



This Week in State Tax (TWIST)

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Kentucky: Manufacturer's Prepared Foods Exempt from Sales Tax

The Commonwealth Court of Appeals recently held that although certain of a taxpayer's products were "prepared foods" under Kentucky law, they were exempt from sales tax as they met an exception to the imposition of tax for prepared food sold by a manufacturer. The taxpayer operated a deli, café, and grocery in one building, producing items like sandwiches, soups, and meatballs. In the back of the building, the taxpayer operated a commercial kitchen and bakery in which it produced about 200 products, including bulk quantities of "salads and spreads" such as chicken salad, pasta salad, quiches, pizzas, etc., which were sold in individual containers in the grocery and deli. A second building was used for making fresh and dry pasta. On audit, the Department of Revenue (Department) assessed additional sales tax on about 20 items (mainly salads and spreads) that it considered taxable "prepared food." After an unsuccessful protest to the Board of Tax Appeals, the taxpayer appealed to the Circuit Court, which reversed the assessment, prompting the Department's appeal to the Court of Appeals.

Kentucky exempts sales of food and food ingredients for human consumption, excluding "prepared food," from the retail sales tax. For the purposes of this case, prepared food is defined generally as items with two or more ingredients combined by the retailer for sale as a single item, with the exception of prepared food sold without utensils provided by a seller that is properly classified under the North American Industrial Classification System (NAICS) as a manufacturer in sector 311. The Department argued the taxpayer's products were prepared food, while the taxpayer contended its products were made in bulk and repackaged, not intended for sale as single items. The appellate court found the statutory definition of "prepared food" was ambiguous and relied on Kentucky case law to narrowly construe tax exemptions against taxpayers. It determined that the taxpayer's salads and spreads were mixed or combined for sale as a single item, and accordingly, were properly considered prepared foods. [Here, it rejected a circuit court finding that they were not prepared foods.] It went on, however, to determine the taxpayer was primarily engaged in food manufacturing and therefore was properly considered a business that primarily manufactured perishable prepared foods under NAICS. The court noted that most of the taxpayer's facilities and employees were involved in food manufacturing, and it therefore constituted a plurality of the taxpayer's business. Thus, the taxpayer was deemed primarily engaged in perishable prepared food manufacturing, and its identified prepared food items were exempt from sales and use tax. Please contact [Dave Perry](#) for questions on *Department of Revenue v. Hale Inc. d/b/a/ Lotsa Pasta* [[2023-CA-1192-MR](#)].

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