.

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While the statute uses the phrase "pollution control facilities," the exemption is applied broadly. Not only can buildings qualify, but also a broad range of equipment, component parts, and appliances, in a variety of industries, so long as the equipment is used to prevent, control, or reduce air, water, sound, or waste pollution.

Kentucky Administrative Regulation 103 KAR 30:260[1] provides guidance for the process and implications of seeking a pollution control exemption. In order to qualify for the exemption, the taxpayer must file an application with the Kentucky Department of Revenue and submit various documentation related to the equipment, as well as the pollution it aims at eliminating or controlling (*e.g.*, air, water, sound, and waste).

Once all of the above is submitted, the Department will take the Application under consideration and may also request additional information/documentation prior to making a determination. If approved, the exemption becomes effective on the date the application is submitted to the Department, not when the Department issues the certificate, and importantly, not retroactive to the date of purchase if made before the application. Therefore, the taxpayer can effectively benefit from the moment the application is submitted and is not disadvantaged if the Department's application review time becomes lengthy.[2]

Kentucky is not an outlier in this area of tax law. Other states have adopted similar tax exemptions for pollution control equipment. While many vary on the type of pollution control equipment that can qualify for an exemption, as well as the type of tax it is exempted from, several states have statutory language that is similar to those in Kentucky.

Ohio provides a similar property tax exemption for air pollution control facilities, energy conversion equipment that converts power usage from natural gas to alternative fuel, noise pollution control equipment, equipment used for solid waste energy conversion, thermal efficiency improvement equipment, and equipment used for water pollution control.[3] Further, Ohio protects the transfer of pollution control equipment from sales tax as well. Pursuant to Ohio Rev. Code Ann. § 5709.25, the transfer of tangible personal property to a holder of an exempt pollution control facility certificate is not

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recognized as a sale if the property that was transferred is incorporated in the pollution control facility. Like Kentucky, a taxpayer must apply for a pollution control exemption certificate from the Ohio Department of Taxation in order to utilize the tax benefits.

Tennessee is similar to Kentucky in terms of its property tax benefit for pollution control equipment in that it still taxes the property; however, it provides a reduced state rate.[4] Unlike Kentucky, Tennessee provides a sales tax exemption for any "chemicals and supplies" used for pollution control purposes in an air or water pollution control facility.[5] Depending on what a business classifies as pollution control facilities, this exemption could apply to a variety of supplies.

Indiana provides more broad exemptions from both property and its gross retail tax for pollution control equipment. Pursuant to Indiana law, if the taxpayer is in the business of manufacturing, processing, refining, mining, recycling or agriculture and purchases property that is incorporated into or consumed by a pollution control facility/equipment acquired for compliance with any state, local, or federal environmental quality statute, regulations, or standards, it can deduct 100% of the sales price from the taxpayer's gross retail and use tax liability.[6] Additionally, Indiana provides a property tax exemption for an "industrial waste control facility," meaning personal property which is used by a manufacturing or coal mining operation and is used to prevent, reduce, or eliminate water pollution or used to meet federal reclamation standards for a coal mining operation.[7]

Texas is another state that provides both a sales tax and property tax benefit for various pollution control equipment. In relation to sales and use tax, labor incurred to repair, remodel, maintain, or restore tangible personal property is exempted if the repair/remodel is required by statute, ordinance, order, rule, or regulation in order to protect the environment or to conserve energy.[8] However, the labor charge must be separately itemized as the equipment itself is still subject to sales and use tax. Texas additionally provides a fairly broad property tax exemption for both real and tangible property if it is used wholly or partly as a facility,

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device, or method for the control of air, water or land pollution.[9]

As industries may be faced with new or renewed environmental regulations in the coming years, it is important to check state and local tax exemptions to ensure any new purchases of equipment could qualify for various tax benefits. If interested in applying for a state pollution control tax exemption certificate, or for more information about your state and federal taxes, contact Elizabeth Moseley or any attorney with Frost Brown Todd's Tax practice group.

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[1] As revised and effective as of November 1, 2019.

[2] It should also be noted that often equipment that previous would have qualified as exempt pollution control equipment from Kentucky sales and use tax can often qualify for the new and expanded industry sales tax exemption provided to various manufacturing equipment.

[3] Ohio Rev. Code Ann. § 5709.20

[4] Tenn. Code Ann. §67-5-604

[5] Tenn. Code Ann. § 67-6-329(a)(19)

[6] Ind. Code § 6-2.5-5-30

[7] Ind. Code §6-1.1-10-9

[8] Tex. Tax Code Ann. § 151.338

[9] Tex. Tax Code Ann. § 11.31

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