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H.B. 467: Tax Incentives for the Construction of Conversion and Conservation Facilities

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H. B. 467: TAX INCENTIVES FOR THE CONSTRUCTION OF CONVERSION AND CONSERVATION FACILITIES

I. INTRODUCTION

One of the most pressing problems facing the United States today is the prospect of a diminishing supply of energy coupled with an ever-increasing demand. The American economy, traditionally based on continued growth and increased consumption of goods, is now confronted with the reality that the earth's resources are limited. Conservation of existing resources and development of new sources of energy are vital if the United States is to maintain its current standard of living.¹

During the winters of 1976-1977 and 1977-1978, Ohio, as well as a number of other states, experienced a critical shortage of natural gas brought on by a combination of factors: unusually cold weather, miscalculation by utility companies in projecting needs of consumers,² and a diminishing supply of natural gas. Residential consumers were encouraged to lower their thermostats and adopt other conservation measures. Thousands of industrial consumers had their allotments severely curtailed in order to ensure that the supply of natural gas would last through the end of the heating season. Severe economic consequences, as well as physical hardships, resulted from the shortage.

It was against the backdrop of this natural gas shortage that the Ohio Legislature enacted House Bill 467³ in July of 1978. The purpose of the bill is to decrease Ohio's dependence on natural gas by encouraging conversion to other more plentiful sources of energy. In addition, the bill is designed to slow the growth rate in energy demand by encouraging more efficient use of existing supplies. Tax exemptions are the means chosen to achieve these goals.

The following discussion of H.B. 467 will begin with a summary of Ohio energy-related legislation. This will be followed by an explana-

1. Many economists suggest that there is a close relationship between the supply of energy and economic growth. Failure to conserve energy, consequently, may lead to unhappy economic consequences because the supply of all our fossil fuels is finite. See generally H. RICHARDSON, *ECONOMIC ASPECTS OF THE ENERGY CRISIS* (1975).

2. The competence of utility companies to forecast future demand has been criticized. See Graff, *State Intervention in the Energy Planning Process* in *ENERGY CONSERVATION AND THE LAW* 86, 87-88 (Proceedings of the Annual National Conference on the Environment Sponsored by the American Bar Association Standing Committee on Environmental Law, April 30-May 1, 1976). See also Lancaster, *The Night the Lights Almost Went Out*, *FORTUNE*, May, 1977, at 57.

3. Am. Sub. H. B. 467, codified in OHIO REV. CODE ANN. §§ 5709.45-.52 (Page Supp. 1978).

tion of the types of facilities for which tax-exempt certificates will be issued under the new legislation. The procedural provisions of the statute will then be reviewed, followed by a textual analysis of the bill. A discussion of the effectiveness of the particular tax incentives selected by the legislature will include a comparison of the Ohio bill with comparable federal and state statutes.

II. ANALYSIS

A. *Ohio Energy Legislation*

H.B. 467 is one of several energy-related statutes in Ohio. Directed at industrial rather than residential consumers,⁴ H.B. 467 became effective upon Governor Rhode's signing in July of 1978. This statute, as well as other energy-related legislation in Ohio, has been fashioned piecemeal in response to specific problems rather than as part of a general energy policy.

Additional Ohio legislation directed toward energy conservation includes section 4511.21 of the Ohio Revised Code which established a reduction in the maximum speed limit.⁵ Similarly, Ohio has empowered the Board of Building Standards to adopt regulations to promote conservation of energy and has provided for the adoption of residential building standards with this goal in mind.⁶ An energy resource development agency has been created and a department of energy empowered, in part, to engage in research, experimentation, and planning.⁷

In 1975, the Ohio Legislature provided for tax exemptions for coal conversion facilities using language similar to that embodied in sections 5709.45-.52 of the Ohio Revised Code.⁸ Coal conversion facilities are defined as facilities built pursuant to a contract with the federal energy research and development administration. This definition relates to facilities which, between July 1, 1975 and December 31, 1982, are constructed, installed, and placed in operation for the purpose of converting coal to solid, liquid, or gaseous fuels or by-products of such fuels.⁹ Coal conversion facilities also include those facilities constructed and placed in operation during the same time period for the purpose of demonstrating the economic, commercial, or technical

4. OHIO REV. CODE ANN. § 5709.45 (Page Supp. 1978). See also Ohio Senate Committee on Ways and Means, Fact Sheet-Proposal to Amend. Am. H.B. 467 (Sept. 20, 1977) (copy on file with the Ohio Legislative Service Commission Library).

5. OHIO REV. CODE ANN. § 4511.21(E), (H), (I), (K) (Page Supp. 1978).

6. *Id.* §§ 3781.10, 4101.083, 4104.02.

7. *Id.* §§ 1551.01-.18.

8. *Id.* §§ 5709.30-.37.

9. *Id.* § 5709.30(A)(1).

feasibility of a plant or facility for the conversion of coal to solid, liquid, or gaseous fuels, or by-products of such fuels, or for the removal of sulphur or sulphur compounds from coal.¹⁰

Sections 5709.45-.52 have also been complemented by other Ohio energy legislation directed at the residential sector. Section 5747.052 of the Ohio Revised Code,¹¹ enacted subsequent to H.B. 467, provides for a credit against the individual income tax of up to five percent of the cost of certain home improvements, including the installation of insulation. This credit may not, however, exceed sixty-five dollars.¹²

B. Eligible Facilities

Sections 5709.45-.52 establish three categories of energy-related facilities and define their characteristics. These facilities are energy conversion facilities, thermal efficiency improvement facilities, and solid waste energy conversion facilities.¹³ Energy conversion is defined as conversion from the use of natural gas to an alternate fuel other than propane, butane, or naphtha, or from the use of fuel oil to an alternate fuel other than propane, butane, naphtha, or natural gas.¹⁴ An energy conversion facility is defined as any additional property or equipment designed, constructed, or installed in a commercial building or site or industrial plant necessary for the primary purpose of energy conversion.¹⁵

The new legislation defines thermal efficiency improvement as the recovery and use of waste heat or steam which is produced incidental to electric power generation, industrial process heat generation, lighting, refrigeration, or space heating.¹⁶ A thermal efficiency improvement facility is described as any property or equipment designed, constructed, or installed in a commercial building or site, or in an industrial plant or site, for the primary purpose of thermal efficiency improvement.¹⁷

10. *Id.* § 5709.30(A)(2).

11. *Id.* § 5747.052.

12. *Id.* § 5747.052(C). The credit may be claimed only once every three years. A taxpayer should be prepared to furnish the Tax Commissioner with support for his claim. *Id.*

13. *Id.* § 5709.45.

14. *Id.* § 5709.45(A)(1), .45(A)(2).

15. *Id.* § 5704.45(B). An example of an energy conversion facility would be an industrial plant using natural gas as a fuel for its boilers which replaces the natural gas furnace with a furnace equipped to burn coal. The new furnace and any other equipment necessary to permit the plant to burn coal would be considered energy conversion facilities.

16. *Id.* § 5709.45(C).

17. *Id.* § 5709.45(D). An example of a thermal efficiency improvement facility would be a plant which, producing steam as a by-product of industrial processes, in-

The three-prong definition of solid waste energy conversion facilities varies slightly from the definitions of the other facilities just discussed. Solid waste is defined as unwanted residual solid or semi-solid material resulting from industrial operations, including public utilities and commercial distribution, research, agricultural, and community operations; the waste includes street dirt, debris, and combustible or non-combustible garbage.¹⁸ Solid waste energy conversion means conversion of solid waste into energy; this definition also provides that utilization of that energy must be for some useful purpose.¹⁹ A solid waste energy conversion facility is property or equipment designed, constructed, or installed in a commercial building or site, or in an electric light, gas, or natural gas company plant, for the primary purpose of solid waste energy conversion.²⁰

When the certificate provided for in the statute is issued, it applies only to that part of an energy conversion facility which is necessary for the primary purpose of energy conversion.²¹ In the case of a solid waste energy conversion facility or a thermal efficiency improvement facility, the certificate is to be effective only with respect to that part of the facility which is used exclusively for the energy-related purpose.²²

The effective date of the certificate is the date the application was filed with the commissioner or the date of completion of construction of the facility to which it applies, whichever is earlier. The application shall not, however, relate to any facility on which construction was completed on or before December 31, 1974.²³ The effective date of a certificate which relates to a facility completed between January 1, 1975 and July 13, 1978 is the date of application for the certificate.²⁴ Taxes payable prior to the effective date of the certificate are not recoverable.²⁵

stalls equipment, recovers this steam, and pipes the steam into a neighboring office building to provide space heating.

18. *Id.* § 5709.45(E).

19. *Id.* § 5709.45(F).

20. *Id.* § 5709.45(G). An example of a solid waste energy conversion facility would be an industrial plant which installs equipment capable of producing useable energy via the burning of solid waste material. Equipment used to burn the solid waste, as well as equipment specially needed to make energy from solid waste useable in the manufacturing process would be solid waste energy conversion facilities.

21. *Id.* § 5709.46.

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

C. Procedural Requirements

1. Application for Exemption

An application for a tax exemption certificate is to be filed with the Tax Commissioner in a manner prescribed by the commissioner.²⁶ The application must contain a descriptive list of materials acquired or to be acquired for the facility.²⁷ If the application is for a thermal efficiency improvement facility, it must include an estimate of the reduction in fuel or power usage that is likely to be realized through the construction of the facility.²⁸ With respect to a solid waste energy conversion facility, the application must include an estimate of the facility's solid waste consumption capacity and energy output.²⁹

The Tax Commissioner, with the aid of the Director of the Department of Energy determines whether to issue the exemption certificate. The Tax Commissioner is to obtain a written opinion from the Director of the Department of Energy after the latter has determined whether the estimated increases in efficiency in power consumption or the estimated solid waste consumption and energy production are likely to be realized through the construction of the proposed facility.³⁰ After receiving the director's opinion, the Tax Commissioner must make three additional determinations:

(1) Whether the proposed facility "was designed primarily for energy conversion, solid waste energy conversion, or thermal efficiency improvement . . . ;"³¹

(2) Whether the proposed facility is "suitable and reasonably adequate" for that purpose;³² and

(3) Whether the proposed facility is intended to be used for that purpose.³³ Before issuing or denying any certificate, the commissioner

26. *Id.* The Tax Commissioner has, in fact, prescribed regulations pursuant to the statute. See [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09, at 4-345. An applicant must file for a certificate on Tax Form ERG 1 (Application for Energy Conversion Facility or Solid Waste Energy Conversion Facility or Thermal Efficiency Improvement Facility). The date of filing is determined by the date the completed application, together with supporting documents and any other required information is received in the office of the Tax Commissioner. *Id.*

27. OHIO REV. CODE ANN. § 5709.46 (Page Supp. 1978).

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.* See also [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(G), at 4-346.

must notify the auditor of the appropriate county and afford the applicant and the auditor an opportunity for a hearing.³⁴

Following a grant of a certificate, the holder must continue to comply with the requirements of the statute and to use the tax-exempt facility for its tax-exempt purpose.

2. Revocation of Exemption

Failure to use the facility for the approved purpose may expose the holder to revocation proceedings. Upon notice and an opportunity for a hearing, the certificate may be revoked. Revocation proceedings may be initiated by the Tax Commissioner or upon complaint of the appropriate county auditor. The certificate may be revoked only for the following specific reasons:

(1) Fraud in obtaining the certificate;³⁵

(2) Misrepresentation in obtaining the certificate;³⁶

(3) Failure of the holder of the certificate to proceed with the construction, reconstruction, installation, or acquisition of facilities for which the certificate was issued;³⁷

(4) Cessation of the use of the facilities to which the certificate relates for the primary purpose of energy conversion, solid waste energy conversion, or thermal efficiency improvement, followed by the use of the facility for a different purpose;³⁸ or

(5) Failure of the exempt facility to substantially provide the reductions in fuel or power consumption or to provide the solid waste consumption and energy production estimated in the application for exemption.³⁹

If appropriate, the commissioner may modify a certificate rather than revoke it entirely.⁴⁰ If a certificate is revoked because it was ob-

34. OHIO REV. CODE ANN. § 5709.47 (Page Supp. 1978). In order to obtain a hearing, the applicant or auditor must file a written request with the Tax Commissioner. The request must be filed within thirty days from the receipt of the acknowledgement from the Tax Commissioner that an application has been filed. [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(E), at 4-346.

35. OHIO REV. CODE ANN. § 5709.47(A) (Page Supp. 1978). *See also* [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(S)(1), at 4-347.

36. OHIO REV. CODE ANN. § 5709.47(A) (Page Supp. 1978). *See also* [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(S)(1), at 3-347.

37. OHIO REV. CODE ANN. § 5709.47(B) (Page Supp. 1978). *See also* [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(S)(2), at 3-347.

38. OHIO REV. CODE ANN. § 5709.47(C) (Page Supp. 1978). *See also* [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(S)(3), at 3-347.

39. OHIO REV. CODE ANN. § 5709.47(D) (Page Supp. 1978). *See also* [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(S)(4), at 3-347.

40. OHIO REV. CODE ANN. § 5709.47(D) (Page Supp. 1978). *See also* [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(T), at 3-347.

tained by fraud or misrepresentation, all taxes that would have been payable had no certificate been issued will be assessed, along with the maximum penalties prescribed by law.⁴¹ Revocation or modification of the certificate is effective upon the mailing of notice to the holder.⁴²

3. Appeal and Transferability of Exemption

Any party aggrieved by a decision of the commissioner to grant, deny, revoke, or modify a certificate may appeal the decision of the commissioner to the Board of Tax Appeals.⁴³ The appeal may be filed following receipt of notice of the action of the commissioner. The procedure to be followed is found in section 5717.02 of the Ohio Revised Code.⁴⁴

The holder of a certificate and tax exemption may transfer it by a written instrument to a purchaser of the tax exempt facility. The exemption then passes to the transferee as of the date of transfer of the facility or the date of transfer of the certificate, whichever is earlier. The transferee must provide written notice of the effective date of the transfer and a copy of the written instrument to the Tax Commissioner and to the appropriate county auditor.⁴⁵

D. "Necessary" Portions of the Facility

The language of the statute, while clear in most respects, does contain some ambiguous sections. The interpretation of key terms will determine whether a particular applicant receives an exemption cer-

41. OHIO REV. CODE ANN. § 5709.51 (Page Supp. 1978).

42. OHIO REV. CODE ANN. § 5709.47(D) (Page Supp. 1978). *See also* [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(U), at 3-347. This termination provision and other procedural provisions apparently satisfy due process requirements. An appeal will lie to the judiciary from administrative decisions made by the Tax Commissioner and the Board of Tax Appeals. No exemption may be terminated, under the statute, except upon notice and an opportunity for a hearing. Although termination of the exemption may precede judicial review of the administrative determination, this comports with due process requirements since the taxpayer has already had a hearing with an opportunity to submit his evidence. *See Goldberg v. Kelly*, 397 U.S. 254 (1970). The requirements of procedural due process, which are applicable in the area of tax exemptions are therefore met. *See Speiser v. Randall*, 357 U.S. 513, 525 (1958).

43. OHIO REV. CODE ANN. § 5709.49 (Page Supp. 1978).

44. *Id.* OHIO REV. CODE ANN. § 5717.02 (Page Supp. 1978). Notice of appeal must be filed with the Board of Tax Appeals and the Tax Commissioner within thirty days after notice of the commissioner's order. *Id.*

45. OHIO REV. CODE ANN. § 5709.52 (Page Supp. 1978). The transferee must notify the commissioner and auditor within ten calendar days of the effective date of the transfer. A copy of the instrument of transfer and a copy of the certificate transferred must be provided as well. [1978-1979 Monthly Record] OHIO AD. CODE (Baldwin) § 5703-1-09(Y), at 3-347.

tificate and the extent of its coverage. The main ambiguity lies in the use of the word "necessary."

Section 5709.46 of the Ohio Revised Code states that a certificate "shall permit tax exemption . . . only for that portion of such energy conversion facility that is *necessary* for the primary purpose of energy conversion"⁴⁶ Courts of various jurisdictions have ascribed different meanings to the word "necessary" depending upon the particular context. In some instances courts have held that "necessary" meant "indispensible" or "absolutely necessary."⁴⁷ In other instances courts have held that "necessary" meant "needful" or "appropriate."⁴⁸ In *Welch v. Helvering*⁴⁹, the United States Supreme Court was called upon to construe the predecessor to section 162 of the Internal Revenue Code⁵⁰ relating to deduction of business expenses and to determine what constituted "ordinary and necessary" business expenses. The Court held that "necessary" meant "needful" or "appropriate," intimating that a more restrictive interpretation would involve the government in second-guessing the business judgment of a taxpayer.⁵¹ Since the word "necessary" is susceptible of many meanings it is necessary to ascertain the intent of the legislature in this instance.⁵²

Sections 5709.45-.52 of the Ohio Revised Code provide an exemption from taxation. The general rule in Ohio is that exemptions from taxation should be narrowly construed. The burden of proving one's right to an exemption falls upon the taxpayer.⁵³ Ohio law provides, however, that while exemptions are certainly to be narrowly construed, a reasonable construction is preferred.⁵⁴

It is also a well-settled rule of statutory interpretation that a statute should be construed so as to further its purposes rather than to defeat

46. OHIO REV. CODE ANN. § 5709.46 (Page Supp. 1978) (emphasis added). Section 5709.45(B) uses the same term in defining an energy conversion facility as "any additional property or equipment designed, constructed, or installed in a commercial building or site . . . *necessary* for the primary purpose of energy conversion." OHIO REV. CODE ANN. § 5709.45(B) (Page Supp. 1978).

47. See, e.g., *John Wanamaker, New York, Inc. v. Otis Elevator Co.*, 186 App. Div. 655, 175 N.Y.S. 78 (1919).

48. See, e.g., *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819).

49. 290 U.S. 111 (1933).

50. Int. Rev. Code of 1924, ch. 234, § 214, 43 Stat. 253, 269 (now I.R.C. § 162).

51. 290 U.S. at 113.

52. See *Belford v. Hueston*, 44 Ohio St. 1, 4 N.E. 471 (1886).

53. *Transue & Williams v. Lindley*, 54 Ohio St. 2d 351, 376 N.E.2d 1341 (1978); *Ohio Children's Society v. Porterfield*, 26 Ohio St. 2d 30, 268 N.E.2d 585 (1971); *National Tube Co. v. Glander*, 157 Ohio St. 407, 105 N.E.2d 648 (1952).

54. *Keller v. Forney*, 108 Ohio St. 463, 141 N.E. 16 (1923).

them.⁵⁵ An unduly narrow construction of the present statute would circumvent the purpose of the legislation and would impede the achievement of the goal of conservation. Businessmen would probably hesitate to engage in a project involving substantial expenditures if their plans were subject to overly strict scrutiny by the state.

The restrictive language of the statute lends support to the idea that a narrow interpretation of the word "necessary" was intended. The statute speaks of primary uses and exclusive uses and requires detailed analyses conducted by the Tax Commissioner in determining the propriety of an exemption.⁵⁶ The restrictive phrases were designed to limit the application of incentives to those situations where incentives are required to encourage conservation.

By refusing exemptions when uses which are not energy-related predominate, the legislature has limited the application of the tax incentive. The legislature has determined that tax incentives are less appropriate when a taxpayer will receive other economic benefits from the construction of the energy-related facility. When a facility would be constructed even without the tax exemption because of its profit potential, the tax exemption is a windfall and an unnecessary subsidy. The "primary use" and "exclusive use" requirements of the statute protect the state treasury against this possibility.

A restrictive interpretation of what constitutes "necessary facilities" would not serve to limit the application of incentives to those situations where they are required. No interpretation of "necessary" would affect the potential profitability of an energy-related facility. The word "necessary" only qualifies what material is eligible for exemption once it has been determined that the primary or exclusive use of the facility is to be its energy-related use, which use produces no economic benefits.⁵⁷ Since the "primary purpose" and "exclusive use" requirements limit the tax exemption to those situations where it is required, an unduly narrow interpretation of what material is "necessary" is not also required for that purpose. To the

55. *E.g.*, *Bate v. State*, 27 Ohio App. 391, 161 N.E. 344 (1927); 50 OHIO JUR. 2d, *Statutes* § 247 (1961).

56. See OHIO REV. CODE ANN. § 5709.46 (Page Supp. 1978).

57. The energy-related use generally produces no short run economic benefits and adds no value to any product produced by a taxpayer. While fuel cost savings might occur in the long run, the restrictive language of the statute is designed only to restrict the allocation of tax incentives to those facilities for which the profit-making incentives would otherwise be insufficient. See *Hearings Before the Senate Committee on Ways and Means*, 112th Gen. Assembly (Sept. 27, 1977) (Statement of Robert S. Ryan, member of the Ohio Energy and Resources Development Administration) (copy on file with the Ohio Legislative Service Commission Library).

extent the commissioner refuses to approve proposed new facilities for an exemption, by using an unnecessarily restrictive reading of "necessary," his decisions may defeat the incentive purpose of the exemption.⁵⁸ The Ohio Legislature undoubtedly did not intend that a taxpayer be granted absolute discretion in determining what material is "necessary."⁵⁹ Neither could the legislature have intended that the statute be so narrowly construed as to defeat its purpose.⁶⁰ The logical construction would be, therefore, that "necessary" as used in the statute means "reasonably necessary."

E. State Tax Incentives

Sections 5709.45-.52 of the Ohio Revised Code provide tax exemptions from the sales, use, real property, business, and franchise taxes. When an exemption certificate has been issued, the transfer of tangible property for incorporation into the tax exempt facility will not be considered a sale of tangible personal property for the purpose of the sales tax or a use for the purpose of the use tax. This is true only if the material has been, or will be incorporated into the facility.⁶¹ Subsequent to the effective date of the certificate and so long as it remains in effect, the tax-exempt facility will not be considered an improvement for the purpose of the real property tax. Neither will the facility be considered as tangible personal property used in business for the purpose of the personal property tax or as an asset of a corporation in determining the value of its issued and outstanding shares or the value of property owned and used by it for the purpose of the franchise tax.⁶²

58. For example, a taxpayer may desire to replace a natural gas furnace with a new furnace equipped to burn coal rather than modify the existing natural gas furnace with equipment designed to burn coal. A complete changeover might minimize long run maintenance costs. A restrictive interpretation of the word "necessary" would discourage the more efficient choke by holding only the equipment which modifies the existing furnace to be "necessary for the primary purpose of energy conversion."

59. This intention is demonstrated by the restrictive language of the statute. Certainly the state has an interest in protecting its revenue and preventing an inequitable distribution of tax burdens. See *Ohio Children's Society v. Porterfield*, 26 Ohio St. 2d 30, 268 N.E.2d 585 (1971).

60. The Tax Commissioner, however, has interpreted the exemptions very narrowly. Section 5709.46 of the Ohio Revised Code states that a certificate granted for an energy conversion facility shall be effective with respect to that part of the facility which is "necessary for the primary purpose of energy conversion." Section 5703-1-09(N) of the Ohio Administrative Code, however, states that the exemptions shall apply to that part of the facility "used exclusively for the purpose of energy conversion." The language of the Administrative Code may thus be more restrictive than the language of the Revised Code.

61. OHIO REV. CODE ANN. § 5709.50(A) (Page Supp. 1978).

62. *Id.* § 5709.50(B)(1), (2), (3) (Page Supp. 1978).

The Ohio Legislative Budget Office has estimated that these exemptions will cost the state and local governments in excess of 10.5 million dollars through 1979.⁶³

The particular tax incentives selected by the Ohio Legislature have been used in other Ohio statutes dealing with environmental problems. For example, the Ohio Legislature used similar incentives in sections 5709.20-.27 of the Ohio Revised Code to combat air and noise pollution. These statutory provisions also contain definitions of eligible facilities,⁶⁴ certification procedures,⁶⁵ provisions for notice⁶⁶ and revocation,⁶⁷ provisions for appeal,⁶⁸ and liability in case of fraud.⁶⁹ These provisions are identical in form to those for energy conversion or conservation facilities.⁷⁰

Similarly, sections 6111.31-.39 of the Ohio Revised Code provide exemptions for water pollution facilities from franchise, use, personal property, and real property taxes.⁷¹ While the tax incentives are the same as those employed for energy-related facilities, the procedures involved in acquiring an exemption certificate for such facilities vary from the procedures established in the energy legislation. Specifically, the procedures established to determine whether a particular water pollution facility qualifies for the tax exemptions provide strict guidelines for prompt action on applications.⁷² In contrast, estimates of the utility of a proposed energy facility are more difficult to evaluate, and action on energy-related applications will probably be less prompt.

Tax incentives have been the customary method to attack environmental problems in Ohio as well as other states. In the 1960's several states amended their tax laws to provide incentives for installation of pollution control facilities by private industry.⁷³ The incentives

63. Fiscal Note, Ohio Legislative Budget Office (Sept. 29, 1977) (copy on file with the Ohio Legislative Service Commission Library).

64. OHIO REV. CODE ANN. § 5709.20 (Page Supp. 1978).

65. *Id.* § 5709.21.

66. *Id.* §§ 5709.22, .23.

67. *Id.* § 5709.22.

68. *Id.* § 5709.24.

69. *Id.* § 5709.26.

70. Compare OHIO REV. CODE ANN. § 5709.25 (Page 1973 & Supp. 1978) with OHIO REV. CODE ANN. § 5709.50 (Page Supp. 1978).

71. OHIO REV. CODE ANN. § 6111.31-.39 (Page 1977).

72. *Id.* § 6111.31.

73. As of March 1970 thirty-one states had adopted such provisions. These states include California, Florida, Massachusetts, Michigan, New York, Pennsylvania, and West Virginia. See McNulty, *State Tax Incentives to Fight Pollution*, 56 A.B.A.J. 747 (1970). See, e.g., OR. REV. STAT. §§ 316.097, 468.150, 468.155 (1953).

traditionally used are exemptions from sales, use, personal property, franchise, and real estate taxes or some combination thereof.⁷⁴

The language and focus of the various state pollution enactments is also similar to that embodied in sections 5709.45-.52 of the Ohio Revised Code. Much of the legislation uses a "primary purpose" or "exclusive use" requirement.⁷⁵ This pollution legislation, however, has been criticized on a number of grounds. The "primary purpose" test may be too strict and, therefore, prevent the tax incentives from being effective.⁷⁶ The best pollution abatement processes are intimately connected with the production process. The primary purpose of the equipment would, therefore, relate to production and not abatement. Thus the "primary purpose" test would not be met and tax exemptions would not be granted where they would produce the greatest social utility.⁷⁷ For example, in *Weyerhaeuser v. State Department of Ecology*,⁷⁸ the applicant applied for an exemption for production facilities relating to the processing of paper pulp. The facilities were newly installed in order to comply with pollution standards. The facilities did, in fact, reduce pollution as the production process chang-

74. See McNulty, *supra* note 73, at 748-49. See also Reitze & Reitze, *Tax Incentives Don't Stop Pollution*, 57 A.B.A.J. 127 (1971); OR. REV. STAT. §§ 316.097, 468.150, 468.155 (1953).

75. See, e.g., W. VA. CODE §§ 11-6A-1 to 11-6A-4 (1974); WYO. STAT. § 35-502.55 (1975), H.B. 88, 1977 Wyo. Sess. Laws 60 (to be codified in WYO. STAT. § 39-1-201(a)(xxi)).

76. See McNulty, *supra* note 73, at 748.

77. The primary purpose test has been interpreted very narrowly by the few courts that have been called upon to review decisions involving tax exemptions for pollution control equipment. See *Statler Indus., Inc. v. Board of Environmental Protection*, 333 A.2d 703 (Me. 1975) (lower court erroneously granted summary judgment in favor of taxpayer when genuine issue of material fact existed whether basic function of equipment was for pollution control); *Ohio Ferro-Alloys Corp. v. Donahue*, 7 Ohio St. 2d, 29, 218 N.E.2d 452 (1966) (chimney constructed for purpose of diffusing polluted smoke ineligible for tax exemption).

Absent special provisions in the exemption statute, equipment used in the production process which also reduces pollution will not be eligible for exemption because it will not meet the primary purpose test. See *Heller v. Fergus Ford, Inc.*, 15 Ill. App. 3d 868, 305 N.E.2d 352 (1973), *aff'd*, 59 Ill. 2d 576, 322 N.E.2d 441 (1975) (denying a tax exemption for that part of an automobile which constituted emission control systems on the ground that the emission control devices were fully integrated into the operational functions of the engines); *Weyerhaeuser Co. v. State Dept. of Ecology*, 86 Wash. 2d 310, 545 P.2d 5 (1976) (declaring that in the absence of ameliorative regulations, equipment designed and operated for the production of products would not be eligible for tax benefits, this would be true even though the equipment was added for the express purpose of pollution reduction). Though there is no case on point, this same reasoning would probably apply in Ohio because tax exemptions are narrowly construed. See *Ohio Children's Society v. Porterfield*, 26 Ohio St. 2d 30, 268 N.E.2d 585 (1971).

78. 86 Wash. 2d 310, 545 P.2d 5 (1976).

ed. The court allowed a partial exemption only because interpretative regulations permitted it. The court stated that in the absence of the ameliorative regulations, the facilities would not have been eligible for exemption because the facilities were used in production.⁷⁹

It is interesting to contrast both the overall approach and the tax incentives used by some other states. Both New York⁸⁰ and California,⁸¹ for example, started by establishing an overall energy policy before pursuing individual problems and establishing incentives. Many states direct their legislation at encouraging increased supply of energy rather than at curtailment of energy demand.⁸² Ohio has taken a more piecemeal approach.

California has a comprehensive set of energy programs,⁸³ and the tax incentives it uses are different from those used by Ohio. California has decided that solar energy represents the best solution to the energy problem and has geared its incentives toward a solar energy solution. This may be due, in part, to the favorable climatic conditions prevalent in California. Ohio, however, has not so limited its incentives.⁸⁴ The

79. *Id.*

80. N.Y. ENERGY LAW §§ 1-101 to 16-108 (McKinney 1978).

81. See CAL. PUB. RES. CODE §§ 25487-25498, 25600-25610 (West Cum. Supp. 1978).

82. *E.g.*, MICH. COMP. LAWS ANN. §§ 319.1-.82 (West 1967 & Cum. Supp. 1978).

83. In 1972 the California Legislature adopted a relatively progressive program relating to energy conversion. California's legislation included a solid waste management program which provided for studies and recommendations relating to economic incentives (including tax incentives). CAL. GOV'T CODE §§ 66785-66786.5 (West Cum. Supp. 1978). The legislation also required the construction (subsequent to completion of feasibility studies) of solid waste energy conversion facilities, in order to deal concurrently with the energy and solid waste management problems experienced by California. *Id.*

Other California legislation relating to energy conservation includes establishment of a commission to decide upon construction and design standards and specifications which would increase efficiency in energy utilization. The standards would pertain to residential and non-residential buildings alike. CAL. PUB. RES. CODE § 25103.7 (West. Cum. Supp. 1978). Lighting and heating standards as well as studies related to new sources of energy have also been provided for by California. CAL. PUB. RES. CODE §§ 25487-25498, 25600-25610 (West Cum. Supp. 1978). Finally, insulation standards have been enacted, violation of which may lead to civil penalties. CAL. PUB. RES. CODE §§ 25910-25926, 25931 (West Cum. Supp. 1978).

Most pertinent to this analysis, however, are the tax incentives adopted by California relating to energy conversion. The incentives, some of which may be found in section 23601 of the Revenue and Taxation Code, are designed to encourage the adoption of solar energy systems. Credits against the corporate income tax as well as credits against the personal income tax are provided. The solar energy facilities themselves, as well as energy conservation measures applied in conjunction with the solar energy systems, are eligible for the credits. See CAL. REV. & TAX. CODE §§ 23601, 17052.5 (West Cum. Supp. 1978).

84. Compare CAL. REV. & TAX. CODE § 23601 (West Cum. Supp. 1978) with OHIO REV. CODE ANN. §§ 5709.45-.52 (Page Supp. 1978).

California benefits are equally applicable to both industry and individuals while the Ohio incentives embodied in sections 5709.45-.52 of the Ohio Revised Code are directed only toward industry.⁸⁵ California's incentives are based on the corporate and personal income tax; Ohio's incentives are introduced via the sales, use, property, and franchise taxes. A taxpayer who utilizes the California credit will enjoy a greater initial cost savings. An Ohio taxpayer will receive his benefits over a period of time, and will be limited in the subsidiary uses he can make of the tax-exempt facility. A California taxpayer is not so limited.⁸⁶

In addition to these points, the California legislation is superior to Ohio's in that it was enacted to implement an existing energy policy and also exemplifies good coordination in attacking multiple and sometimes conflicting problems. Solar energy has been the focal point of California's energy conversion policy since its inception, and solar energy incentives have been coordinated with a program of solid waste energy management to combat both pollution and energy problems. Ohio's program is less cohesive; this legislation, for example, is directed at one narrow aspect of the energy problem—the natural gas shortage.⁸⁷ As previously noted, Ohio's energy legislation exemplifies a piecemeal approach to the energy problem.

Some commentators have criticized the use of tax incentives as being misdirected, misused, and a burden on the public in general.⁸⁸ In lieu of tax incentives, tax penalties for pollution or wasteful use of energy might be appropriate.⁸⁹ Presumably, these criticisms and suggestions would apply to sections 5709.45-.52 of the Ohio Revised Code due to its similarity to the criticized pollution legislation previously mentioned.

F. Federal Energy Legislation

The federal government, as part of a comprehensive energy plan, has also provided tax incentives to industry to encourage construction

85. Compare CAL. REV. & TAX. CODE §§ 17052.5, 23601 (West Cum. Supp. 1978) with OHIO REV. CODE ANN. § 5709.45 (Page Supp. 1978). But see OHIO REV. CODE ANN. § 5747.052 (Page Supp. 1978).

86. Compare CAL. REV. & TAX. CODE § 17052.5 (West Cum. Supp. 1978) with OHIO REV. CODE ANN. §§ 5709.45-.47 (Page Supp. 1978).

87. See Ohio Senate Committee on Ways and Means, Fact Sheet-Proposal to Amend. Am. H.B. 467 (Sept. 20, 1977) (copy on file with the Ohio Legislative Service Commission Library).

88. See Reitze & Reitze, *supra* note 74, at 127. But see McNulty, *supra* note 73, at 747; Avins, *Tax Incentives and Pollution: The Need for Hysteria Control*, 58 A.B.A.J. 54 (1972).

89. Reitze & Reitze, *supra* note 74, at 128.

of energy conservation facilities. The tax incentives, however, differ from those granted by the Ohio Legislature. The incentives are achieved by increasing the investment tax credit against income tax. This recent federal energy legislation is embodied in the National Energy Act of 1978,⁹⁰ which contains many provisions geared toward energy conservation and conversion to alternate sources of energy. The part of the National Energy Act that is similar in purpose to sections 5709.45-.52 of the Ohio Revised Code is the Energy Tax Act of 1978.⁹¹ The Act provides tax incentives to companies and businesses which invest in defined property either for the conservation of fuel or for the conversion from oil or gas to other fuels.⁹² Equipment used for the energy-related purpose must meet standards prescribed by the Secretary of the Treasury, after consultation with the Secretary of Energy.⁹³ The tax benefits provided by the Energy Tax Act of 1978 terminate after December 31, 1982.⁹⁴

The amount of the credit which may be claimed is equal to ten percent of the qualified investment in the eligible facilities.⁹⁵ Property to which the credit applies includes alternate energy property,⁹⁶ solar wind energy property,⁹⁷ and specifically defined energy property,⁹⁸ as well as other energy property.⁹⁹ There is no ceiling on the amount of credit which may be claimed under the provisions of this Act.¹⁰⁰ The investment credit allowed for non-energy related property is, on the other hand, subject to a maximum ceiling.¹⁰¹

There is no provision in either Ohio Revised Code sections 5709.45-.52 or the federal Energy Tax Act of 1978 which would prevent a taxpayer from receiving the benefits of both the state and federal tax incentives concurrently. In this respect the federal provisions and Ohio provisions of energy-related tax law complement each other.

90. The National Energy Act consists of the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (1978); Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174 (1978); National Energy Conservation Policy Act of 1978, Pub. L. No. 95-619, 92 Stat. 3206 (1978); Powerplant and Industrial Fuel Use Act of 1978, Pub. L. No. 95-620, 92 Stat. 3289 (1978); and the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3350 (1978).

91. Pub. L. No. 95-618, 92 Stat. 3174 (1978).

92. *Id.* § 301, 92 Stat. at 3194.

93. *Id.* § 301(b), 92 Stat. at 3198.

94. *Id.* § 301(a), 92 Stat. at 3195.

95. *Id.*

96. *Id.* § 301(b), 92 Stat. at 3196.

97. *Id.*

99. *Id.*

98. *Id.*

100. 92 Stat. at 3199.

101. See I.R.C. § 46(c).

G. Effectiveness

It is difficult to predict at this time whether Ohio's new energy legislation will have substantial effect on energy conversion or conservation. Some have even questioned the necessity for the legislation. The Ohio Legislative Budget Office has asserted that additional tax incentives were unnecessary as some of the tax exemptions existed prior to the enactment of sections 5709.45-.52. The Budget Office also noted that there would be additional administrative costs resulting from the statute.¹⁰² Businessmen base their decisions on many factors and the Budget Office argued that a corporation that would choose to build a facility based upon factors unrelated to the tax incentives will reap a windfall from the additional tax incentives provided by the statute.

In addition, there now appears to be a supply of natural gas which exceeds the current demand. Consumer sales of natural gas have dropped in both residential and industrial sectors.¹⁰³ Spokesmen from utility companies attribute the diminishing demand to consumer conservation measures as well as new, more efficient processes of production.¹⁰⁴ The high cost of gas, as compared to other types of fuel, has also played a part in the reduction of consumer demand. It should be noted, however, that the surplus is, in large part, not due to an increase in supply.¹⁰⁵ Previously adopted conservation and conversion measures are having their effect. This, however, does not minimize but rather emphasizes the importance of energy conservation. The supply of natural gas, despite a temporary surplus, is limited.¹⁰⁶ Relaxation of "energy frugality" can only serve to precipitate another energy crisis.

Businessmen will undoubtedly consider factors other than the tax incentives in making their decisions. As previously noted the language of sections 5709.45-.52 is also very strict. Incentives with respect to energy conservation are likely to have some effect, however, because they add to the market incentive of long-run cost decreases based upon fuel cost savings. A corporation would not be spending one hundred dollars now to recover fifty dollars in tax benefits. A corporation would be spending one hundred dollars now to recover fifty dollars now and to save more in the future. In spite of its strict requirements, the tax incentives will prove to be a consideration, though not the only one, in influencing a taxpayer's energy decisions. At the same time, the

102. Fiscal Note, Ohio Legislative Budget Office (Sept. 29, 1977) (copy on file with the Ohio Legislative Service Commission Library).

103. Dayton Journal Herald (Dayton, Ohio), Feb. 5, 1979, at 1, col. 1.

104. *Id.* at 5.

105. *Id.*

106. See, e.g., MIT ENERGY LABORATORY POLICY STUDY GROUP, ENERGY SELF-SUFFICIENCY (1974).

legislation answers the Budget Office's concern by providing sufficient safeguards from abuse of the exemptions since the commissioner may review and revoke an exemption.¹⁰⁷

Tax penalties or fines, rather than tax incentives, might be less effective in combatting the energy problem. Such a negative approach would probably involve more monitoring of industry and, therefore, entail greater administrative expense and waste of resources. The means chosen by the Ohio Legislature, however, introduce a positive additional saving incentive into the businessman's decision and thereby enlist his own financial self-interest to encourage conservation. As of February 26, 1979, forty applications for tax exemptions had been filed with the Department of Taxation.¹⁰⁸

III. CONCLUSION

Sections 5709.45-.52 of the Ohio Revised Code were passed in July of 1978 as an emergency measure, in response to Ohio's natural gas problem. The legislation, one of several energy-related statutes in Ohio, establishes three types of energy facilities and aims at encouraging fuel conservation and conversion to those types of fuel in greater supply.

The particular tax incentives chosen by the Ohio Legislature were copied from those found in pollution legislation both in Ohio and in other jurisdictions. The statute is complementary, however, to federal legislation; facilities eligible for the Ohio tax benefits may also be eligible for federal tax benefits created by the Energy Tax Act of 1978.

The necessity and effectiveness of the statute have been questioned. The restrictive language and ambiguities which were incorporated in the statute partly in response to these criticisms may present problems to applicants for exemptions. A reasonable interpretation of the language, however, would resolve part of this problem. The statute may then provide the additional impetus needed in specific cases to promote conservation and conversion to more plentiful sources of energy.

Warren Landau

Code Sections Affected: §§ 5709.45-.52.

Effective Date: July 13, 1978.

Sponsors: Carney (H) & O'Shaughnessy (S).

Committees: Committee on Energy and Environment(H) &
Committee on Ways and Means (H&S).

107. OHIO REV. CODE ANN. § 5709.47 (Page Supp. 1978).

108. Telephone conversation with Richard Levin, Ohio Department of Taxation (March 6, 1979).
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