Kentucky: Underground Pipeline is Tangible Personal Property for Ad Valorem Tax Purposes

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The Kentucky Court of Appeals held that Marathon Pipeline, LLC's ("Marathon") underground pipeline is tangible personal property for Kentucky property tax purposes, not real property. Department of Revenue v. Marathon Pipeline, LLC, No. 2021-CA-0626-MR (Ky. App. May 13, 2022) (designated not to be published). The Court affirmed the decision of the Franklin Circuit Court, which had in turn affirmed the decision of the Kentucky Claims Commission ("KCC"). Marathon is a public service corporation ("PSC"), and the pipeline transports crude oil to a refinery for processing and manufacturing into gasoline and other products. The pipeline is located in an activated foreign trade zone, and tangible personal property located in such zones was taxed at a highly favorable rate.

In 2012, the pipeline was assessed at a value of $60 million. Over the course of 2012 and 2013, Marathon replaced and repaired 40 miles of the pipeline, and in 2014, after completion of that project, the Department increased the assessment to $242 million, then valued it at $225 million in 2015, and $240 million in 2016. Marathon protested those assessments, asserting the value should be $120 million, $106 million, and $106 million, respectively. The Department denied the protest, and ruled that the pipeline was real property. Marathon appealed to the KCC. At the KCC, both parties hired an expert appraiser. The KCC determined that the pipeline should be classified as tangible personal property, and that the taxable value of the property was $117,719,894 for 2014, $106,385,565 for 2015, and $116,087,260.80 for 2016. The Department appealed, and the Circuit Court affirmed.

Before the Court of Appeals, the Department argued that the pipeline was real property because it increased the "value or utility" of the land, and cited to case law that held a similar underground oil pipeline was real property. The Department also relied on a regulation, 103 KAR 8:090, which classified a transmission pipeline was real property. Marathon argued that the pipeline was a trunk line, not a transmission line.

In holding for Marathon, the Court of Appeals adopted the KCC and trial court's reasoning that the pipeline was tangible personal property. Key to this analysis was testimony in the record that the pipeline was buried due to above ground restrictions, and has not adapted to the use of the land above it. Furthermore, Marathon testified that its intent was not to make the pipeline part of the realty, and instead wanted the pipe to be moved or replaced when needed. Indeed, Marathon had completed such a replacement project in 2012. The Court thus held that the pipeline was not annexed to the realty, was moveable, was not adapted to the use or purpose of the land, and was intended to be moved and was not a permanent addition to the land. The Court also addressed the regulation, and noted that the pipeline was described in federal regulatory documents as a trunk line, not a transmission line. And, the regulation did not define a transmission line.

The Court further held that the Department's treatment of the pipeline was not uniform to other similar situations, and uniform treatment is required by Kentucky law. Marathon presented testimony that another similar pipeline had been classified by the Department as tangible personal property. And, the regulation at issue classified a gathering line, another type of pipeline that transports crude oil, as tangible personal property, but the Department could provide no reason why a gathering line and transmission line should be classified differently. Thus, the pipeline was tangible personal property.

As to the valuation issue, the Court noted that a finding of fact by the administrative tribunal is conclusive if supported by substantial evidence, and the reviewing court must give deference to a hearing officer's decision regarding credibility of witnesses and weight of the evidence. Here, the hearing officer heard testimony from both parties' expert witnesses. The hearing officer ultimately agreed with Marathon's expert and provided extensive reasoning as to why he accorded Marathon's expert more weight. The Court thus affirmed the KCC's determination of value.

Many taxpayers believe their property classifications are a "done deal" and that the Department's classification must stand. This case serves as a reminder taxpayers should review assessments carefully, and think through whether personal property should be classified as real property and vice versa. Real property assessments may incorrectly include tangible personal property that should be taxed separately. This case also illustrates the importance of presenting substantial evidence to administrative tribunals. While hiring an appraiser is an expense, it is often necessary to show that a taxpayer's opinion of value is correct. The administrative tribunal is required to make its findings based on substantial evidence, and an expert witness is the gold standard.

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