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## Tax Exemption for Pollution Control Devices in Pennsylvania

*Kirk W. Junker\**

### INTRODUCTION

In current legal and political atmospheres, when governments are embracing notions such as pollution prevention and the three "R's"—reduce, reuse and recycle, while discarding command and control types of regulatory enforcement,<sup>1</sup> some may be surprised to learn that since 1971 Pennsylvania law has permitted the exemption of corporate assets from capital stock valuation for the purpose of paying capital stock taxes, if the assets are devoted to pollution control or abatement.<sup>2</sup> Straightforward though the idea of tax exemption for pollution control assets may seem, the execution of the statutory exemption, together with the regulation which was promulgated thereunder,<sup>3</sup>

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1. See, e.g., the Federal Pollution Prevention Act of 1990, 42 U.S.C. §§ 13101-13109 (Supp. IV 1992); Pennsylvania's Land Recycling and Environmental Remediation Standards Act, 1995 Pa. Legis. Serv. 21 (Purdon) (to be codified at PA. STAT. ANN. tit. 35, §§ 6026.101-909). One can also trace this trend in relevant literature, beginning for instance, with Gail H. Allyn, *Developing A Plan to Prevent Pollution*, ENVTL. PROTECTION, Dec. 1993, at 19-23, and continuing to entire volumes devoted to symposia on pollution prevention. See, e.g., Symposium, *Pollution Prevention*, 29 GA. L. REV. 313 (1995). Therein, see especially Kenneth Geiser, *The Unfinished Business of Pollution Prevention*, 29 GA. L. REV. 473 (1995). In addition, the Pennsylvania Department of Environmental Protection has established a Pollution Prevention and Compliance Assistance Program which will exist at the same organizational level as traditional programs such as the Air Quality Program, the Water Quality Program and the Oil and Gas Program.

2. Tax Reform Code of 1971, PA. STAT. ANN. tit. 72, § 7602.1 (1990 & Supp. 1995). This holds true for foreign corporations when paying franchise taxes under the same section. For a discussion of the options for domestic and foreign corporations, see Dominic Fulco III, Case Digest, *Tax*, 56 TEMP. L. Q. 867 (1983).

3. See 61 PA. CODE § 155.11 (1994).

yields a wide variety of hermeneutic fruit under the scrutiny of the judiciary and the advocacy of lawyers.

Part I of this article discusses the Tax Reform Code (the "Code") which allows for a tax exemption for pollution control devices and reviews the Code's statutory language. Part II details the problem created by the broad and undefined language used in Section 602.1 of the Tax Reform Code ("Section 602.1").<sup>4</sup> This portion of the article details the problem created because of changing pollution control and abatement technology but unchanging statutes. Part II reviews the appropriate interpretative methods in an attempt to apply the current statute to today's technology. Part III reviews the Pennsylvania Environmental Hearing Board's solution—apportionment—and discusses the federal government's and other states' use of apportionment in their statutes. The article concludes that technology in the 1990's used to abate or control pollution is not as easily identifiable, separate or discrete, as the current statutory exemption suggests.

### I. THE LANGUAGE OF THE TAX REFORM CODE

The statutory language at issue is Section 602.1 of the Tax Reform Code of 1971 which states:

Notwithstanding the foregoing provisions of section 602, [which imposes capital stock and franchise taxes], to the contrary, equipment, machinery, facilities and other tangible property employed or utilized within the Commonwealth of Pennsylvania for water and air pollution control or abatement devices which are being employed or utilized for the benefit of the general public shall be exempt from the tax imposed under this Article VI. The Department of Revenue shall have the power, through publication in the Pennsylvania Bulletin, to prescribe the manner and method by which such exemption shall be granted and claimed.<sup>5</sup>

The Department of Revenue exercised the power granted to it in Section 602.1 when it promulgated its pollution control devices exemption regulation ("Section 155.11"),<sup>6</sup> which provides:

*Pollution control devices exemption.* Exemptions for pollution control devices shall be as follows:

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4. PA. STAT. ANN. tit. 72, § 7602.1 (1990 & Supp. 1995).

5. *Id.* On August 4, 1991, the Pennsylvania General Assembly amended the Code by substituting, in the first sentence, "tangible property" for "assets," and in the second sentence, "through publication in the Pennsylvania Bulletin" for "by regulation," and "granted and claimed" for "claimed." 1991 Pa. Laws 97, 137.

6. 61 PA. CODE § 155.11.

(1) *General.* An exemption will be given for water and air pollution control or abatement devices which have been employed or utilized for the benefit of the general public during the tax year in question. The pollution control devices exemption is expressed as a deduction from the Capital Stock Tax exempt assets fractions, or as a deduction from the Property Factor in the case of a Foreign Franchise Tax taxpayer or a Capital Stock Tax taxpayer which elects to compute and pay its tax on the basis of the Three Factor Formula as provided in section 602(b) of the TRC [PA. STAT. ANN. tit. 72, § 7602(b) (1995)].

(2) *Condition precedent.* As a condition precedent to the granting by the Department to the taxpayer of the pollution control device exemption, the taxpayer is required to apply to the Department of Environmental [Protection] and obtain a certificate for the purpose of claiming exemption for each specific pollution control device. This certification is designated "Notice of State Certification" (DER Form ER-BWQ-21). See section 602.1 of the TRC [PA. STAT. ANN. tit. 72, § 7602(b) (1995)]. The taxpayer is required to file with the Department the Notice of State Certification covering the specific control device for which exemption is claimed during the tax period in question. This requirement for the filing of a Notice of State Certification may apply not only to a new device but may also apply to modifications or changes of an existing device.

(3) *Notice of State Certification by the Department of Environmental [Protection].* Notice of State Certification shall conform with the following:

(i) The Notice of State Certification issued by the Department of Environmental [Protection] shall certify:

- (A) That certain components are components to a water or air pollution device.
- (B) That a device is installed and completed in place.
- (C) That is employed or utilized to remove pollutants commencing in, or during, the tax year in question.
- (D) That, where a plan approval or permit is required by the Department of Environmental [Protection], plan approval or permit has been obtained.

(ii) The Department of Environmental [Protection] certification is not required to be filed annually. The exemption shall be subject to audit by the Department, or the taxpayer may be called upon by the Department to update the prior Certification upon which particular equipment has been based.<sup>7</sup>

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7. *Id.* The Conservation and Natural Resources Act, 1995 Pa. Legis. Serv. 110 (Purdon) (to be codified at PA. STAT. ANN. tit. 71, §§ 1340.101-1103), changed the name of the former Pennsylvania Department of Environmental Resources to the Department of Environmental Protection. *Id.* § 501. For the purposes of consistency, this article will use the term Department of Environmental Protection even when referring to actions of the former Department of Environmental Resources. The term "Department of Environmental Resources" will appear only when it is part of a proper case name. The Conservation and Natural Resources Act also established a



This regulation identifies the manner in which the exemption is calculated and the procedure to follow in order to qualify for an exemption. With its regulation, the Department of Revenue transferred to the Department of Environmental Protection (the "DEP") the responsibility to determine if an application demonstrates eligibility for a tax exemption.

## II. THREE INTERPRETATIONS OF THE POLLUTION CONTROL TAX EXEMPTION IN SECTION 602.1

### A. *The Meaning of Section 602.1*

The most significant problem in applying the statute and regulation arises in attempting to determine the assets that are included in the phrases "equipment, machinery, facilities and other tangible property," and "pollution control or abatement devices," which are used in both Section 602.1 of the Code and Section 155.11 of the regulation (collectively "Section 602.1").<sup>8</sup>

Attorneys and judges have interpreted Section 602.1 in a number of ways. These interpretations can be divided into three categories—the liberal or expansive interpretation, the conservative or strict interpretation, and a hybrid interpretation that uses aspects of the first two together with some foreign elements.

According to the liberal interpretation, Section 602.1 means that every device, no matter how slightly, incidentally or indirectly it controls or abates pollution, whether by design, coincidence or accident, qualifies for a complete exemption under the statute. This liberal reading would include as "pollution control devices" such surprising items as parking lots (which keep rain from leaching potential water pollutants out of soil), roofs of all types (which keep potential air pollutants in and rain out, thus preventing soil leachate), and any power-consuming device that is more efficient than others which perform the same task (because it requires less electricity to be produced and thus results in less pollution generated at the power generation plant, or less gasoline burned, etc.).<sup>9</sup>

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new agency known as the "Department of Conservation and Natural Resources" and transferred some of the functions of the agency formerly known as the Department of Environmental Resources to the Department of Conservation and Natural Resources. *Id.* §§ 301-322.

8. The language of § 602.1 and § 155.11 shall be collectively referred to as "Section 602.1" unless specific differences between the statute and regulation are being discussed.

9. Brief in Support of Appellant's Motion for Summary Judgment at 15-22, *Cambria CoGen Co. v. Commonwealth of Pennsylvania, Dep't of Env'tl. Resources*,

The strict construction of Section 602.1, however, would require that in order for a device to be exempt from taxation, the device must have been designed and must operate *primarily* as a pollution control device, not just incidentally so. Thus, the device must be primarily devoted to the public's benefit—as a “pollution control device.” The strict interpretation would allow such devices as baghouses and oil/water separators to qualify.<sup>10</sup>

These first two interpretations, in attempting to discern meaning from the ambiguity of Section 602.1, have several shortcomings. First, they both assume that in reviewing a facility to identify pollution control devices, each device is physically separate and therefore separately identifiable as either a pollution control device or as a device which does not control pollution. When the statutory exemption was enacted, the nature of most technology was that it was either a source of pollution or was a pollution control device, bolted onto a smokestack or the end of a pipe to control pollution. As technology has changed, however, this simple dichotomy is no longer true. An example of this is in a boiler combustion chamber where limestone is introduced to capture sulfur dioxide as coal and coal refuse are burned.

A liberal interpretation suggests that the boiler is an air pollution control device, because sulfur dioxide is captured inside the boiler. A strict interpretation dictates that the boiler, because it is a source of combustion and air pollution, cannot be a pollution control device. In this instance, one cannot point to a discrete and separate device and demonstratively say “that is a pollution control device,” and point to another and say “that is a source of pollution.” In the case of the boiler with internal sulfur dioxide capture, the same device is both a pollution control device and a source of pollution.

In addition to the difficulty of identifying separate devices as pollution control devices, one arrives at the problem that some devices are not always used for the same purposes at all times. For example, although a baghouse is normally used as an air pollution control device to clean the air for the public's health and for environmental benefits, it may also be used to collect fine particles at a stone crushing operation for resale as a separate product, or for reintroduction into the product stream. And it may serve both functions at the same time. Also, a motor used to drive a conveyor belt which moves products may also be used to drive a blower for a baghouse, and therefore be a necessary part

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EHB Docket No. 92-308-MJ, 1995 WL 75063 (Pa. Env. Hrg. Bd. Feb. 19, 1995).

10. Brief in Support of Appellee's Motion for Summary Judgment at 3, *Cambria CoGen*.

of a pollution control device. Therefore, one cannot look only to the physical properties of the device to determine whether it is a pollution control device; one must look to its function. Despite the fact that function may also change over time, or oscillate, a "certification is not required to be filed annually."<sup>11</sup> This is consistent with the state of technology when the statutory provision was enacted; the function of a device was expected to remain constant over time.

While the notion of exclusive and permanent categories based on physical properties rather than function may have accurately reflected the state of pollution control technology when Section 602.1 was enacted, it no longer does so. Two decisions by the Pennsylvania Environmental Hearing Board (the "EHB"), *Cambria CoGen Co. v. Commonwealth of Pennsylvania, Department of Environmental Resources*,<sup>12</sup> and *York Water Co. v. Commonwealth of Pennsylvania, Department of Environmental Resources*,<sup>13</sup> in which the parties litigated the meaning of Section 602.1, have demonstrated that the physical properties interpretation is outdated.<sup>14</sup> To deal with the changing state of pollution control technology, the EHB articulated a third, or "hybrid" interpretation. This third interpretation attempts to apportion a device's tax liability between the portion of the device which is designed and used for pollution control as a primary purpose and the portion of the device which is designed and used for some other purpose, such as generating electricity or steam.<sup>15</sup> The third interpretation recognizes that many devices do not lend themselves to having their parts separated for identification as control devices, although taken as a whole, the unit may, by design, perform some pollution control function.<sup>16</sup>

On its face, Section 602.1 does not admit of such an apportionment scheme. The statute and regulation speak of exemptions for "devices" only, not for portions of the value of devices.<sup>17</sup> If one

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11. 61 PA. CODE § 155.11(3)(ii).

12. EHB Docket No. 92-308-MJ, 1995 WL 75063 (Pa. Env. Hrg. Bd. Feb. 10, 1995).

13. EHB Docket No. 94-057-E, 1995 WL 347899 (Pa. Env. Hrg. Bd. June 1, 1995), *appeal docketed*, No. 1554 C.D. 1995 (Pa. Commw. Ct.).

14. See *infra* Section III.C for a detailed discussion of *Cambria CoGen*, *York Water* and the EHB's role in interpretation of Pennsylvania's pollution control tax exemption.

15. See *Cambria CoGen*, 1995 WL 75063, at \*16-\*18.

16. *Id.*

17. It is unclear what is intended by the language of Section 155.11, which states "[t]hat certain components are components to a water or air pollution device." 61 PA. CODE § 155.11(3)(i)(A). At first glance, it seems as though the word "control" should precede the word "device." Also, the addition of the word "component" in the

wants to use such a hybrid interpretation, one would need either a legislatively or judicially created formula for apportionment or several case-by-case formulae. No such formulae exist presently in Pennsylvania.<sup>18</sup> Consequently, until and unless the statutory exemption or the regulation promulgated thereunder is changed, one must work within the confines of that which is in existence. Significantly, however, this hybrid interpretation finds company in a similar federal law, Section 169 of the Tax Reform Act of 1969,<sup>19</sup> and in Pennsylvania with the recent judicial interpretations in *Cambria CoGen* and *York Water*.<sup>20</sup> Although this may be the way of the future, before extrapolating upon the emerging hybrid interpretation in Pennsylvania, one must understand the nature and limitations of the established liberal and strict interpretations of the law.

### *B. Statutory Construction of Pennsylvania's Tax Exemption*

Although it may seem rather obvious, one must remember that the position from which one must begin to interpret the exemption in question is that the legislature has imposed a tax liability upon the property in question. From this beginning, one may then qualify for exemptions. One does not, however, begin from the position of entitlement to exemption. That is to say, the burden of proof is, as always, on the taxpayer. In the case of Section 602.1, the taxpayer must prove why a device qualifies as a pollution control device. One may find help in interpreting the pollution control device exemption by working through Pennsylvania's Statutory Construction Act.<sup>21</sup> The most important provisions therein for present purposes require one to look to legislative intent<sup>22</sup> and to the presumptions in ascertaining that intent.<sup>23</sup>

#### *1. The Statutory Construction Act of 1972—§ 1921; Legislative Intent Controls*

To develop an interpretive framework for the pollution control

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section does not provide relief from the shortcomings engendered by the word "device," as discussed above.

18. Such formulae are extant elsewhere, however. See, e.g., Guidelines for Certification, 40 C.F.R. app. A § 20 (1995) (using a five percent rule for a similar deduction from federal taxes).

19. 26 U.S.C. § 169 (1994).

20. See *infra* Section III.C for a detailed discussion of *Cambria CoGen* and *York Water*.

21. 1 PA. CONS. STAT. §§ 1921-1939 (1975).

22. *Id.* § 1921.

23. *Id.* § 1922.

device exemption, one may look directly to the Pennsylvania General Assembly. In trying to determine just how one should interpret Section 602.1, the Statutory Construction Act provides guidance: "The object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly. Every statute shall be construed, if possible, to give effect to all its provisions."<sup>24</sup>

Pennsylvania courts have echoed this rule. The supreme court has stated: "It is another rule of statutory construction that the legislature is presumed to attach importance to every word."<sup>25</sup> Thus, the Statutory Construction Act requires one to give effect to all provisions and "[w]hen the words of a statute are clear and free from all ambiguity, the letter of it is not to be disregarded under the pretext of pursuing its spirit."<sup>26</sup>

The regulation reiterates the precise words of the statute—pollution control or abatement for the benefit of the general public. Repetition of this language in both the statute and the regulation suggests its importance. Read literally, the words seem simple enough—yet the fact that litigation occurs suggests otherwise. The Statutory Construction Act identifies factors to consider in order to discern the legislative intent:

When the words of a statute are not explicit, the intention of the General Assembly may be ascertained by considering, among other matters:

- (1) The occasion and necessity of the statute.
- (2) The circumstances under which it was enacted.
- (3) The mischief to be remedied.
- (4) The object to be attained.
- (5) The former law, if any, including other statutes upon the same or similar subjects.
- (6) The consequences of a particular interpretation.
- (7) The contemporaneous legislative history.
- (8) Legislative and administrative interpretations of such statute.<sup>27</sup>

## 2. *The Intent of the General Assembly*

The first items to consider are the occasion, necessity, circumstances, and mischief to be remedied. Ordinarily, the legislative history of a statute provides this backdrop. Given that the Pennsylvania legislature does not record a history of discussion on the

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24. *Id.* § 1921(a).

25. *O'Reilly v. Fox Chapel Sch. Dist.*, 555 A.2d 1288, 1291 (Pa. 1989) (citing *Commonwealth v. Lobiondo*, 462 A.2d 662, 664 (Pa. 1983)).

26. 1 PA. CONS. STAT § 1921(b).

27. *Id.* § 1921(c).



statutes which it passes, we must look to other sources in an effort to gain insight into the occasion, necessity, circumstances and mischief for which this legislation was enacted.

In the absence of written Pennsylvania legislative history regarding these tax exemptions, the federal government's record provides insight into the political mood at the time. At the federal level, during the 1969 hearings on tax reform before the House Ways and Means Committee, industry representatives testified that if no tax exemptions were afforded for investments in pollution control facilities, many industrial facilities would be financially unable to comply with all the applicable federal, state and local environmental regulations.<sup>28</sup> The industry representatives further testified that such investments do not increase productivity, efficiency, cost control or profits, but benefit *solely* the general public.<sup>29</sup> Therefore, they argued, because pollution investment serves *only* a social purpose, the public should share the investment cost.<sup>30</sup> Consequently, the federal government, through the House Ways and Means Committee, enacted a tax incentive provision for pollution control facilities.<sup>31</sup>

The report of the House Ways and Means Committee indicates that Congress' intent in passing the tax provision law was to "provide an incentive to private industry for anti-pollution efforts."<sup>32</sup> Legislators recognized that by passing environmental legislation, they were asking industry to make investments which provided health and environmental benefits to the general public, but which did not result in economic profits for industry. Because "[o]nly capital investments in tangible property are eligible [to receive a tax break],"<sup>33</sup> the tax incentive provision only applies to specific company expenditures such as "bolt-on" devices which were not previously part of a plant. Moreover, investments which reduce air or water pollution and increase earnings, improve competitive positions, expand production or cut costs do not receive a tax benefit. Any investments which only serve incidentally to control pollution do not meet the federal statute or guide-

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28. Paul R. McDaniel & Alan S. Kaplinsky, *The Use of the Federal Income Tax System to Combat Air and Water Pollution: A Case Study in Tax Expenditures*, 12 B.C. IND. & COMM. L. REV. 351, 352 (1971) (citations omitted).

29. McDaniel & Kaplinsky, *supra* note 28, at 352 (citations omitted).

30. *Id.*

31. See 26 U.S.C. § 169.

32. H.R. REP. No. 413, 91st Cong., 1st Sess. (1969), reprinted in 1969 U.S.C.C.A.N. 1645, 1852.

33. Daniel Givelber & Daniel Schaffer, *Section 169 of the Internal Revenue Code: An Income Tax Subsidy for the Control of Pollution*, 14 ARIZ. L. REV. 65, 73 (1972).



lines.<sup>34</sup>

The Pennsylvania exemption can be traced back to public sentiments in the 1960's when the pollution problem rose to the forefront and became a national issue. Literature of the time suggests a rather linear process leading to the enactment of the legislation.<sup>35</sup> In response to political and public calls for regulation, the federal and state governments regulated industrial pollution. Recognizing that non-profitable capital investments would need to be made, industry lobbied for tax "breaks" to facilitate compliance with environmental regulations. To remedy this "mischief," as it is called by the Statutory Construction Act,<sup>36</sup> many states either amended or adopted tax laws offering remuneration for devices which industry needed to "bolt-on" to existing pollution sources.<sup>37</sup>

By 1971, at least thirty-five states had passed laws which provided tax incentives for pollution control facilities.<sup>38</sup> Pennsylvania acted consistently with this trend by passing Section 602.1, a capital stock and franchise tax exemption to the Tax Reform Code of 1971 for devices which control or abate water and air pollution.<sup>39</sup> Prior to this enactment, Pennsylvania had no law providing for pollution control device tax exemptions.

In adopting Section 602.1, Pennsylvania, like the federal government, distinguished between investments which serve only a "social" purpose and capital expenditures which profit industry. Claims by industry that pollution control devices do not increase earnings, improve competitive positions, expand production or cut costs but serve *only* a social purpose helped persuade the federal government to provide an exception for these types of expenditures.<sup>40</sup>

34. H.R. REP. No. 413, 91st Cong., *supra* note 32, reprinted in 1969 U.S.C.C.A.N. at 1853.

35. See, e.g., John W. McNulty, *State Tax Incentives to Fight Pollution*, 56 A.B.A. J. 747 (1970); Kenneth R. Reed, Note, *Economic Incentives for Pollution Abatement: Applying Theory to Practice*, 12 ARIZ. L. REV. 511 (1970); John W. McNulty, *Amortization of Pollution Control Facilities: How the New Election Works*, 34 J. TAX'N 211 (1971); Arnold W. Reitze & Glenn Reitze, *Tax Incentives Don't Stop Pollution*, 57 A.B.A. J. 127 (1971); Givelber & Schaffer, *supra* note 33; Charles P. LeBeau, Comment, *Tax Incentives to Combat Pollution*, 50 J. URB. L. 273 (1972); K. Martin Worthy, *Pollution Facilities Continue to Provide Substantial Tax Benefits*, J. TAX'N, July 1972, at 2 (1972); John Heinz, *Environment/Taxes: Tax Incentives for Pollution Control*, 8 J. CORP. TAX'N. 83 (1981).

36. 1 PA. CONS. STAT. § 1921(c)(3).

37. Reed, *supra* note 35, at 530.

38. *Id.* at 526-28.

39. See PA. STAT. ANN. tit 72, § 7602.1.

40. McDaniel & Kaplinsky, *supra* note 28, at 352. Contrary to popular general assertions, actual economic and social scientific research on the effects of pollution

Pennsylvania's anti-pollution statute paralleled this rationale. Much like the federal government, which singled out pollution control facilities,<sup>41</sup> the Pennsylvania statute states that to receive an exemption, capital investments must be made for devices which control or abate pollution. The statute further specifies that "pollution control or abatement devices which are being employed or utilized for the benefit of the general public shall be exempt from the tax imposed."<sup>42</sup> By including the term "benefit of the general public," the legislature limited the exemption and acknowledged that industry would need to make investments which are not intended to result in an economic profit. It is a distinction of type, not of degree. Devices which perform functions other than or in addition to benefitting the public, therefore, do not qualify under Section 602.1.

After reviewing the concerns which the federal statute was designed to address, one must conclude that Section 602.1 was intended to address the same concerns, but at a state level. Thus, the purpose of Section 602.1 is to provide Pennsylvania industry with remuneration for capital investments which do nothing more than control or abate air and water pollution for the benefit of the general public.

### 3. Presumptions in Ascertaining Legislative Intent

In addition to examining the matters identified in Section 1921(c) of the Statutory Construction Act to determine legislative intent, Section 1922 articulates certain presumptions which are read into legislative enactments.<sup>43</sup> The presumptions required by the Statutory Construction Act are that the General Assembly does not intend an absurd, impossible or unreasonable result, that it does intend an entire statute to be effective and certain, that it does not intend it to be unconstitutional, that it intends to follow binding judicial precedent, and perhaps most important for the particular statute at hand, "[t]hat the General Assembly intends to favor the public interest as against any private interest."<sup>44</sup>

The first presumption presented is "[t]hat the General Assem-

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regulation on competitiveness indicates that if it can in fact be measured at all, the stringency of pollution regulation is not a factor in competitiveness. See Adam B. Jaffe et al., *Environmental Regulation and the Competitiveness of U.S. Manufacturing: What Does the Evidence Tell Us?*, 33 J. ECON. LITERATURE 132 (1995).

41. See *infra* notes 71-76 and accompanying text.

42. PA. STAT. ANN. tit. 72, § 7602.1 (emphasis added).

43. See PA. CONS. STAT. § 1922.

44. *Id.* § 1922(5).

bly does not intend a result that is absurd, impossible of execution or unreasonable."<sup>45</sup> This presumption is well illustrated by examining the wide net cast by a liberal interpretation of Section 602.1. If every roof, parking lot, and improved efficiency machine qualifies as a control device, little remains as taxable assets. The liberal interpretation would allow nearly every device to qualify as a pollution control device, thus making the tax-imposing statute absurd. Likewise, if one reads Section 602.1 liberally, and an enormity of capital assets becomes tax exempt, then the entire capital stock tax provision<sup>46</sup> becomes the exception rather than the rule, and consequently quite ineffective. Clearly, a liberal interpretation may produce an unreasonable interpretation.

In contrast, a strict interpretation does work. Even though the strict interpretation may exclude hybrid devices, such as the boiler described earlier in this article, it is an interpretation which is demonstrably reasonable and capable of execution.

Another presumption in the Statutory Construction Act is "[t]hat the General Assembly does not intend to violate the Constitution of the United States or of this Commonwealth."<sup>47</sup> The Pennsylvania Constitution does not explicitly address Section 602.1, but it does make clear that tax liability is the status quo and the general rule, and exemptions are granted only as narrow and specific exceptions to that rule.<sup>48</sup> The constitution states: "The General Assembly may by law exempt from taxation: . . . (iii) that portion of public property which is actual and regularly used for public purposes."<sup>49</sup> The notion of distinguishing public from private uses and benefits presented in this constitutional section suggests a simple and elegant foundational formula for interpreting the pollution prevention exemption: if a device benefits the public and not the private concern which installed it, the public should help pay for it by foregoing taxes owed by the concern to the Commonwealth's tax pool. But, if the private concern profits from the device, the public should not be made to pay for it by exempting the device from capital stock valuation and ultimately, exempting payment into the tax pool.<sup>50</sup>

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45. *Id.* § 1922(1).

46. PA. STAT. ANN. tit 72, §§ 7601-7606 (1990 & Supp. 1995).

47. 1 PA. CONS. STAT. § 1922(3).

48. *See* PA. CONST. art. VIII, § 2.

49. *Id.* § 2(a)(iii).

50. Even these middle-of-the-road corollary conditional statements have a shortcoming of their own—they omit an additional antecedent which would recognize that a private industry's pollution is not itself private—it uses and pollutes the public's water and air. Such factors must be included in a true environmental economic assessment, rather than a simple cost/benefit analysis. *See* PLATER ET AL.,

Furthermore, article VIII, section 5 of the Pennsylvania Constitution makes it clear that only those areas enumerated in article VIII, section 2 may be exempt: "All laws exempting property from taxation, other than the property above enumerated [in article VIII, section 2] shall be void."<sup>51</sup>

In order to satisfy this presumption, the tax exemption must be construed narrowly. A strict reading of the tax exemption is supported by decisions of the Pennsylvania Supreme Court. The supreme court has addressed taxation and exemptions from taxation generally: "All property is liable to taxation for the purpose of raising revenue for governmental purposes except such property as is exempted therefrom by statutory enactment within the constitutional limitations."<sup>52</sup> Although this decision does not consider Section 602.1, the court's construction upon the same issue (taxation and exemption) may be used to understand the measures of the taxation exemption provision.

This leads to the fifth presumption in the Statutory Construction Act, "[t]hat the General Assembly intends to favor the public interest as against any private interest."<sup>53</sup> The presumption is explicit in Section 602.1, wherein the General Assembly limited exemptions to "equipment, machinery, facilities and other tangible property employed or utilized within the Commonwealth of Pennsylvania for water and air pollution control or *abatement devices which are being employed or utilized for the benefit of the general public.*"<sup>54</sup>

No reading of the statutory exemption can ignore the requirement that to qualify for a tax exemption, the devices must benefit the general public. Clearly, the General Assembly had only the power to exempt private property from taxation when the property benefits the general public.<sup>55</sup> The Supreme Court of Pennsylvania underscored that rationale in *Appeal of Municipal Authority of Borough of West View*.<sup>56</sup> In *Borough Of West View*, the court held that "[t]he test under constitutional provisions exempting from taxation public property used for public purposes is the

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ENVIRONMENTAL LAW AND POLICY: NATURE, LAW, AND SOCIETY 28-66 (1992).

51. PA. CONST. art. VIII, § 5.

52. *Commonwealth v. 2101 Coop.*, 183 A.2d 325, 335 (Pa. 1962) (citing *Commonwealth v. Perkins*, 21 A.2d 45, 47 (Pa. 1941), *aff'd*, 314 U.S. 586 (1942)).

53. 1 PA. CONS. STAT. § 1922(5).

54. PA. STAT. ANN. tit. 72, § 7602.1 (emphasis added).

55. "The General Assembly may by law exempt from taxation . . . that portion of public property which is actually and regularly used for public purposes." PA. CONST. art. VIII, § (2)(a)(iii).

56. 113 A.2d 307 (Pa. 1955).

use of the property.<sup>57</sup> The court also removed any doubt as to its intention when it noted that the use of the property determines whether a tax exemption constitutionally may be granted.<sup>58</sup> Pennsylvania's intermediate appellate courts have followed this teaching.<sup>59</sup>

Thus, in turning to the pollution control device exemption, the use of a device will determine whether an exemption may be allowed. The reasoning for an exemption for devices which only serve to benefit the general public is relatively simple: installing devices which clean the public's air and water *and* paying taxes on the value of those same devices into the general tax pool benefits the public in both instances, and is an economic burden on industry in both instances. Either the devices must benefit the public by their function of cleaning the air or water (and therefore incur no tax liability) or the devices must benefit private industry (and therefore be subject to taxation like all other private property).

If devices are not dedicated to the primary purpose of pollution control, they must be abatement devices utilized primarily for the benefit of the general public. If a device is neither, it does not merit a tax exemption. Applying this fifth presumption to the statutory provision demonstrates that only a strict interpretation of what constitutes a pollution control or abatement device can be said to benefit the general public. A liberal interpretation, covering such things as parking lots, roofs and buildings, would provide a private benefit, which is contrary to the presumption.

#### 4. Another Construction Yardstick

Further help for interpreting the pollution control exemption is provided by the rule of strict and liberal construction.<sup>60</sup> The rule of strict and liberal construction explicitly requires that the provisions of the pollution control device exemption be strictly construed. Section 1928(b)(5) of the Statutory Construction Act states: "All provisions of a statute by the classes hereafter enu-

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57. *Borough of West View*, 113 A.2d at 309 (emphasis added).

58. *Id.*

59. See, e.g., *Pennsylvania Turnpike Comm'n v. County of Fulton*, 171 A.2d 882, 884 (Pa. Super. Ct. 1961) ("To qualify, therefore, for tax exemption it must be established that the property is being used for a public purpose . . ."); *Reading Mun. Airport Auth. v. Schuylkill Valley Sch. Dist.*, 286 A.2d 5, 7 (Pa. Commw. Ct. 1972) (holding that property leased by a municipal authority to a private party, who in turn leased it to an individual, was not used to benefit the general public and therefore was not exempt from local taxation).

60. See 1 PA. CONS. STAT. § 1928.



merated shall be strictly construed: . . . (5) Provisions exempting persons and property from taxation."<sup>61</sup>

Pennsylvania courts have consistently upheld the principle of strict construction of tax exemptions under the Pennsylvania Constitution and under both the current and repealed versions of the rule of strict and liberal construction.<sup>62</sup> An exemption should be limited to the terms stated,<sup>63</sup> and any ambiguity should be construed against an expansion of the exemption.<sup>64</sup> If a tax exemption is claimed, the claimant bears the burden of demonstrating that the claim falls within the provision of the statute.<sup>65</sup> A judicial body in Pennsylvania is not only obligated to ensure that exemptions contained in taxing statutes are narrowly construed, but it also is forbidden from judicially creating additional exemptions,<sup>66</sup> or extending exemptions by implication.<sup>67</sup>

Moreover, "there is no exception to this rule of strict construction."<sup>68</sup> Therefore, because statutes involving tax exemptions are strictly construed, the "exemption should be limited to the terms stated, and any ambiguity should be resolved *against* an expansion of the exemption."<sup>69</sup> The rule of strict construction of tax exemptions and Pennsylvania case law employing the rule make clear that pollution control devices used by industry may only be tax exempt if a strict reading of Section 602.1 so permits them to be.

The end result of the above statutory construction exercise is a rather clear demonstration that the legislative intent behind Pennsylvania's tax exemption for pollution control devices, as written, must have been a strict construction.

Although liberal construction creates the problems discussed above, namely by allowing a wide variety of devices which either do not control or abate pollution or do not benefit the public to

61. *Id.* § 1928(b)(5).

62. *See, e.g.*, *Fidelity-Philadelphia Trust Co. v. Hines*, 10 A.2d 553, 555 (Pa. 1940); *Commonwealth v. Philadelphia Toilet & Laundry Co.*, 13 A.2d 411, 412 (Pa. 1940); *YMCA v. City of Reading*, 167 A.2d 469, 472 (Pa. 1961). The repealed version of the rule of strict and liberal construction also explicitly required strict construction of statutes which entitle persons or property to exemption from taxation. *See* PA. STAT. ANN. tit. 46, § 558(3) (1969), *repealed by* Statutory Construction Act of 1972, 1972 Pa. Laws 1339, 1351.

63. *Lehigh Valley Coop. Farmers v. Commonwealth Bureau of Employment*, 447 A.2d 948, 950 (Pa. 1980).

64. *O'Reilly v. Fox Chapel Sch. Dist.*, 555 A.2d 1288, 1291 (Pa. 1989).

65. *Appeal of Univ. of Pittsburgh*, 180 A.2d 760, 761 (Pa. 1962).

66. *In re Estate of Highberger*, 360 A.2d 580, 582 (Pa. 1978).

67. *Commonwealth v. Union Collieries Co.*, 93 A.2d 460, 461 (Pa. 1953).

68. *Appeal of Pittsburgh Inst. of Aeronautics*, 258 A.2d 850, 852 (Pa. 1969).

69. *O'Reilly v. Fox Chapel Sch. Dist.*, 555 A.2d 1288, 1291 (Pa. 1989) (emphasis added).



qualify for tax exemption, strict construction runs into the problem of demanding an "all-or-nothing" application of the exemption. An "all-or-nothing" application does not adequately reflect the nature of current pollution control which may occur within the same device as the pollution itself does, not in a discretely separate unit. The recognition of this shortcoming of the strict construction of the exemption challenged Pennsylvania's judiciary to construct a new interpretation. Thus, the hybrid interpretation arrived on the scene in Pennsylvania.

### III. APPORTIONMENT—THE HYBRID BETWEEN THE LIBERAL AND STRICT CONSTRUCTIONS

The notion of apportionment announced by the EHB in *Cambria CoGen* is not new to the overall picture of pollution control device tax exemptions.<sup>70</sup> Both the federal government and some state governments already have in place schemes for acknowledging certain aspects of processes as controlling pollution, without requiring that those aspects be identifiable as the sole function of discrete components.

#### A. *The Federal Scheme for Apportionment*

The federal government's tax "break," in the form of an amortization deduction, rather than an exemption, addresses some of the ambiguities of Pennsylvania's Section 602.1. "Every person, at his election, shall be entitled to a deduction with respect to the amortization of the amortizable basis of any certified pollution control facility . . . based on a period of 60 months."<sup>71</sup> "Certified pollution control facility" is defined as:

[A] new identifiable treatment facility which is used, in connection with a plant or other property in operation before January 1, 1976, to abate or control water or atmospheric pollution or contamination by removing, altering, disposing, storing, or preventing the creation or emission of pollutants, contaminants, wastes, or heat and which . . . does not significantly—

- (i) increase the output or capacity, extend the useful life, or reduce the total operating costs of such plant or other property (or any unit thereof), or
- (ii) alter the nature of the manufacturing or production process or facility.<sup>72</sup>

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70. See *infra* notes 96-117 and accompanying text for a discussion of *Cambria CoGen*.

71. 26 U.S.C. § 169(a).

72. *Id.* § 169(d)(1). The statute defines "new identifiable treatment facility" to

The statute does not authorize certification of a pollution control facility "to the extent it appears that by reason of profits derived through the recovery of wastes or otherwise in the operation of such property, its costs will be recovered over its actual useful life."<sup>73</sup>

The federal deduction (from federal taxes) takes measures which, if contained in Pennsylvania's Section 602.1, would serve to remedy several of the shortcomings identified above. First, the federal definition of "certified pollution control facility" is much more specific than Pennsylvania's definition of "pollution control or abatement device," insofar as it requires that for a device to be certifiable, it must remove, alter, dispose, store or prevent the creation of pollutants, contaminants, wastes or heat.<sup>74</sup> This appears to be an outrageously liberal definition, liable to include just about everything, until one focuses on the limitation that such a facility must not "significantly increase the output or capacity, extend the useful life, or reduce the total operating costs of such plant or other property."<sup>75</sup> This limitation serves to strike the necessary balance discussed above between when the public should pay for a device because it cleans the environment but lowers operator profits, and when the operator should pay for the device because it generates profits. This balance is again explicitly and directly addressed in the federal deduction through the limitation that "the Federal certifying authority shall not certify any property . . . to the extent it appears that by reason of profits derived through the recovery of wastes or otherwise in the operation of such property, its costs will be recovered over its actual useful life."<sup>76</sup>

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include:

Only tangible property (not including a building and its structural components, other than a building which is exclusively a treatment facility) which is of a character subject to the allowance for depreciation provided in section 167, which is identifiable as a treatment facility, and which is property—

- (i) the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1968, or
- (ii) acquired after December 31, 1968, if the original use of the property commences with the taxpayer and commences after such date.

In applying this section in the case of property described in clause (i) there shall be taken into account only that portion of the basis which is properly attributable to construction, reconstruction, or erection after December 31, 1968.

*Id.* § 169(d)(4).

73. *Id.* § 169(e).

74. *Id.* § 169(d)(1).

75. *Id.* § 169(d)(4).

76. 26 U.S.C § 169(e).

### B. Other States' Schemes for Apportionment

A review of other states' exemptions and regulations for pollution control devices demonstrates several ways in which some sort of apportionment can be attained, and by contrast, shows how Pennsylvania's exemption as written does not support the notion of apportionment. These states' provisions fall into two broad categories: (1) those which limit the exemption to equipment "primarily" dedicated to pollution control; and (2) those which provide an apportionment mechanism to determine the amount of the exemption.

For instance, in Alabama, "[the Code provides a tax exemption for t]he storage, use or consumption of all devices or facilities, . . . used or placed in operation *primarily* for control, reduction or elimination of air or water pollution."<sup>77</sup>

In the Illinois tax exemption provision, "[p]ollution control facilities" is defined as "any system, method, construction, device or appliance appurtenant thereto sold or used or intended for the *primary* purpose of eliminating, preventing, or reducing air and water pollution."<sup>78</sup>

In Maine, the legislature stated that "[t]he following real estate is exempt from taxation: . . . . Air pollution control facilit[ies] . . . [which] mean any appliance, equipment, machinery, installation or structures installed, acquired or placed in operation *primarily* for the purpose of reducing, controlling, eliminating or disposing of industrial air pollutants."<sup>79</sup>

Similarly, in Ohio, "[a]ir pollution control facility' means any property designed, constructed, or installed for the *primary* purpose of eliminating or reducing the emission of, or ground level concentration of, air contaminants which renders air harmful or inimical to the public health or to property within this state."<sup>80</sup>

In New Jersey, "[a]ny equipment, facility or device constructed or installed either prior to or subsequent to the effective date of this act and used *primarily* for the purpose of abating or preventing pollution of the atmosphere or the waters of this state . . . shall be exempt from taxation under this chapter to which this

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77. ALA. CODE § 40-23-62(18) (1975) (emphasis added).

78. ILL. ANN. STAT. ch. 35, para. 105/2a (Smith-Hurd 1993) (emphasis added).

79. ME. REV. STAT. ANN. tit. 36, § 656(1)(E)(2)(a) (West 1964) (emphasis added).

80. OHIO REV. CODE ANN. § 5709.20(B) (Anderson 1996) (emphasis added).

act is a supplement."<sup>81</sup>

In Massachusetts, "[a]ny structure, building, device, appliance, machinery, equipment or other property . . . which is constructed, installed or placed in operation, *in whole or in part*, for the purpose of eliminating industrial waste or reducing such waste [shall receive an exemption] . . . . If any such structure, building, device . . . is used solely and in its entirety for the elimination or control of water or air pollution, the exemption granted hereunder shall be total; if, however, only a portion of such structure, building, device . . . is used for the elimination or control of water or air pollution, the exemption shall be prorated."<sup>82</sup>

New Hampshire provides that "any treatment facility, device, appliance or installation *wholly or partly* for the purpose of reducing, controlling or eliminating any source of air or water pollution shall be entitled to have the value of said facility . . . or a percentage thereof . . . [is] exempted from the taxes levied under this chapter."<sup>83</sup>

And finally, in New York, "[t]he term 'air pollution control facilities' shall mean facilities which remove, reduce, or render less noxious air contaminants emitted from air contamination sources . . . but excluding such facilities installed for the *primary* purpose of salvaging materials which are usable in the manufacturing process or are marketable and excluding those facilities which rely for their efficacy on dilution, dispersion or assimilation of air contaminants in the ambient air after emission."<sup>84</sup>

By adding a term to their statutory exemptions such as "primarily," these other states have prevented the liberal interpretation from taking hold. If a device is required to be used "primarily" for pollution control, then a device used incidentally or secondarily for pollution control will clearly not qualify for exemption. In at least two states with such limiting language in the legislation, courts have made that interpretation clear. In *Ethyl Corp. v. Adams*,<sup>85</sup> the Supreme Judicial Court of Maine wrote that "[i]n order [t]o qualify as a water [or air] pollution control facility . . . [any facility] must have been 'installed, acquired or placed in operation *primarily for the purpose of* reducing, controlling or eliminating water pollution."<sup>86</sup> In *Illinois Cereal Mills v.*

81. N.J. STAT. ANN. § 54:4-3.56 (West 1986) (emphasis added).

82. MASS. GEN. LAWS ANN. ch. 59, § 5, cl. (44) (West 1988) (emphasis added).

83. N.H. REV. STAT. ANN. § 72-12-a (1991) (emphasis added).

84. N.Y. REAL PROP. TAX LAW § 477-a (McKinney 1996) (emphasis added).

85. 375 A.2d 1065 (Me. 1977).

86. *Ethyl Corp.*, 375 A.2d at 1075.

*Department of Revenue*,<sup>87</sup> the Illinois Court of Appeals held that property not sold, used or intended for the primary purpose of reducing or eliminating pollution does not fall within the Use Tax Act provision, which defines exempt pollution control facilities.<sup>88</sup>

Yet, even without such limiting language in the legislation, Ohio courts have held likewise. In *Sun Oil Co. v. Lindley*,<sup>89</sup> the Ohio Supreme Court held: "Hence it is our conclusion that R.C. 5709.21 . . . does not permit exemption of property which serves a pollution control purpose and also provides an incidental function which benefits the taxpayer's production processes."<sup>90</sup> In *Marietta Coal Co. v. Lindley*,<sup>91</sup> the Ohio Supreme Court stated: "Lastly, only such part of the facility as is used *exclusively* for pollution control is entitled to the tax exemption."<sup>92</sup>

In conclusion, other state courts, with or without the aid of limiting legislative language, have held that the exemptions are limited to devices which are first and foremost for the purpose of pollution control.

#### C. Two Pennsylvania Cases on Point—Cambria CoGen and York Water

As Section 602.1 provides, a taxpayer first applies to the Pennsylvania Department of Environmental Protection (the "DEP") for certification of its devices as pollution control or abatement devices used to benefit the general public.<sup>93</sup>

In responding to public comments, objections, and suggestions received regarding the promulgation of Section 155.11, the Department of Revenue stated:

Since pollution control devices are within the purview of the Department of Environmental [Protection], that Department possesses the expertise and administrative ability to determine what constitutes a pollution control device and whether such a device is "employed or utilized for the benefit of the general public [referring to the language of PA. STAT. ANN. tit. 72 § 7602.1]."<sup>94</sup>

87. 346 N.E.2d 69 (Ill. App. Ct. 1976).

88. *Illinois Cereal Mills*, 346 N.E.2d at 71.

89. 383 N.E.2d 908 (Ohio 1978).

90. *Sun Oil*, 383 N.E.2d at 911.

91. 450 N.E.2d 1164 (Ohio 1983).

92. *Marietta Coal*, 450 N.E.2d at 1167 (emphasis added).

93. 61 PA. CODE § 155.11(2)-(3).

94. Bureau of Corporation Taxes, *Rules & Regulations—Pollution Control Device Exemption*, 7 Pa. Bull. 2833, 2899 (1977). There is a question as to whether this delegation of authority by one executive agency of the Commonwealth to another executive agency of the Commonwealth was lawfully permitted by Section 602.1,

If the DEP certifies the devices, the certification is returned to the taxpayer who must then forward it to the Department of Revenue along with its capital stock or franchise tax. If the DEP denies certification of the device, the taxpayer has thirty days within which to appeal the denial to the EHB.<sup>95</sup>

Having labored through the statutory construction exercise for general interpretation of the pollution control device exemption in Part II.B., and having examined how the federal and state legislatures have framed their statutes and how state courts have construed state statutes in Parts III.A. and III.B., we now analyze the EHB decisions which specifically interpret Pennsylvania's exemption.

In 1995, the EHB issued its only two decisions which serve to further explain and interpret Pennsylvania's exemption for assets devoted to pollution abatement or control from franchise or capital stock tax. The first of these decisions is *Cambria CoGen Co. v. Commonwealth of Pennsylvania, Department of Environmental Resources*.<sup>96</sup> The second is the EHB's adjudication in *York Water Co. v. Commonwealth of Pennsylvania, Department of Environ-*

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and whether the review process created by the Department of Revenue and the DEP under the extant regulatory scheme is an unconstitutional violation of rights to due process, uniformity of taxation and equal protection. This issue is currently before the Pennsylvania Commonwealth Court. See Brief for Appellant at 13, *York Water Co. v. Commonwealth of Pennsylvania, Dep't of Env'tl. Resources, EHB Docket No. 94-057-E, 1995 WL 347899* (Pa. Env. Hrg. Bd. June 1, 1995), *appeal docketed*, No. 1554 C.D. 1995 (Pa. Commw. Ct.). The Pennsylvania Commonwealth Court has jurisdiction over appeals from decisions of the EHB. 42 PA. CONS. STAT. § 763(a)(1) (1990).

95. See 25 PA. CODE § 1021.52(a) (1995) (giving the EHB jurisdiction over appeals from "actions" of the DEP). The applicability of the EHB appeal procedure to the DEP's certification decisions regarding pollution control device tax exemptions is currently under review by the Pennsylvania Commonwealth Court. See Brief for Appellant at 7-13, *York Water*; Brief for Appellee at 12-17, *York Water*. Both the DEP and York Water, on the latter's appeal from DEP's denial of certification, argue that the DEP's denial is properly characterized as "advice" to the Department of Revenue, and is not, therefore, a final "action" appealable to the EHB. *Id.* If the commonwealth court agrees with this argument, denials of certification would not become final appealable actions until the Department of Revenue formally recognizes the DEP's advice.

The procedure followed would be this: All corporate tax reports are "settled" by the Department of Revenue with the concurrence of the Department of Auditor General. PA. STAT. ANN. tit. 72, §§ 801-802 (1995). A taxpayer who is not satisfied with this settlement may, within ninety days, petition the Department of Revenue's Board of Appeals for resettlement. *Id.* § 1102. A taxpayer not satisfied with the resettlement may, within ninety days, petition the Department of Treasury's Board of Finance and Review. *Id.* § 1103. The taxpayer may then appeal the decision of the Board of Finance and Review within thirty days to the commonwealth court. 42 PA. CONS. STAT. § 763(a)(1) (1990).

96. EHB Docket No. 92-308-MJ, 1995 WL 75063 (Pa. Env. Hrg. Bd. Feb. 10, 1995).



*mental Resources*.<sup>97</sup> Both opinions interpreted and commented on the pollution control device exemption found in Section 602.1.

Cambria CoGen Company ("Cambria") operates an eighty-five megawatt electric power plant near Ebensburg, Pennsylvania.<sup>98</sup> Not only does Cambria produce electric power at the plant which it sells to a local electric utility, but Cambria also produces steam at the plant, which is sold to a nearby nursing home.<sup>99</sup>

As per Section 155.11, Cambria applied to the DEP for certification of nearly its entire facility as a pollution control or abatement device.<sup>100</sup> The DEP, in response, certified that Cambria's waste water treatment pond, neutralization sump pump, oil/water separator, dust collection equipment and boiler baghouses are all pollution control or abatement devices.<sup>101</sup> It is interesting to note that all of these devices fit neatly into the historical understanding of pollution control or abatement devices as being separate and discretely identifiable units solely devoted to the task of pollution control or abatement. The DEP denied certification to Cambria's circulating fluidized bed boilers, fuel handling system, limestone handling system, coal refuse storage dome, coal storage tepee, ash storage silos, and ash conditioning equipment.<sup>102</sup> The most expensive items for which the DEP denied certification were Cambria's circulating fluidized bed boilers.<sup>103</sup> The boilers, in comparison to the other devices for which exemptions were sought, are items which do not fit neatly within the historical notion of separate and discrete pollution control or abatement devices. In its very thorough opinion, the EHB provided a good description of the operation of these boilers:

The facility has two circulating fluidized bed ("CFB") boilers, each of which consists of a furnace, two cyclone units and structural components capable of burning 47 tons per hour of the blended coal and coal refuse. Fuel and limestone are injected into the base of the furnace and entrained in a fluidized mass supported by the combustion air. The entrained material and flue gas flow into a cyclone collector which separates the hot gases from the solid bed and ash material, with the solid material being injected back into the furnace's combustion chamber.

The direct injection of limestone into these boilers permits the limestone to absorb sulfur released as the fuel is burned. The furnace heat calcines the limestone to form calcium oxide. The calcium oxide reacts

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97. EHB Docket No. 94-057-E, 1995 WL 347899 (Pa. Env. Hrg. Bd. June 1, 1995), *appeal docketed*, No. 1554 C.D. 1995 (Pa. Commw. Ct.).

98. *Cambria CoGen*, 1995 WL 75063, at \*3.

99. *Id.*

100. *Id.* at \*5.

101. *Id.*

102. *Id.*

103. *Cambria CoGen*, 1995 WL 75063, at \*5.

with sulfur dioxide to form calcium sulfate. Calcium sulfate is an inert solid which can be removed from the flue gases in either a baghouse or with bottom ash. Limestone is injected for the sole purpose of capturing sulfur and sulfur compounds in the by-products from burning coal refuse. The boiler's design is sufficiently efficient to eliminate the need for additional flue gas desulfurization equipment to meet current air pollution control standards.<sup>104</sup>

Upon denial by the DEP of certification for the above-mentioned devices, Cambria appealed to the EHB.<sup>105</sup> Among other issues in its appeal, Cambria argued that because pollution control occurs when limestone reacts with sulfur compounds inside the boiler chamber, which also happens to be the place where pollution is produced when coal and coal refuse combust, the boiler itself qualifies as a certifiable pollution control or abatement device.<sup>106</sup> Cambria also contended that this pollution control or abatement system is superior to the alternative of attaching a pollution control device such as a flue gas scrubber to the smokestack after combustion occurs in the boiler chamber.<sup>107</sup>

The DEP argued, on the other hand, that the boilers are in fact pollution sources and not pollution control devices.<sup>108</sup> Thus, the public should not be required to pay for a pollution source which serves to profit a private industrial concern, through a reduction in the public's tax pool.<sup>109</sup> In addition, the DEP argued that if a circulating fluidized bed boiler is properly categorized as a pollution source it cannot also be categorized as a pollution control device, because nowhere in the statute or regulation is there a quantitative or qualitative method by which to apportion those parts or functions of the boiler which serve to control or abate pollution separate from those parts or functions of the boiler which serve to create pollution.<sup>110</sup>

By contrast, in the federal tax scheme there is a provision for such apportionment whereby a fuel penalty is created.<sup>111</sup> The fuel penalty permits exemption for that portion of fuel used to combust the inert limestone material injected into the boiler chamber for the purposes of pollution control or abatement.<sup>112</sup> The fuel penalty concept assumes that the rest of the combustion

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104. *Id.* at \*4.

105. *Id.* at \*5.

106. *Id.* at \*9.

107. *Id.* at \*15.

108. *Cambria CoGen*, 1995 WL 75063, at \*12.

109. *Id.*

110. *Id.* at \*17.

111. *See* Guidelines for Certification, 40 C.F.R. app. A. § 20.

112. *Id.*

process is performed to provide power for electricity and steam, both of which are saleable products which profit the private concern producing them.

In ruling on this issue, the EHB held that although the Pennsylvania scheme does not provide for apportionment, it also does not prohibit apportionment.<sup>113</sup> Thus, the EHB remanded the issue concerning the degree to which a circulating fluidized bed boiler with limestone injection for sulfur compound control constitutes a pollution control device back to the DEP for apportionment.<sup>114</sup> It is important to note that this problem cannot simply be solved by further reduction of a process into smaller constituent parts. The question is what part of the combustion process, which is an intangible process not reducible to separate and discrete parts, is devoted to pollution control which benefits the public and which the public should pay, and which part of the combustion process is for the production of power which profits the concern producing the power and for which the public should not pay? In *Cambria CoGen*, in reading Section 602.1, the EHB concluded that: "[The legislature] exempted equipment used for both water pollution control or abatement and air pollution control or abatement so long as this equipment's use is to the benefit of the general public. Thus, a public benefit from the equipment is required before such equipment may be exempted under section 602.1."<sup>115</sup> The EHB also noted that section 155.11 "repeats that statute's public benefit requirement" from Section 602.1.<sup>116</sup> Moreover, the EHB recognized the DEP's responsibility to make a determination of public benefit by citing to the Pennsylvania Department of Revenue's pronouncement in adopting section 1-55.11. This brings to mind the Pennsylvania Department of Revenue comment noted above:

Since pollution control devices are within the purview of the Department of Environmental [Protection], that Department possesses the expertise and administrative ability to determine what constitutes a pollution control device and whether such a device is "employed or utilized for the benefit of the general public."<sup>117</sup>

Other state courts have been faced with the same issue. They have consistently and specifically denied applications for boilers.

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113. *Cambria CoGen*, 1995 WL 75063, at \*17.

114. As of this writing, Cambria has yet to re-submit an application to the DEP claiming some scheme of apportioning the ratio of pollution to pollution control.

115. *Cambria CoGen*, 1995 WL 75063, at \*13.

116. *Id.* at \*14.

117. 7 Pa. Bull. at 2899.

In *Ethyl Corp. v. Adams*,<sup>118</sup> the Maine Supreme Court refused to permit a bark-oil boiler tax exemption status even though its primary purpose involved the disposal of waste bark.<sup>119</sup> The court reasoned that because the bark-oil boiler served a *second* purpose, the production of steam, the entire device was outside the meaning of the statute.<sup>120</sup> In *Timken Co. v. Lindley*,<sup>121</sup> the appellee installed two new boilers which increased a plant's capacity to produce steam.<sup>122</sup> Though the appellee alleged that but for conforming with environmental standards it would not have installed the new boilers, the Ohio Supreme Court nonetheless denied the tax exemption.<sup>123</sup> In its decision in *Timken*, the court held that the statute "does not permit exemption of property which serves a pollution control purpose and also provides an *incidental* function which benefits the taxpayer's production processes."<sup>124</sup> Most importantly, the *Timken* court held that, "[i]f the test to be applied in determining what facilities shall receive an air pollution control certificate is to be broadened, the General Assembly must take such action."<sup>125</sup>

The Illinois Court of Appeals also denied certifying boilers as pollution control devices in *Illinois Cereal Mills v. Department of Revenue*.<sup>126</sup> In *Illinois Cereal Mills*, the court denied certification for exemptions of gas-fired boilers even though the boilers were installed solely to meet environmental requirements of government agencies.<sup>127</sup> The court recognized that the boilers produced less pollution than coal fired boilers. Yet, relying on the words of the statute, the court found that the statute:

[D]oes not seem to refer to equipment like the gas fired boilers even though they were installed because they were less polluting than the equipment formerly used. Rather the words refer to equipment . . . which have no substantial function in the manufacturing or processing of a product other than to abate the pollution caused by the plant operation."<sup>128</sup>

In the only other published case interpreting either Section

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118. 375 A.2d 1065 (Me. 1977).

119. *Ethyl Corp.*, 375 A.2d at 1078-79.

120. *Id.*

121. 416 N.E.2d 592 (Ohio 1980).

122. *Timken*, 416 N.E.2d at 595.

123. *Id.* at 596.

124. *Id.* (citing *Sun Oil Co. v. Lindley*, 383 N.E.2d 908 (Ohio 1978)) (emphasis added).

125. *Id.*

126. 346 N.E.2d 69 (Ill. App. Ct. 1976).

127. *Illinois Cereal Mills*, 346 N.E.2d at 71.

128. *Id.*

602.1 or Section 155.11, the EHB, in its adjudication of *York Water*, focused the public benefit requirement in upholding the DEP's denial of certification to York's flocculators, chemical treatment equipment, dual media filters and settling basins.<sup>129</sup> In *York Water*, the EHB relied heavily upon its determinations and interpretations in the then-recent *Cambria CoGen* opinion. As the court stated:

As we ruled in *Cambria CoGen*, where a device was used by CoGen to help bring about the efficient generation of saleable steam or electricity by CoGen, it was not used for the benefit of the general public and was not exemptible. The situation with York's equipment is similar to the coal and coal refuse storage equipment in *Cambria CoGen*, i.e., it is used to produce a saleable product to York's customers. The evidence shows York's equipment is used to produce drinking water which York sells to its customers. While York's customers are arguably members of the public, these customers are the only people benefitted by the safe drinking water provided by York.<sup>130</sup>

#### CONCLUSIONS

In interpreting the pollution control device exemption from imposition of a capital stock and franchise tax found in Section 602.1 of the Tax Code, and the Department of Revenue's regulations found in Section 155.11, the EHB has recognized that technology in the 1990's which abates or controls pollution is not as easily identifiable as separate and discrete technology as the statutory exemption from 1971 would suggest. At that time, governmental regulation required industry to attach end-of-pipe and end-of-stack bolt-on pollution control devices to its manufacturing processes. Industry responded to governmental demands by stating that it would be willing to do so, but that the costs of such pollution control devices were prohibitive and that industry would therefore need governmental help in attaching such devices to control pollution. Governments responded, not by creating direct funding to industry for the attachment of such devices, but instead by creating tax exemptions, such as the one found in Section 602.1, to ease industry's burden. The logic behind such reasoning functions similar to a linear mechanical equation. If industry, so the General Assembly reasoned, is to install pollution control devices by expenditures of capital to benefit only the public at a cost to industry, then the public should be made to pay at least in part for the installation of these end-of-pipe and

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129. *York Water*, 1995 WL 347899, at \*14-15.

130. *Id.* at \*10 (citing *Cambria CoGen*, 1995 WL 75063, at \*4).



end-of-stack devices. By reducing the tax pool the public would be, in effect, paying for the end-of-pipe and end-of-stack devices which would clean the water and clean the air for the public's benefit at the cost to industry.

This logic served well during an era when pollution control was achieved by bolting on separate discrete devices which would have the effect of controlling or abating pollution. Since that time, however, technology has changed and pollution control and pollution abatement options are no longer limited to attaching a scrubber to a smokestack or attaching a filtration device to an end of a discharge pipe. Today, pollution control or abatement is often part of the manufacturing process and, therefore, part of the pollution source. Thus, the clear anticipated distinction of the legislature in 1971 becomes fogged when control of pollution is an integral part of the production process. Moreover, even after the assets are identified, the complexity of evaluating and quantifying the costs of pollution control equipment and environmental compliance makes the Department of Revenue's job of evaluating potential loss to the Commonwealth's revenues because of these tax exemptions very difficult.<sup>131</sup> The *Cambria CoGen* case is a good illustration of this problem.

In *Cambria CoGen*, the EHB opined that such a distinction need not only be one of separate tangible physical control devices, but could also be one of apportioning singular devices according to the functions of those devices.<sup>132</sup> At the same time, the EHB also recognized the somewhat equational nature of the tax exemption.<sup>133</sup> As such, if a device benefits only the public in that it is used exclusively to remove, abate or control pollution, then the public should pay for that device owned and operated by industry through a deficit in the tax pool. The other half of the equation, however, is that if a device incidentally prevents pollution but at the same time profits the industry utilizing the device, then the public should not be made to pay for the device even though it may in some fortuitous fashion abate pollution. This equation, historically traced to the necessity of bolting pollution abatement equipment onto existing factories in the late 1960's and early 1970's, finds support in the "general public" requirement from Section 602.1 upon which the EHB relied.

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131. See ROBERT REPETTO, JOBS, COMPETITIVENESS, AND ENVIRONMENTAL REGULATION: WHAT ARE THE REAL ISSUES? (1995); Jaffe et al., *supra* note 40, at 3; ECONOMICS AND STATISTICS ADMINISTRATION, BUREAU OF THE CENSUS, U.S. DEPT OF COMMERCE, POLLUTION ABATEMENT COSTS AND EXPENDITURES (1993).

132. *Cambria CoGen*, 1995 WL 75063, at \*15-\*16.

133. *Id.* at \*17.



*Cambria CoGen* is a solid first step in recognizing that today's technology cannot be discretely divided into tangible property which is either wholly devoted to the purpose of pollution prevention or is wholly devoted to the purpose of profit generation. The decision provides reassurance that devices which only incidentally provide pollution control should not be funded by public tax dollars. The decision also makes clear that a pollution control device must be for the benefit of the general public to be considered tax exempt. Yet, the precise formulae for apportioning devices which have a partial primary purpose of pollution control are not settled. That can either be accomplished as the federal government does with a statutorily-created quantitative five percent threshold, and with a more explicit statutory definition of "qualifying facilities," or as several other states do with qualitative thresholds, using words such as "primarily" to facilitate application of the standard. Pennsylvania's statutory exemption and regulation are in need of a great deal of interpretation because they lack such things as threshold amounts and explicit definitions for "pollution control" or "abatement."

In judicially interpreting the pollution prevention exemption or amending the statute or regulation, today's political environment would suggest the following hierarchy of principles: First, the popular notion that good environmental practice is good business should be put to the test. As such, a free market may drive innovation and pollution control. At least one economist, Dr. Michael Porter of Harvard University, has collected convincing evidence which supports the notion that good environmental practices provide competitive advantages.<sup>134</sup> This holds true to the extent that the government may even set standards of compliance which current technology cannot achieve in order to prod research and development toward achieving these standards: a process known as "technology-forcing."<sup>135</sup>

Second, only when the social good of pollution control either is not profitable, or cannot be made profitable, even through "technology forcing," does the public, through duly-enacted legislation and duly-promulgated regulation need to decide how much of its tax pool it can forgo to achieve desired levels of clean air and

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134. See Michael E. Porter, *The Competitive Advantage of Nations*, HARV. BUS. REV., Mar.-Apr. 1990, at 73-93. See also WALLACE OATES ET AL., THINKING ABOUT THE PORTER HYPOTHESIS (1993); John Carey & Mary Beth Regan, *Are Regs Bleeding the Economy?*, BUSINESS WEEK, July 17, 1995, at 75-76.

135. For a succinct discussion of technology forcing, see Commonwealth of Pennsylvania, Dep't of Env'tl. Resources v. Penn Power Co., 416 A.2d 995 (1980) (holding that technology forcing is constitutional). See also Comment, *Forcing Technology: The Clean Air Act Experience*, 88 YALE L. J. 1713 (1979).

water. The currently popular mechanism for this is the tax exemption for pollution control devices.

Pennsylvania's exemption, as written, exempts "pollution control and abatement devices."<sup>136</sup> It does not explicitly include pollution prevention devices. The technology which was available when the statutory exemption and accompanying regulation were written is not the same technology that is being employed today. If technology is capable of preventing pollution at a cost to the industrial taxpayer, for which that taxpayer receives no economic advantage, and which benefits only the general public and not the industrial taxpayer, a new exemption reflecting the abilities of this technology is in order. Likewise, if technology is partially devoted to pollution control or abatement, and partially devoted to the creation of profit, and those parts are not discretely distinguishable, then a new exemption guiding that apportionment is in order. Without a new or additional exemption which recognizes that indivisible devices may both pollute and control pollution at the same time, and may function to pollute sometimes and control pollution at other times, Section 602.1 is not the slipper that will fit the foot of extant technology.

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136. PA. STAT. ANN. tit. 72, § 7602.1.