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Kentucky Tax Law, Second Edition

Office of Continuing Legal Education at the University of Kentucky College of Law

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Monograph

Series

**Kentucky Tax
Law**

Second Edition

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KENTUCKY TAX LAW

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CHAPTER I.

REAL AND PERSONAL PROPERTY TAXATION

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REAL AND PERSONAL PROPERTY TAXATION

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[1.1] REAL AND PERSONAL PROPERTY TAXATION

By
Thomas A. Brown and Mark F. Sommer

[1.2] ASSESSMENT OF PROPERTY FOR KENTUCKY AD VALOREM TAXATION -- GENERAL PRINCIPLES AND OVERVIEW

A. [1.3] INTRODUCTION

From the first taxes imposed in colonial New England, commonly known as "faculty taxes," to the relatively late comer, "sales and use taxes," states, and local and county governments by virtue of their blessing, have continually expanded their taxing powers. Throughout this expansion, one mainstay of the tax structure throughout the states, Kentucky included, has been the "ad valorem tax" (hereinafter also sometimes referred to as "property tax"), which is a tax upon property "according to value." Black's Law Dictionary at 51 (6th ed. 1990).

Although decreasing over time in its contribution to most states' tax coffers, the property tax continues to contribute to the general revenue of states in a big way nonetheless. Its decrease over time is marked, down from roughly 50% of total tax revenues (all states) in 1902 to approximately 7.8% near 1940, and even further since then. Even in Kentucky is the change noticeable. Most recently, the percentage of the Kentucky general fund supplied by all types of property taxes decreased from 7.9% in 1978-1979 to 7.8% in 1992-1993, notwithstanding a 163% increase during the same period in total annual Kentucky property tax collections, from \$134,963,779 to \$354,757,842. 1992-1993 Kentucky Revenue Cabinet Statistical Report at p. 6. Even as an ever decreasing percentage of total tax revenues, the property tax still accounts for a large amount of Kentucky tax revenue. As a result, its importance in the area of Kentucky taxation remains the same today as it did years ago.

B. [1.4] NATURE OF THE KENTUCKY PROPERTY TAX

In general, property taxes are thought of as "impersonal" taxes, characterized as such due to the tax attaching to the "thing" (the property) rather than the "person" (the taxpayer/owner). Courts of long ago thought of the property tax as a "direct" tax, that being one that is imposed directly on property according to its value. South Nashville St. R. Co. v. Morrow, 11 S.W. 348 (Tenn. 1880). In its simplest terms the property tax may be seen as a tax levied directly upon the rights of ownership of property.

Typically, it is the property's legal owner or titleholder that is required to "list" property for taxation and, correspondingly, pay applicable tax. See KRS 132.220; see also Fayette County Bd. of Supervisors v. O'Rear, 275 S.W.2d 577 (Ky. 1954). In Kentucky, to "list" property for taxation means to ensure that the property is on the tax rolls of the government by notifying the taxing authorities that such property has a tax situs in Kentucky, informing the taxing authorities of its fair cash value, and attesting to such value. For tangible and intangible personal property, listing is generally accomplished by the filing of property tax returns completed under oath with the Property Valuation Administrator ("PVA") or Revenue Cabinet. Typically, real property is assessed directly by the governing PVA without action by the taxpayer. The listing of property by the taxpayer is not, in and of itself, the tax assessment, but is only evidence from which the assessment is made. Kentucky River Coal Corp. v. Knott County Bd. of Supervisors, 54 S.W.2d 377, 381 (Ky. 1932).

C. [1.5] WHAT IS PROPERTY?

In Kentucky property tax matters, Kentucky courts have consistently construed the meaning of "property" in the broadest form possible:

'Property' as used in the revenue statute means everything of value that a person owns that is or may be the subject of sale or exchange or that when offered for sale will bring some price. . .

The term (property) is therefore said to include everything which is the subject of ownership, corporeal or incorporeal, tangible or intangible, visible or invisible, real or personal, choses in action as well as in possession, everything which has an exchangeable value, or which goes to make up one's wealth or estate.

Button v. Drake, 195 S.W.2d 66, 69 (Ky. 1946); *see also* Commonwealth ex rel Huntsman v. Kentucky Distilleries & Whse. Co., 136 S.W. 1032 (Ky. 1911) ("property" means anything of value that a person owns that is or may be the subject of sale or exchange); Raydure v. Bd. of Supervisors, 209 S.W. 19, 23 (Ky. 1919) (the test is whether the thing has a cash value and a bidder could be found who would pay a cash price). The KRS sets out equally broad definitions, defining "real property" as all lands within this state and improvements thereon. *See, e.g.*, KRS 132.010(3); 133.010(4). "Personal property" is also broadly defined as every species and character of property, tangible and intangible, other than real property. *See, e.g.*, KRS 132.010(4); 133.010(5).

D. [1.6] CONSTITUTIONAL PROVISIONS

Kentucky's ad valorem tax derives its authority from the Constitution of the Commonwealth of Kentucky ("Kentucky Constitution"). *See* Gillis v. Yount, 748 S.W.2d 357 (Ky. 1988). The Constitutional provisions directly governing property taxation are set out at Sections 170 through 175 of the Kentucky Constitution. Ky. Const. §§ 170-175 (1915).

(1) [1.7] SECTION 171 OF THE KENTUCKY CONSTITUTION

Section 171 is entitled "State Tax to be Levied," and holds that the General Assembly shall provide for an annual tax which shall be levied and collected for public purposes. The provisions of Section 171 have been interpreted to apply only to the taxation of property, and not to non-property taxes. *See* Greene v. Kentenia Corp., 194 S.W. 820 (Ky. 1917); City of Louisville v. Cromwell, 27 S.W.2d 377 (Ky. 1930); Gillis v. Yount, *supra*; *but see* Great Atlantic & Pacific Tea Co. v. Kentucky Tax Commission, 128 S.W.2d 581 (Ky. 1939); City of Louisville v. Koehler, 264 S.W.2d 80 (Ky. 1954). The tax required by Section 171 of the Kentucky Constitution must be sufficient to defray the estimated expenses of the Commonwealth for each fiscal year. The General Assembly has implemented this constitutional mandate through its enactment of KRS 132.020, which provides for the levy of an annual ad valorem tax for state purposes and KRS 132.190, specifying the property subject to taxation.

Importantly, Section 171 also sets forth a uniformity requirement, requiring that taxes shall be uniform upon all property of the same class. The constitutional requirement of uniformity has been the subject of tremendous litigation. *See generally* Gillis v. Yount, 748 S.W.2d 357 (Ky. 1988); *see also* Eminence Distillery Co. v. Henry County Bd. of Supervisors, 200 S.W. 347 (Ky. 1918); George v. Scent, 346 S.W.2d 784 (Ky. 1961); Martin v. High Split Coal Co., 103 S.W.2d 711 (Ky. 1937). Query whether today this uniformity requirement applies to all types of taxes, and not simply ad valorem taxes. *See* City of Louisville v. Koehler, *supra*.

(2) [1.8] SECTION 172 OF THE KENTUCKY CONSTITUTION

Section 172, entitled "Property to be Assessed at Fair Cash Value," provides that all property not exempted from taxation by the Kentucky Constitution shall be assessed for taxation at its fair cash value. "Fair cash value" has been interpreted by Kentucky courts to mean "the price which would be agreed upon by a party who desired to, but was not compelled to buy the property and an owner who desired to, but was not compelled to sell it." Evans v. Allen, 205 S.W.2d 514, 515 (Ky. 1947); see also Kenmot Coal Co. v. Perry County Bd. of Supervisors, 91 S.W.2d 47 (Ky. 1936); Floyd County v. Kentucky-West Virginia Gas Co., 407 S.W.2d 721 (Ky. 1966). In other words, fair cash value is that price which would be obtained in a voluntary sale between a willing buyer and seller, both fully informed and neither under a compulsion to buy or sell. Evans v. Allen, 205 S.W.2d at 515. As a result of the mandate in Russman v. Luckett, 391 S.W.2d 694 (Ky. 1965), the Revenue Cabinet/PVAs were ordered to assess *all* property (real, tangible and intangible) at its true value, up from the then custom of assessing only portions of a property's fair cash value. This remains the law today. This Section of the Constitution has been interpreted to be all inclusive, effectively requiring that all property over which a taxing authority has jurisdiction must be assessed for property tax, except that property which is exempted. See Commonwealth v. Union Refrigerator Transit Co., 80 S.W. 490 (Ky. 1904); see also Marion Nat'l Bank v. Burton, 90 S.W. 944 (Ky. 1906).

(3) [1.9] SECTION 170 OF THE KENTUCKY CONSTITUTION

Section 172 and Section 3 (a part of Kentucky's Bill of Rights) of the Constitution provide that no property shall be exempt from taxation except as provided within the Kentucky Constitution. Section 170 of the Kentucky Constitution, entitled "Property Exempt from Taxation," specifically exempts the following property:

- Public property used for public purposes;
- Places of religious worship;
- Institutions of purely public charity;
- Nonprofit educational institutions;
- Public libraries;
- Household goods of a person used in the home;
- Places of burial not held for profit;
- Real property owned and occupied by an institution of religion;
- All personal property of an institution of religion;
- Crops grown in year assessment is made, and in hands of producer;
- A homestead, which is a residential unit maintained by the owner, who is sixty-five years of age or older, as his personal residence, up to the assessed valuation of sixty-five hundred dollars (modified by KRS 132.810; exemption now equals \$18,400); and,
- Bonds of Kentucky, and of Kentucky county, municipality, taxing and school districts.

Ky. Const. § 170 (1915).

An explanation of the decisions, interpretations and rulings surrounding the exemptions contained in Section 170 of the Kentucky Constitution would require more space than is available. Accordingly, when seeking to rely on a particular exemption, practitioners must ensure that the exemption provisions have been adequately researched and are constitutionally grounded. See, e.g., Gillis v. Yount, 748 S.W.2d 357 (Ky. 1988); Yount v. Calvert, 826 S.W.2d 833 (Ky.App. 1991); Revenue Cabinet v. St. Ledger, et al., Case No. 92-CA-002689 (Ky.App. 1994), on appeal, Case No. 94-SC-468-D (Ky.).

(4) [1.10] SECTION 172A OF THE KENTUCKY CONSTITUTION

Section 172A of the Kentucky Constitution, entitled "Assessment of Farm Land According to Value for Farm Purposes," provides for the assessment of farmland (farm or agricultural property) according to the value of the property when used for agricultural and horticultural uses. Timberland is generally classified as farm property. KRS 132.010(9). Horse farms may also be so classified. *Id.* However, dwelling houses situated on farmland do not qualify for a decreased value under this provision. Dolan v. Land, 667 S.W.2d 684 (Ky. 1984). Nor may this provision be used to reduce the value of property for other types of taxes, such as estate tax or inheritance tax. See Revenue Cabinet v. Estate of Iva W. Field, Case No. 92-CA-002570-MR (Ky.App. 1993).

E. [1.11] STATUTORY PROVISIONS

Although the Kentucky property tax is mandated and empowered by the Kentucky Constitution, in essence, the law which applies in the working day-to-day property tax setting is that set forth within the KRS. There are four (4) principal chapters of the KRS which need to be reviewed when examining property tax issues. The major provisions of each chapter are discussed below.

(1) [1.12] KRS CHAPTER 132

KRS Chapter 132 is entitled "Levy and Assessment of Property Taxes," and sets forth the great majority of the provisions which are relevant to practitioners. KRS 132.020(1) provides that an annual ad valorem tax for state purposes shall be paid by the owner (or person assessed) at the rate set forth therein. This section also sets forth the concept of the "State rate," which is the tax rate imposed upon the various classifications of property which have been created by the General Assembly, all broken out from the basic categories of real, tangible personal and intangible personal property. This Section also imposes the four percent maximum annual tax rate provisions more commonly known as "House Bill 44." See KRS 132.020(7)-(9).

KRS 132.190 sets forth the property which is subject to Kentucky property taxation, also introducing the concept of "situs" (where property is located for taxing purposes). KRS 132.200 lists those classes of property which are subject to State of Kentucky tax only. The result is that counties, cities, schools or other taxing districts may not tax property so designated. Next, KRS 132.220 sets out the principal compliance requirements for purposes of the Kentucky property tax, i.e., assessment dates, listing requirements, ownership of property and the effect thereof, and liability for taxes. As set forth therein, January 1st of each tax year is the general assessment date for Kentucky property, with certain exceptions where the assessment date is September 1st. KRS 132.230 provides what information must be given to the Revenue Cabinet/PVA when listing property for taxation. The Revenue Cabinet may require, in addition to general information, "such other facts as may be required in the blanks provided." Taxpayer appeals regarding tangible and intangible property are provided for by KRS 132.486. Finally, KRS 132.990 sets out some of the penalties which may be imposed by the Revenue Cabinet.

(2) [1.13] KRS CHAPTER 133

KRS Chapter 133, entitled "Supervision, Equalization and Review of Assessments," provides the procedural provisions necessary for the accurate implementation of the Kentucky property tax, namely appeals, correction of errors, notice to taxpayers and authorities, and the applicable time periods for implementation of most property tax provisions. This chapter also provides taxpayers with appeal rights. KRS Sections 133.020 and 133.030 create the County Board of Assessment Appeals, to which taxpayers must appeal real property tax valuation issues. See KRS 133.120, KRS 133.123 and KRS 133.125. Subsequent action, including refund actions, is now prohibited unless the taxpayer complies with all of the procedures therein. Appeals of tangible and intangible property matters, formerly made to the local County Board

of Assessment Appeals, are now made directly to the Revenue Cabinet in a manner similar to most other taxes, i.e., through the general audit review/protest procedures of KRS Chapter 131. See KRS 132.486(3).

(3) [1.14] KRS CHAPTER 134

KRS Chapter 134 is entitled "Payment, Collection and Refund of Taxes." It sets out the requirements of the Kentucky property tax with respect to the payment and refunds of tax. This chapter also mandates the responsibilities of the County Sheriff in the collection of property taxes and the duties of other County officials. KRS 134.800 and KRS 134.830 are the governing tax statutes on motor vehicles and motorboats.

(4) [1.15] KRS CHAPTER 136

This chapter, entitled "Corporation and Utility Taxes," provides for certain property taxes addressing specific property. These include:

<u>Property Type</u>	<u>Statute</u>
Bank for Cooperatives (Capital Stock)	136.300(1)
Bank Shares	136.270/136.280
Brokers Accounts Receivable	136.050
Domestic Life Insurance (Capital Reserves)	136.320
Production Credit Associations	136.300
Savings and Loan Associations	136.290(1)
Stocks, Bonds & Other Intangibles	136.120(1)
(In state business)	136.020(1)
Patents, Trademarks, Receivables, Royalties, etc.	136.120(1)
(Out-of-state business)	136.020(2)
Car Lines	136.120(4)
Watercraft	136.181
(Commercial & Recreational)	

This chapter also provides an exemption from the intangible personal property tax for shareholders in a corporation that pays taxes to Kentucky on at least 75% of its total property, wherever located. KRS 136.030. As such, these taxpayers need not list such shares for intangible property tax. Corporations comply with these provisions by filing Revenue Form 62A383, entitled "Stock Exemption Form" with the Revenue Cabinet. Note that this provision has been subject to constitutional challenge. St. Ledger, et al. v. Revenue Cabinet, supra.

F. [1.16] REGULATORY PROVISIONS

The Kentucky Revenue Cabinet is empowered by KRS 131.130(1) to "make rules and regulations" for purposes of all tax laws in Kentucky. Although the Revenue Cabinet has been fairly active in issuing guidance governing other areas of taxation, e.g., corporate income and license tax, sales taxes, etc., it has promulgated relatively few administrative pronouncements that provide guidance to Kentucky taxpayers with respect to Kentucky property taxes.

(1) [1.17] ADMINISTRATIVE REGULATIONS

The Administrative Regulations promulgated by the Revenue Cabinet are found at Chapter 103 of the Kentucky Administrative Register ("KAR"). Tax regulations must be promulgated pursuant to specific legislative and statutory requirements. See KRS 13A.010 et. seq. Regulations, so long as lawfully

promulgated, have the force and effect of law, but only to the extent they are not in conflict with state or federal law. The majority of the regulations promulgated set out internal Revenue Cabinet/PVA requirements, such as directives to Sheriffs, PVAs, etc., and are of little guidance to taxpayers.

(2) [1.18] REVENUE CABINET REVENUE CIRCULARS

Revenue Circulars are rather lengthy tax-related pronouncements. They typically set forth general tax principles with respect to a particular type of tax or taxpayer/industry/market segment. Revenue Circulars are published in the four (4) volume Kentucky Tax Service published and sold by the Kentucky Revenue Cabinet. Newly issued or revised Revenue Circulars are announced in the bi-monthly Revenue Cabinet publication, *Kentucky Tax Alert*. At present, the Revenue Cabinet has issued only a handful of Revenue Circulars relating to property taxation, the majority of which address internal operating procedures.

(3) [1.19] REVENUE CABINET REVENUE POLICIES

Revenue Policies set forth the Revenue Cabinet's public policy on one particular tax-related issue. The "authority" upon which the Revenue Cabinet relies for the position advanced in the Revenue Policy is also provided. Newly issued and revised Revenue Policies are published in *Kentucky Tax Alert* and also in the *Kentucky Tax Service*. Revenue Policies, similar to Revenue Circulars, do not constitute precedent in Kentucky courts, nor are they similar either in force or effect to lawfully promulgated administrative regulations. Chapperal Coal Corp. v. Revenue Cabinet, File Nos. K89-R-1086, K89-R-1087, and K89-R-1088, Order No. K-14077 (KBTA 1991).

(4) [1.20] KENTUCKY TAX ALERT

The *Kentucky Tax Alert* is a practitioner newsletter published bi-monthly by the Revenue Cabinet. The stated purpose of the *Kentucky Tax Alert* is to provide general information about Kentucky tax law, regulations, policy and procedures to practitioners throughout the state. Recently published Revenue Policies and Revenue Circulars, as well as discussions of proposed regulations pending litigation, and timely news articles are provided.

G. [1.21] GOVERNMENTAL AUTHORITIES

(1) [1.22] OFFICE OF THE KENTUCKY ATTORNEY GENERAL

The Attorney General of Kentucky issues "Opinions" on a wide-ranging list of topics, including property taxation. The Attorney General has been fairly active in the issuance of Opinions ("OAGs") in the area of Kentucky property taxation; these should be consulted when researching property tax issues. By admission, OAGs in Kentucky are "advisory only." OAG 84-136. They are not conclusive nor binding, though the pronouncements are usually followed. OAG 78-192. Recipient government officials are expected to conform to the rulings of the Kentucky Attorney General. See Cottingim v. Stewart, 142 S.W.2d 171, 176 (Ky. 1940). As a result, members of the judiciary are likely to find an opinion of the Attorney General persuasive and will seek to conform their analysis to the ruling of the Attorney General. Thus, if a ruling is pro-taxpayer, the Opinion may suffice for the taxpayer's purpose, notwithstanding its lack of precedential value.

(2) [1.23] KENTUCKY REVENUE CABINET

The Revenue Cabinet is an executive/cabinet level office of the Commonwealth of Kentucky. The Revenue Cabinet's published Mission Statement provides:

The Revenue Cabinet is charged with the responsibility of administering the tax laws as promulgated by the legislature.

The cabinet is charged with the following responsibilities:

- collecting the revenues which form the financial base for state agencies whose programs provide services for the benefit of Kentucky citizens.
- collecting revenues in a fair and equitable manner from all taxpayers of the Commonwealth, and
- encouraging voluntary compliance through written information, public seminars and increased taxpayer service.

Revenue Cabinet management believes that efficient administration of the tax system is an essential ingredient in fulfilling its mission and maintaining public trust.

The powers and duties of the Revenue Cabinet are set out at KRS 131.130. The Revenue Cabinet is empowered to exercise all administrative functions of the state of Kentucky with respect to all revenue and tax laws. KRS 131.030(1). The major organizational units of the Revenue Cabinet are described in KRS 131.020; a listing of departments and their office holders is appended hereto. In addition, the Revenue Cabinet maintains supervisory power over local officials, including PVAs, regarding tax matters. KRS 131.140. The Revenue Cabinet has *exclusive* authority over the assessment of tangible and intangible property. KRS 132.486(1). Generally, PVAs still maintain much control over real property matters. Attorneys of the Kentucky Revenue Cabinet represent the Commonwealth in proceedings before the Kentucky Board of Tax Appeals ("KBTA") and all courts of the Commonwealth regarding taxation matters.

(3) [1.24] TAXATION BY OTHER GOVERNMENTAL ENTITIES

Property taxes are imposed not only by the Commonwealth of Kentucky, but also by county and local governments as well as school and other special districts. The taxes are imposed for general as well as specific purposes. Although the imposition statutes are spread throughout the KRS, all are subject to the maximum tax rate provisions set out in Section 157 of the Kentucky Constitution. *See also* KRS 132.027.

a. [1.25] County Government

The fiscal court of each county is required to levy an ad valorem tax on all property subject to county taxation. KRS 68.090(1). The maximum ad valorem tax rate shall not exceed fifty cents (50¢) per \$100 of value of the property taxed by the county. KRS 68.090(1); *see also* Ky. Const. § 157 (1915). In Urban-County Government areas (presently only Lexington-Fayette County), the taxing entity may exercise all ad valorem property taxing powers pursuant to the Kentucky Constitution, subject to the maximum limits, which are applicable for cities of the class to which the largest city within the county belonged on the day immediately preceding the effective date of the Urban-County Government. KRS 67A.850. Assessments made by the state, typically for tangible and intangible property, shall be used by the county. KRS 132.280.

b. [1.26] Cities

Cities of the first class (presently only Louisville) are likewise required to raise revenue from the imposition of ad valorem taxes, pursuant to KRS 91.260(1). Cities other than cities of the first class (cities of the second through sixth classes) are also required to impose an annual ad valorem tax pursuant to the provisions of KRS 92.280(1). Cities, as a matter of convenience, typically adopt the assessment value determined by the county PVA, as allowed by KRS 132.285.

c. [1.27] School Districts

School districts, through their Boards of Education, are directed to levy an ad valorem tax upon all property subject to local taxation located within the school district. KRS 160.460(1)&(3). The effect of this direction is that all property which may be taxed by local governments may be taxed by school districts, subject to the tax rate limits of KRS 160.470.

d. [1.28] Special Taxing Districts

Kentucky law also allows special districts to levy ad valorem taxes on real property and, in some instances, on tangible (but not intangible) personal property. These districts include fire protection districts (KRS 75.010 to 75.260), community improvement districts (KRS 107.310 to 107.500), ambulance service districts (KRS 108.080 to 108.180), solid waste management districts (KRS 109.115 to 109.190), public library districts (KRS 173.450 to 173.650), library districts (KRS 173.710 to 173.800), subdivision road districts (KRS 179.700 to 179.990), public health districts (KRS 212.720 to 212.760), tuberculosis sanatorium districts (KRS 215.080 to 215.390), hospital districts (KRS 216.310 to 216.360), mosquito control districts (KRS 249.510 to 249.631), levee districts (KRS 266.010 to 266.990), and drainage and reclamation districts (KRS 268.010 to 268.990). Taxes may also be imposed by certain governmental entities for library services (KRS Chapter 173), "911" emergency telephone services (KRS 65.760), bands or orchestras (KRS 97.610), airport development (KRS 184.134), mass transportation (KRS 96A.020), parks (KRS 97.590), and riverport development (KRS 65.50).

[1.29] ASSESSMENT AND TAXATION OF REAL PROPERTY

A. [1.30] INTRODUCTION

As could be expected, the taxation of real property generates the largest amount of property tax revenue within Kentucky; yet, it requires the least amount of taxpayer involvement. As a result, Kentucky tax officials pursue real property taxes with significantly more vigor than intangible or tangible personal property taxes.

For the individual Kentuckian who owns a single-family dwelling, essentially no compliance work is necessary for a tax assessment to issue on his or her property. In practice, the PVA actually "lists" property for taxation, with no return due from the taxpayer. Each fall, a tax bill arrives showing (1) the fair cash value of the property being taxed, (2) the rate imposed, and (3) the amount of tax due. In most circumstances, the taxpayer's only other contact with the real property assessment process could be earlier in the year, when the taxpayer receives Revenue Form 62A352, entitled "Notice to Property Owners of Assessment by Property Valuation Administrator," explaining and providing notice of the fair cash value of the property as determined by the PVA. Once property is listed, and assuming the valuation is acceptable to the taxpayer and no changes affecting value have been made to the property, no taxpayer action is needed. KRS 132.220(2). Should the valuation be unacceptable to the taxpayer, the taxpayer is free to pursue the statutory appeal processes and procedures described herein.

Only in the listing of real property used for farming or agricultural purposes and commercial or industrial purposes, where valuation is typically much more difficult to ascertain, do compliance requirements become noteworthy. Taxpayers in these circumstances must closely monitor the rules and regulations governing the listing, review, appeal, and payment surrounding ad valorem taxes on real property.

B. [1.31] SITUS OF THE PROPERTY

Regardless of the type or classification of the property, the state may tax only such property as is subject to its sovereignty and which has a taxable situs in Kentucky. Commonwealth v. Union P.R.R., 283 S.W. 119 (Ky. 1926). "Situs" means the location where a thing is considered, for jurisdictional purposes, so that it may be taxed. Black's Law Dictionary at 1387 (6th ed. 1990). A state may not, simply by imposing a tax, create a tax situs. Allphin v. Ohio River Co., 306 S.W.2d 941 (Ky. 1957). Property must have actual situs within a taxing unit or some legal nexus such as domicile to tie it to the taxing unit. Bd. of Education of Catlettsburg v. Ashland Oil & Refining Co., 350 S.W.2d 475 (Ky. 1961).

Unlike tangible, and in many instances, intangible personal property, each of which is property capable of being transported, determining the situs of real property is relatively simple. Its situs is within whatever county or governmental entity's boundary the land lies. Notwithstanding this simple concept, some problems do arise regarding the situs of real property. For example, in circumstances where a parcel of real property has a situs within two Kentucky counties, the taxpayer must ensure that each county is taxing only its proportionate part; failure to accurately divide multi-county property may result in the taxpayer paying increased or, correspondingly, decreased taxes due to differences in each county's tax rates.

C. [1.32] PROPERTY CLASSIFICATION

Real property for Kentucky property tax purposes includes residential, farming or agricultural property, commercial and industrial properties and timber or mineral interests (oil, coal and gas). Regarding the separation of mineral interests from the fee itself, Kentucky courts long ago recognized that a single property may be divided into several estates and each taxed. Raydure v. Bd. of Supervisors of Estill County, 209 S.W. 19 (Ky. 1919).

The Kentucky Constitution exempts certain real property from taxation:

- Public property used for public purposes
- Places of religious worship

- Institutions of purely public charity
- Nonprofit educational institutions
- Public libraries

- Places of burial not held for profit

- Real property owned and occupied by an institute of religion

- A homestead, which is a residential unit maintained by the owner, who is sixty-five years of age or older, as his personal residence, up to the assessed valuation of sixty-five hundred dollars (modified by KRS 132.810)

Ky. Const. § 170 (1915).

Organizations seeking property tax exemption must file Revenue Form 62A023, entitled "Application for Exemption--Ad Valorem Taxes," to obtain an exemption.

Residential property is improved property measured by feet or yards, or fractions of acres. Included within residential property is any improvement upon residential property, for which its highest and best use is an individual's residence. See KRS 132.010(13). Anything other than a duplex or triplex will be likely classified by the PVA as commercial property, whereas duplexes and single-family dwellings will typically be classified as residential property. A condominium unit will be classified as residential property. Mobile homes are also traditionally classified as residential real estate. KRS 132.750.

Farm or agricultural property is real property used in connection with the production of agricultural products, usually crops native to Kentucky (tobacco, corn, wheat, soybeans, etc.) or animals common to Kentucky (cows, pigs, poultry and horses). "Agricultural land" includes tracts of land ten acres or larger. KRS 132.010(9). "Horticultural land" covers tracts of land five acres or larger. KRS 132.010(10). Improvements on property used for such purposes would be included within the classification of farm property. However, a residence located on farm property will typically not constitute agricultural property, but would be assessed as residential property, along with a reasonable amount of real property upon which the residence is situated. Dolan v. Land, 667 S.W.2d 684 (Ky. 1984). A tenant house should qualify, however. It is likely that most timberland within the Commonwealth would constitute farm property under the Revenue Cabinet's past interpretations.

Commercial property, unlike residential and farm property, is real property with buildings/improvements created and constructed for a specific business purpose. This does not mean, however, that unimproved land which is intended for business development purposes. As a hybrid between the relatively small acreage of a personal residence and the relatively large acreage of farm property, commercial property may range from small parcels of property measured on a square foot basis to extremely large parcels measured on an acreage basis, such as shopping malls. Included within the commercial property classification is real property which constitutes industrial property, which is property when valued at its highest and best use is used for manufacturing or processing.

Non-fee interests in real property, such as timber rights or subsurface mineral rights, constitute the last classification of real property for Kentucky property tax purposes. These rights may be transferred to another, by sale or lease, separate and apart from the fee of the property, thereby conveying a real property interest fully taxable as such. See Commissioner v. Elkhorn Piney Coal Mining Co., 43 S.W.2d 684 (Ky. 1931); see also Raydure v. Bd. of Supervisors, 209 S.W. 19, 22 (Ky. 1919). They may be transferred both by outright sale and by lease. See Head v. Little, 226 S.W.2d 322 (Ky. 1950). The leasehold interest may be taxable as real property should the leasehold have a value.

Finally, Kentucky law recognizes that the value of real property may be separated for tax assessment purposes from the improvements situated thereon. See Raydure v. Bd. of Supervisors, 209 S.W. at 24. If the owner of real property is a tax-exempt entity, improvements situated thereon may be taxed to a lessee as if the lessee owned the improvements in fee simple. See Broadway & Fourth Ave. Rlty. Co. v. City of Louisville, 197 S.W.2d 238 (Ky. 1946); see also Louisville Garage Corp. v. City of Louisville, et al., 198 S.W.2d 40 (Ky. 1946). Notwithstanding the exemption of the actual real property upon which the improvements are situated, the value of the leasehold interest is taxable as real property. Dept. of Revenue v. Hobart Mfg. Co., 549 S.W.2d 297 (Ky. 1977); KRS 132.195.

D. [1.33] LEASED PROPERTY

Ordinarily, real property held under a lease is not taxable in the hands of the lessee. Wolfe County v. Beckett, 105 S.W. 447 (Ky. 1907). However, leased real property may in certain circumstances give rise to tax implications on behalf of the lessee, notwithstanding the lack of holding a fee simple interest in the property. Typically the situation arises in the lease of mineral or timber interests in real property (see Bd. of Supervisors v. Superior Oil Corp., 276 S.W. 527 (Ky. 1925)), but often arises in the lease of property by a for-profit taxpayer from a nonprofit taxpayer/owner. Recognizing the inequality and lack of uniformity

regarding this situation, KRS 132.195 was enacted, which provides that when real estate is leased to a natural person, association, partnership or corporation, for any reason, in connection with a business conducted for profit, the leased property shall be subject to taxation in the same amount and to the same extent as though the lessee were the actual fee simple owner of the real estate. This statute, similar in intent and scope as KRS 132.193 (liability for lease of tax exempt tangible personal property) has enabled the state to remedy the perceived inequality that had arisen due to large charitable or public institutions (e.g., churches and governmental entities) asserting property was tax-exempt property, which property was yielding rental or lease income from its lease.

E. [1.34] PROPERTY VALUATION

As the revenue generated from the taxation of real property constitutes the largest portion of the Revenue received by the Commonwealth (and of local taxing jurisdictions) from its property tax structure, valuation constitutes a very important portion of the PVA's duties. For residential property, the valuation method is much less complex than in valuing commercial, industrial, farm and agricultural or timber and mineral interests. Residential real property is primarily valued for Kentucky ad valorem tax purposes by the use of various recent sale data. The PVA obtains property transfer data from the County Clerk's office from which assessments are derived. KRS 132.480. Kentucky law requires that the true consideration paid for real property or, if a gift, its fair cash value, be provided under oath. KRS 382.440. Also, KRS 132.815 requires a monthly report to be submitted by all Kentucky certified electrical inspectors to the Revenue Cabinet listing data surrounding all inspections performed during the previous month, such data to be used for assessment purposes.

In those instances where recent sales data is unavailable or of little consequence, systematic re-valuation programs, mandated by the General Assembly in KRS 132.690, are typically implemented by the PVA's office. Such programs may take the simple form of representatives of the PVA's office walking or driving through residential areas, measuring structures and knocking on doors, or it may take a "high-tech" approach, such as that recently exhibited by the Jefferson County PVA's office, which included the videotaping of entire residential communities located within Jefferson County. Alternative methods of re-assessment have been found to be constitutional. See Revenue Cabinet v. Leary, 888 S.W.2d 878 (Ky. 1994).

For commercial, industrial and agricultural/farm properties, PVAs traditionally exert more effort in researching and monitoring the assessed value of such properties. PVAs are required by KRS 132.690 to physically inspect all property not less than once every four years. See Revenue Cabinet v. Leary, *supra*. The Revenue Cabinet has been engaged in an in-depth mapping project which will detail information regarding every parcel of real property within every county of the state. KRS 132.670. This mapping will allow local PVAs to maintain more accurate data on parcels of property, including commercial and industrial properties, which will lead to more accurate assessments. PVAs, in addition to the above, maintain photographs, either surface or aerial or both, of most properties located within each county in order to assist them in making assessments.

As a result of the decision in Gillis v. Yount, 748 S.W.2d 357 (Ky. 1988), the Revenue Cabinet began assessing unmined minerals at fair cash value. The Revenue Cabinet has sole responsibility for assessment of unmined minerals. See KRS 132.820. Gillis v. Yount declared unconstitutional KRS 132.020(5), which provided that unmined coal was to be taxed at the rate of \$.001 per \$100 of value; it is now taxed at the same rate as real property. The Revenue Cabinet has created compliance forms which it is requiring all taxpayers having *any* interest in any type of unmined mineral to comply with. These forms, entitled "Unmined Coal Information Return," Revenue Form 62A200 (long form), and Revenue Form 62A201 (short form), must be filed with the Revenue Cabinet. Information provided by taxpayers is used in a computerized database and model of the properties which have unmined minerals beneath the surface throughout the state.

Non-coal mineral interests are also subject to tax and must be reported by taxpayers. KRS 132.820(1). Note that even though Kentucky is replete with limestone, it may not be taxed in the ground as real property. See Adams Stone, et al., v. Revenue Cabinet, Civil Action No. 89-CI-458 (Franklin Cir. Ct. 1993), on appeal, Case No. 93-CA-001999 (Ky.App.).

Section 172A of the Kentucky Constitution authorizes the General Assembly to provide for special use valuation for agricultural and horticultural land. Taxpayers wishing to take advantage of this property must complete Revenue Form 62A351 entitled "Application for Valuation, Assessment, and Taxation of Land under the Agricultural and Horticultural Land Use Act." See, e.g., KRS 132.450. Additionally, taxpayers wishing to avail themselves of the constitutionally provided homestead exemption (see Ky. Const. § 170) must file Revenue Form 62A350 entitled "Application for Exemption under the Homestead Amendment." See, e.g., KRS 132.810.

F. [1.35] LISTING PROPERTY FOR TAXATION

KRS 132.220(1) requires all taxpayers to list their real property annually for taxation. Real property shall be listed annually between January 1st and March 1st, reflecting fair cash value as of January 1st. A real property tax return may be filed, or such property may be listed in person. KRS 132.220(2). Property accurately and correctly listed the previous year need not be listed again. Id. However, should the Revenue Cabinet or the PVA request, in writing, a real property owner shall submit a return to verify existing information or to provide additional information. Id.

[1.36] ASSESSMENT AND TAXATION OF TANGIBLE PERSONAL PROPERTY

A. [1.37] INTRODUCTION

KRS 132.190(1)(a) imposes an ad valorem tax on all non-exempt personal property. Tangible personal property includes every item of tangible property except real property. KRS 132.010(3). This includes business furnishings, automobiles, equipment, manufacturing and farming machinery, merchandise, livestock and other materials and goods, just to list a few. In general, personal property may be defined as movable property, i.e., that property not permanently affixed to real property. In determining whether or not an item constitutes personal property or real property, the determination requires three considerations: (1) the manner in which it is affixed to the real property; (2) the intention of the party who affixed it, i.e., whether to leave permanently or to remove at some future time; and (3) the purpose for which the premises are used. Thus, items remain personal property if they can be removed from the realty without serious injury either to the realty or to the item itself.

B. [1.38] SITUS OF THE PROPERTY

The situs of tangible personal property is at the domicile of the owner unless it is located for an indefinite period or permanently in a place other than the owner's domicile. Simple v. Commonwealth, 205 S.W. 789, 792 (Ky. 1918). Thus, where personal property of a resident has no permanent situs, it is taxable at the domicile of the owner. Ashland Oil and Refining Co. v. Department of Revenue, 258 S.W.2d 359 (Ky. 1953). Accordingly, the general rule is that the situs of tangible personal property is at the place where it has a permanent physical location regardless of the residence of the owner. See Millett's v. Commonwealth, 211 S.W. 562 (Ky. 1909); Commonwealth v. Hagan, 99 S.W. 906 (Ky. 1907). Reeves v. Island Creek Fuel & Transportation Co., 230 S.W.2d 924 (Ky. 1950), *aff'd*, 340 U.S. 853 (1950).

As between counties, the question will often arise whether it is properly taxable in the county in which the owner resides, or by the county in which it is located. There is a presumption that all personal property is subject to assessment in the place where located on the assessment date. OAG (unnumbered) (1/17/56); see also John Ross & Company v. Bd. of Supervisors, 217 S.W. 677 (Ky. 1920). Thus, an owner

of property may have to prove that the property was located in the particular county for temporary purposes only. For example, cattle temporarily in pasture in a county other than that in which the owner resided was held not taxable in such county. Hill v. Caldwell, 119 S.W. 749 (Ky. 1909).

C. [1.39] PROPERTY CLASSIFICATION

All tangible personal property may be classified under one of the following five (5) principal areas:

(1) [1.40] TANGIBLE PERSONAL PROPERTY EXEMPTED BY CONSTITUTION OR STATUTE

The following tangible personal property is exempted by § 170 of the Kentucky Constitution, with the exception of domestic fowl [KRS 132.190(1)(a)]: tangible personal property owned and used for governmental purposes; tangible personal property owned by purely charitable institutions and institutions of religion; non-profit educational institutions and public libraries; crops grown in the calendar year in which the assessment is made that are still in the hands of the grower; household goods of a person used in the home; and twenty-five (25) domestic fowl.

(2) [1.41] TANGIBLE PERSONALTY TAXED AT FULL STATE AND LOCAL RATES

In essence, any property not listed within KRS 132.200 may be taxed by authorities other than the state. The most complete listing of this group is provided on Revenue Form 62A500, which has separate listings under these categories: motor vehicles; aircraft; watercraft; computer equipment; collectibles; business furniture and fixtures; professional trade tools and equipment; research libraries; drilling, mining and construction equipment; materials and supplies; precious metals; mobile homes; "other" tangible personal property such as tractors, gasoline and electrical motors, and all tangible property not specified elsewhere.

(3) [1.42] TANGIBLE PERSONALTY TAXED BY THE STATE ONLY

Pursuant to KRS 132.200, the most relevant items of tangible personal property that are subject to state taxation only (i.e., not subject to taxation by a county, city, school or other taxing district) are: farm implements and farm machinery; livestock, ratite birds and domestic fowl; manufacturing machinery, work in process and raw materials of a manufacturer (but not finished goods); telecommunications equipment; goods in transit in public warehouses; unmanufactured agricultural products; certified pollution control equipment; certified alcohol production facilities; fluidized bed energy facilities; recycling machinery; farm machinery and equipment subject to floor plan financing; all non-titled motor vehicles held for sale by a dealer on consignment; and foreign trade zone personalty.

(4) [1.43] TANGIBLE PERSONALTY TAXED BY THE STATE AND UNDER A LIMITED LOCAL RATE

Tangible personal property which is taxable by the state, but at a limited local rate, is limited to tobacco and other farm products which are not at the manufacturer's plant or in the hands of the grower or his agent as of the assessment date of each year. KRS 132.200(a). The listing of such property is made by the taxpayer under the separate heading of unmanufactured agricultural products on Revenue Form 62A500.

(5) [1.44] TANGIBLE PERSONALTY TAXED AT A REDUCED STATE RATE AND FULL LOCAL RATE

Recently, reduced state rates have been enacted for various types of property. These include raw materials and goods held for sale in the regular course of business -- \$.05 per \$100.00 [KRS 132.020(10)]; distilled spirits, distilled spirits inventory including in-process materials -- \$.05 per \$100.00 [*Id.*] (note that governmental authorities other than the state may tax or exempt business inventories [KRS 132.028 and

KRS 68.246]); and operating property of railroads operating solely within Kentucky -- \$.10 per \$100.00 [KRS 132.020(11)].

D. [1.45] LEASED PROPERTY

One problem taxpayers face with respect to the taxation of tangible personal property is its effect on leased property. As all property must be taxed unless exempted (Ky. Const. § 172), the problem boils down to who is to pay property tax on leased property. In general, the owners of property must pay the property tax. *See, e.g.*, KRS 134.060. However, in some instances, due to contractual provisions, the lessor (i.e., the owner of the equipment) pays the tax, while in other instances, the lessee pays the tax. As a general rule, the Revenue Cabinet/PVA are not bound by a lease contract; thus, the person in possession of the property will likely be assessed. *But see Crawford v. Wiedemann*, 159 S.W. 555 (Ky. 1913); *Commonwealth v. First Christian Church*, 183 S.W. 943 (Ky. 1916). Revenue Form 62A500-L provides that if leased property is not listed by the lessee of the property, the lessee is to provide pertinent information to the Revenue Cabinet so that the lessor may be assessed. Additionally, KRS 132.193 provides that if leased personalty, otherwise exempted from taxation, is held by a for-profit lessee, the personalty shall be taxable to the for-profit lessee as if it were the owner.

E. [1.46] PROPERTY VALUATION

Tangible personal property tax is assessed on the fair cash value of the subject property, typically the willing buyer-willing seller test. When this value cannot be determined, the Revenue Cabinet looks to the following for guidance: original cost of the property; condition of the property; appreciation and obsolescence applicable to the property; the additions which have been made since installation which would add to the original cost; replacement value of the property on the assessment date; the utility value of the property; and the general industry custom and usage in valuing tangible personalty for tax purposes. January 1st is the assessment date for all tangible personalty (KRS 132.220(1)), except for unmanufactured tobacco products, which are assessed as of September 1. KRS 132.220(1). For most types of depreciable tangible personal property, the most likely source of information for valuation purposes is the taxpayer's books.

Problems arise when using the financial valuations of tangible personalty of a taxpayer. Inventories should be reported utilizing full absorption costing, i.e., first in, first out (FIFO) costing. Even if for accounting purposes the value of property is zero, the Revenue Cabinet maintains that a taxpayer may not completely write off property for tax purposes if the property is still in use. Thus, the net book value developed from the application of annual depreciation methods to cost is not a realistic value for ad valorem tax purposes. *Cleveland C.C. & St. L.R.Y. v. Backus*, 154 U.S. 439 (1894). If the property is abandoned, however, a write down/off would appear in order.

Depreciable tangible personalty is listed on Schedule A of Revenue Form 62A500, although this schedule does not include aircraft, Kentucky registered motor vehicles and assets used in farming and manufacturing. Depreciable assets employed such as manufacturing machinery, qualifying commercial radio, television and telephonic equipment and certified pollution control facilities should be listed separately on Schedule B. The valuation of tangible personal property is based upon conversion factors established for depreciable property with differing expected economic lives. All depreciable property is classified in one of six economic life ranges. Form 62A500 contains the data necessary to determine the fair cash value of tangible personal property, which is to be shown by age. The cost should be net of additions, disposals and transfers occurring during the year. The resulting costs remaining at year end are then listed in the original cost column. Each year end cost is then multiplied by the corresponding conversion factor to determine the estimated fair cash value. The use of the aforementioned schedules do not appear to be mandatory [*but see* KRS 131.130] although it should be noted that whenever a taxpayer reports tangible personalty at a value which is determined by methods other than those previously mentioned, the

taxpayer must include an affidavit explaining the valuation method utilized and the reason for its use. Fair cash value is what must be taxed.

F. [1.47] LISTING PROPERTY FOR TAXATION

Kentucky imposes a duty upon each person owning or having an interest in property within the Commonwealth to list such property with the PVA of the county where such property is located. KRS 132.220. This is typically provided for by the annual filing of Revenue Form 62A500. However, the statutes provide for the following additional sources of information to assist the PVA and the Revenue Cabinet in assessing tangible personal property:

(1) [1.48] MOTOR VEHICLE REGISTRATION CERTIFICATES

Each week, the county clerk is required to furnish the PVA with a copy of the registration certificates for each motor vehicle registered within the county. KRS 132.485(1).

(2) [1.49] HOUSE TRAILER REGISTRATION CERTIFICATES

Similarly, the county clerk is required to furnish the PVA weekly with a copy of the registration certificate for each house trailer registered within the county. KRS 132.485(1).

(3) [1.50] BOAT REGISTRATION CERTIFICATES

The county clerk is also required to furnish the PVA with a copy of the registration certificate for each boat registered. KRS 235.050(1).

(4) [1.51] STORAGE WAREHOUSE REPORT

Every warehouse company within a county is required to furnish a report to the PVA providing information as to all property held in storage as of January 1 each year, as well as the names and addresses of the owners of such property. KRS 132.260(1).

(5) [1.52] REPORTS OF PROPERTY HELD IN PAWN OR PLEDGE

Every person engaged in the business of receiving property in pledge or as security for money or other things advanced to pawnors or pledgers is required to file an annual report providing the fair cash value of all property pledged as of January 1 of each year. KRS 132.270. This information is then used to ensure that the property should be assessed against the person holding it, not the holder of the property.

(6) [1.53] REPORTS OF PERSONS PROVIDING RENTAL SPACE FOR PARKING HOUSE TRAILERS (TRAILER PARKS)

Every person providing rental space for house trailers and mobile homes is required by statute to keep a register of all house trailers which make use of the trailer park. This report must contain, among other items, the name of the owner or occupier and all of the inhabitants of each house trailer and the license number of all units. KRS 132.260.

(7) [1.54] MERCHANT'S INVENTORY INFORMATION

Although the KRS does not require it, the Revenue Cabinet routinely furnishes, on a confidential basis, merchant inventory information obtained from income tax returns to the PVAs for assessment purposes. When all sources of information are reviewed, an assessment is issued by the Revenue Cabinet/PVA.

G. [1.55] FILING THE RETURN

All individuals, partnerships, corporations and other *business* entities owning, leasing or having a beneficial interest in taxable tangible property which is located within the Commonwealth on January 1 of each year must file Revenue Form 62A500, Tangible Property Tax Return. There is no requirement for an individual, non-business taxpayer to file such a return. A property tax return must be filed for each location and business activity at which tangible property is located within Kentucky; consolidated or joint returns are not permitted.

As for leased property, lessors of tangible personal property must file Revenue Form 62A500 with the PVA in each county where leased property is located. The leased property must be listed by the owner, regardless of the terms of a lease agreement which addresses the shifting of the property tax liability. A lessee of tangible personal property must file Revenue Form 62A500-L as an attachment to its tangible personal property tax return. Only if the lessee is obligated to purchase the property is he deemed to be the owner and, therefore, liable for the tax; otherwise, the lessor is deemed to be the owner and liable for the tax. *But see* Trinity Temple Charities, Inc., et al. v. City of Louisville, 188 S.W.2d 91 (Ky. 1945); Purcell v. City of Lexington, 216 S.W. 599 (Ky. 1919). Finally, in the case of goods held on consignment, the consignee (to whom the goods have been consigned) is required to list consigned tangible personal property on Revenue Form 62A500-C. This form is filed as an attachment to Revenue Form 62A500 and is similar in structure to Revenue Form 62A500-L. The consignor (owner) should report the consigned goods as inventory on Revenue Form 62A500.

Equitable versus legal ownership is the desired taxable ownership; KRS 134.060 contemplates such a result. Various authorities have addressed such issue. *See generally*, Crawford v. Wiedeman, *supra*; OAG 64-701; OAG 62-589; Commonwealth v. First Christian Church, 183 S.W. 943 (Ky. 1916); Kentucky Power Co. v. Revenue Cabinet, 705 S.W.2d 904 (Ky. 1985). Thus, the underlying aspects of the lease involved must be examined when determining who is legally liable for the tax.

[1.56] ASSESSMENT AND TAXATION OF INTANGIBLE PERSONAL PROPERTY

A. [1.57] INTRODUCTION

Intangible personal property is that property which in some way evidences value or a right to value under the laws and customs of the state. Prime examples of intangibles are stocks, mutual funds, options, warrants, money market funds, loans, notes, mortgages receivable, land contracts, cash in deposits, accounts receivable, installment accounts, retirement plans and annuities, IRAs, trusts, commercial paper and interests in estates. By all means, however, this list is not all-inclusive. As with tangible personal property, KRS 132.190(1) and (2) provide that all intangible personal property of individuals residing within Kentucky, as well as intangible personal property of corporations organized under the laws of Kentucky, unless the intangible personal property has acquired a business situs without this state, shall be subject to taxation.

The Revenue Cabinet enforces the Kentucky intangibles tax with vigor. The Revenue Cabinet has begun increased enforcement through "cross-matching" informational-type tax forms, e.g., 1099-DIV, 1099-INT, brokers reports, etc., with the intangible property tax returns filed, or not filed, by the recipients of the dividend or interest income. Likewise, the Revenue Cabinet cross-matches information received from income tax and inheritance tax returns for purposes of the Kentucky intangible property tax. Through the use of a centralized data bank, the Revenue Cabinet enforcement efforts appear to have paid off.

B. [1.58] SITUS OF THE PROPERTY

The general rule is that the situs of intangible personal property follows the owner, although situs may be fixed wherever by the General Assembly. City of Henderson v. Barret's Exr., 153 S.W. 992 (Ky. 1913). KRS 132.190(4) provides that the situs of intangible personal property shall be at the residence of the real or beneficial owner, and not at the residence of the fiduciary or agent having actual custody or possession of the intangible property. Accordingly, even if a Kentucky resident owns a note secured by a mortgage on non-Kentucky property, it is taxable. Revenue Policy 62P110 (6/1/83). An administrator, executor, trustee, guardian, conservator, curator or agent that resides within Kentucky is not liable for intangible personal property taxes on property held by such person if the real or beneficial owner of the intangible personal property is not a resident of Kentucky. KRS 132.190(5).

In the case of a resident of Kentucky, intangible personalty shall be taxable by Kentucky unless, prior to the date of assessment (typically January 1) the taxpayer has changed his place of abode to that outside of Kentucky. This change requires the taxpayer's intent to continually reside permanently outside of Kentucky. KRS 132.190(4); *see also* Semple v. Commonwealth, 205 S.W. 789 (Ky. 1918).

The intangible property of corporations organized under the laws of Kentucky which have acquired a business situs within Kentucky is also taxable. KRS 132.190(1)(b). The modern test as to whether intangible property has obtained a business situs within Kentucky is whether there has been localization of possession and control over the property in a business away from the owner's domicile and the integration of that property with local business. *See* Commissioner v. Madden's Executor, 97 S.W.2d 561 (Ky. 1936); *see also* Bd. of Supervisors v. Baldwin Piano Co., 178 S.W.2d 212 (Ky. 1944). In order for intangible property to obtain a situs in a place where a non-resident is doing business (i.e., within Kentucky), an overriding circumstance which must be present is that the taxpayer must maintain a nearly permanent business presence, as compared with isolated, temporary or sporadic transactions. Baldwin Piano Co., supra; American Barge Line Co. v. Bd. of Supervisors, 55 S.W.2d 416 (Ky. 1932). In circumstances involving notes, accounts receivable, etc., the presence of the documentary evidence within Kentucky may be enough to subject them to the Kentucky intangibles tax, if the normal books of account are kept within Kentucky. Commonwealth v. Peebles, 119 S.W. 774 (Ky. 1904); American Barge Line Co., supra. It is difficult to avoid the intangibles tax. *See* Commonwealth v. Louisville & Nashville R.R. Co., 479 S.W.2d 15 (Ky. 1972); Revenue Cabinet v. Bomar, 486 S.W.2d 532 (Ky. 1972); *but see* Commonwealth v. Madden's Ex'r, 97 S.W.2d 561 (Ky. 1936).

C. [1.59] PROPERTY CLASSIFICATION

Unlike real or tangible personal property, intangible property is subject to taxation *only* by the state. KRS 132.020(4) provides that no ad valorem tax may be levied by any other governmental entity (e.g., counties, cities, schools, etc.) on intangible property taxed under KRS 132.020(2). Similar to tangible personalty, intangible personal property may be "classified" under one of the following three (3) principal areas:

(1) [1.60] INTANGIBLE PERSONAL PROPERTY EXEMPTED BY CONSTITUTION OR STATUTE

Bonds of Kentucky and county, municipality, taxing and school districts of Kentucky (Ky. Const. § 171); shares of stock, but not bonds, in corporations that pay tax to Kentucky on 75% of its property, wherever located (KRS 136.030; Revenue Policies 62P040 (6/1/83) and 62P050 (6/1/83)); bonds or obligations of the United States Government, including FHA, FHC, Federal Reserve Banks, Federal Land Banks, GNMA, IDBs, TVA (KRS 136.030; Revenue Policies 62P040 (6/1/83) and 62P050 (6/1/83)); cash on deposit in Kentucky credit unions; bank shares in Kentucky national or state chartered banks (Revenue Policy 62P120

(12/1/86)); value of certain electing domestic corporations (KRS 136.030(1)(b)); and deposits in Kentucky banks (Revenue Policies 62P016 (12/1/86) and 62P018 (12/1/86), *but see St. Ledger, et al., supra*).

(2) [1.61] INTANGIBLE PERSONALTY TAXED BUT AT LOW STATE RATE

Accounts receivable, notes, bonds, credits, etc., arising out of or created in the course of regular and continuing business transactions substantially performed outside of this state (KRS 132.020(2); Revenue Policy 62P140 (12/1/86)); intercompany accounts between parent corporations and subsidiaries (parent owns 80% or more of subsidiary) (KRS 132.020(3); Revenue Policy 62P085 (12/1/86)); stock of a corporation's parent; corporation or subsidiary corporation pension or retirement plans (KRS 132.020(3); Revenue Policy 62P090 (12/1/86)); rights, royalties, patents, copyrights, etc., owned by a taxpayer; life insurance of a taxpayer; term life insurance of a taxpayer; and retirement plans (IRAs, pensions and profit sharing plans, and deferred compensation plans).

(3) [1.62] INTANGIBLE PERSONALTY TAXED AT FULL STATE RATE

This category includes all remaining intangibles not previously subject to lower rates, or exempted entirely, including out-of-state bank deposits and savings accounts; notes and mortgages; accounts receivable; bonds; partnership notes receivable; intangible property held by a broker; regulated investment company (mutual funds) shares; bonds issued by a private educational institution; vendors lien; mortgage on property outside of Kentucky; intangible trust property; options and warrants; money market funds; land contracts; retail repurchase agreements; cash and money on hand; stockholder loans and employee loans; shares of stock; and installment accounts.

D. [1.63] PROPERTY VALUATION

As required by the Constitution, intangible personal property is assessed at "fair cash value." Most intangible personalty is assessed as of January 1; cash on hand and out-of-state deposits are assessed as of September 1. KRS 132.220(1). Notwithstanding the different assessment dates, they are reported on the same form at the same time. The easiest type of intangible personalty to value is, of course, cash on hand. In many instances, valuation of intangible property is fairly simple and accurate, e.g., stocks and bonds listed on public exchanges; however, it is very difficult to value closely held stock, bonds, notes, etc. *See* Revenue Policy 62P010 (12/1/86). Because of valuation differences, the KRS sets forth certain provisions governing the valuation of intangible personalty.

E. [1.64] APPLICABLE TAX RATES

KRS 132.020(1) imposes an ad valorem tax of twenty-five cents (25¢) per \$100 of fair cash value of all money in hand, shares of stock, notes, bonds, accounts and other credits, whether secured by mortgage, pledge or otherwise, or unsecured. Accounts receivable arising from business transactions substantially performed within Kentucky are taxable at the \$.25 rate; otherwise, the rate is \$.015 per \$100 of value. *See* Revenue Policy 62P140 (12/1/86). KRS 132.020(2) provides for an ad valorem tax of one and one-half cent (1½¢) per \$100 of value for intangible personal property with a situs within Kentucky in the form of accounts receivable, notes, bonds, credits, non-domestic bank deposits, and any other intangible property right arising out of or created in the course of the regular and continuing business transactions substantially performed outside of Kentucky. This rate is also applied to patents, trademarks, copyrights and licensing and royalty agreements and to the shares of capital stock of any affiliated company, as well as to notes, bonds, accounts receivable and all other intercompany intangible personal property due from such affiliated company. "Affiliated company" is defined as a parent or subsidiary corporation in which the owner or the person assessed directly or indirectly owns or controls not less than ten percent of the outstanding voting stock of the corporation involved. KRS 132.020(3).

F. [1.65] LISTING THE PROPERTY FOR TAXATION

Intangible property is listed for Kentucky ad valorem tax purposes through the filing of Revenue Form 62A376, entitled "Intangible Property Tax Return." From this return, filed with either the local PVA or directly with the Revenue Cabinet, the Revenue Cabinet generates a tax assessment. Notwithstanding the filing of the form, other sources of information from which the Revenue Cabinet may obtain information to list intangible property for taxation are:

(1) [1.66] REVENUE FORM 62A383, ENTITLED "STOCK EXEMPTION INFORMATION"

This form is used by corporations which pay tax on at least 75% of their property, wherever located, in order to provide an exemption to the corporations' shareholders for the shareholders' intangible tax on the stock of the corporation involved.

(2) [1.67] COUNTY CLERKS' MORTGAGE REPORTS

County clerks are required to report to the PVA complete statements detailing all purchased money notes, mortgage notes, and similar obligations for funds due.

(3) [1.68] INCOME TAX RETURNS OF INDIVIDUALS AND TAXABLE ENTITIES

With respect to individuals, the interest and dividend sections of the tax return, if detailed on the return, may provide an indication of intangibles owned by the taxpayer. In business situations, a balance sheet is typically provided with the income tax return, from which similar information may be gathered.

(4) [1.69] INHERITANCE TAX RETURNS

The Revenue Cabinet obtains significant information for intangible property tax purposes from inheritance tax returns filed in estate situations, as well as from safe deposit reports and estate inventories prepared as a part of the estate settlement process.

(5) [1.70] COMPUTERIZED DATA BANK AND FORM CROSS MATCHING PROVISIONS

Using computer enhanced information retrieval systems, the Revenue Cabinet has begun a strengthened enforcement program using information from all of the above sources, as well as cross-matching and cross-referencing all documents filed with federal and state taxing authorities.

G. [1.71] FILING THE RETURN

Intangible personal property is listed for ad valorem tax purposes by the filing of Revenue Form 62A376. This tax return must be filed with the PVA of the county of taxable situs or with the Department of Property Taxation, Revenue Cabinet, each year between January 1 and April 15. If an individual taxpayer extends his/her Federal Income Tax return, the return may be timely filed as of the extended filing date for the Federal return; however, no 2% discount will be allowed. KRS 132.220(1). The return, although typically distributed with the Kentucky income tax returns, is *not* to be filed with or made a part of the Kentucky income tax return. The intangible property tax is paid in the same manner as are all Kentucky property taxes -- namely a tax bill is received during the fall of the assessment year from the Sheriff of the situs county. Thus, unlike most taxes, no payment is made with or attached to the intangible property tax return.

[1.72] APPEALS OF PROPERTY TAX ASSESSMENTS AND PROCEDURAL MATTERS

A. [1.73] PAYMENT OF TAX

Tax payments are not to be sent with the property tax returns filed with the Revenue Cabinet or PVA. Tax bills are distributed by the Sheriff of each county. Tax bills are delivered to the Sheriff by the County Clerk prior to September 15th of each year. The Sheriff then mails the Notice of Tax Due to each taxpayer and collects the receipts from the tax notices.

All property taxes are due and payable on September 15th following the assessment date. KRS 134.020(1). Taxpayers may then reduce their property tax bill by two percent (2%) by paying the tax bill by December 1st. The provisions of this section allowing a discount have been held constitutional. Buchanan v. West Ky. Coal Co., 291 S.W. 32 (Ky. 1927). Bills paid between December 1st and December 31st are due at face value, and on January 1st, any unpaid bill becomes delinquent. KRS 134.020(3). Upon the passage of this date the tax becomes delinquent and a lien attaches. Green v. Moore, 135 S.W.2d 682 (Ky. 1939). Taxes may be collected by the sheriff for a period of up to five years. KRS 132.290(2). Query whether there is a statute on the reclassification of property. Interest will be imposed on any delinquent taxes pursuant to KRS 131.010(6). A two percent (2%) penalty is added to all delinquent tax bills if paid by January 31, while bills still outstanding by January 31 are subject to a ten percent penalty. KRS 134.020(4).

B. [1.74] VALUATION APPEALS

(1) [1.75] REAL PROPERTY

When property has been reassessed resulting in a change in assessed value, the PVA is required to give notice to the taxpayer pursuant to KRS 132.450(2). Notice is given on Revenue Form 62A352, entitled "Notice to Property Owner of Assessment by Property Valuation Administrator".

(a) [1.76] CONFERENCE WITH THE PVA AND HEARING BEFORE THE LOCAL BOARD OF ASSESSMENT APPEALS

For purposes of appeals, the tax rolls of each county are opened for a thirteen (13) day period beginning the first Monday in May, which shall be six (6) days per week, so that taxpayers may inspect the assessments of any or all property in the county. KRS 133.045(1). Aggrieved real property owners must respond by letter or other written petition within one (1) day of the open inspection period stating their reasons for the appeal to the Board of Assessment Appeals, specifically identifying the property involved, and stating the taxpayer's opinion of the property's fair cash value. KRS 133.120(2). However, prior to going to the Board, taxpayers must first have a mandatory conference (which is very informal and may be held by telephone) with the PVA's office, not later than the close of the open inspection period. Failure to go through this informal conference may jeopardize future appeal rights. KRS 133.120(1). Taxpayers may make an appeal on Revenue Form 62F031 ("Appeal to Local Board of Assessment Appeals"). The local Board has subpoena and service of process powers. KRS 133.120(7). Taxpayers may be present during the Board of Assessment Appeals hearing phase, which is typically held in late May. KRS 133.030. Any taxpayer who has listed his/her real property at fair cash value may challenge as too low any other assessment of real property in such county. KRS 133.120(2). Upon the review of an assessment by the County Board of Assessment Appeals, the taxpayer will receive a copy of Revenue Form 62A354 ("Notice to Property Owner of Final Ruling of Board of Assessment Appeals") notifying the taxpayer of the Board's final decision.

b. [1.77] NOTICE OF APPEAL

No Notice of Appeal-type filing to the County Board of Assessment Appeals is required; however, a service copy of the Petition of Appeal to the KBTA should be served upon the PVA, and possibly upon the County Clerk of Courts (who is the record keeper of the Local Board of Assessment Appeals) or the County Attorney. *See* KRS 133.120(11).

c. [1.78] APPEAL TO THE COURTS

Should at this time a taxpayer remain aggrieved by the assessment figures, or if the PVA is aggrieved, an appeal may be taken to the Kentucky Board of Tax Appeals pursuant to the provisions of KRS 131.340(3). KRS 133.120(10). This appeal is *de novo*. KRS 131.345. A petition to the KBTA must be filed (*i.e.*, physically received) within 30 days from the date of the certified letter notifying the taxpayer of the final ruling/decision of the County Board of Assessment Appeals.

d. [1.79] JUDICIAL REVIEW & APPEAL

The KBTA in Frankfort, Kentucky is the *de novo* trial level forum for property tax disputes in Kentucky. The KBTA has adopted the Kentucky Rules of Civil Procedure and the Kentucky Rules of Evidence in its proceedings. *See* 803 KAR. Although adopting the Civil Rules of Procedure, the KBTA operates in a less traditional judicial forum, more like an administrative hearing. Proceedings are transcribed, orders issued, and in many instances, briefs submitted by counsel to the KBTA. The KBTA has subpoena and service of process power. KRS 131.350. Only members of the Bar of the Commonwealth of Kentucky may practice before the KBTA.

e. [1.80] HEARINGS

Hearings are typically held in Frankfort, Kentucky at the KBTA's offices. Many times, because of the sheer number of appeals processed, hearings are held around the state. Most hearings are held with all three members of the KBTA present; however, KBTA rules provide that hearings may be held with as few as one member present.

f. [1.81] SUBSEQUENT APPEALS

After a hearing at the KBTA, should a party to a proceeding still be aggrieved, an appeal may be taken as a matter of right to the circuit court governing the real property, subject to the Civil Rules. A filing fee is required for this appeal. A further appeal of right lies with the Kentucky Court of Appeals. KRS 131.370.

(2) [1.82] PERSONAL PROPERTY

For tangible and intangible personal property, taxpayers may no longer petition the local County Board of Assessment Appeals for review of grievances. All functions relevant to the assessment, including the review and appeal of assessments, have been transferred to the Revenue Cabinet. *See* Ky. Acts 1986, Ch. 371, § 1, and Ky. Acts 1988, Ch. 303, § 6; *see also* KRS 132.486. Accordingly, taxpayers aggrieved in matters involving tangible and intangible personal property must follow the ordinary protest procedures regarding taxes administered by the Revenue Cabinet. KRS 131.110. This section provides that any assessment made by the Revenue Cabinet shall be final if the taxpayer fails to protest in writing to the Revenue Cabinet within 45 days from the date of such notice. After review of a taxpayer's protest, the Revenue Cabinet will issue its decision in the matter by way of a "Final Ruling Letter" if the matter cannot be resolved. Refund claims would likewise be denied by way of a Final Ruling Letter. If the taxpayer is aggrieved by

the Revenue Cabinet's final ruling, the taxpayer may, pursuant to KRS 131.340(3), appeal to the Kentucky Board of Tax Appeals, as previously set forth.

No filing fees are required for a property owner seeking to have its appeal heard, whether at the Local Board of Assessment Appeals or further on to the KBTA in Frankfort. However, should a taxpayer be aggrieved by a decision of the KBTA, a filing fee would be necessary to perfect jurisdiction of an appeal in a circuit having appropriate jurisdiction.

C. [1.83] REFUNDS

(1) [1.84] GENERALLY

Taxpayers that have erroneously paid ad valorem taxes may seek refunds of such taxes, pursuant to KRS 134.590. Situations that may give rise to such refunds are assessments made against the wrong party, an incorrect assessment, etc. Refunds of ad valorem taxes may not be made by way of a class action lawsuit. Swiss Oil Corp. v. Shanks, 208 Ky. 64, 270 S.W. 478 (1925), cert. denied, 273 U.S. 407 (1927). Refund requests or claims for refund should be made to the appropriate taxing authority; this would include each and every taxing district listed on a tax bill. The statute of limitations for a refund of ad valorem tax is two years from the date of payment of the tax. KRS 134.590(2). Interest would be allowable on the refund pursuant to KRS 131.183(2).

(2) [1.85] REAL PROPERTY

KRS 133.120 sets out protest and appeal rights. This section requires a conference with the PVA and an appeal to the County Board of Assessment Appeals in order for any further review to occur. Failure to comply could jeopardize a subsequent refund claim. However, numerous cases have challenged the issue of whether (pre-change in law) a refund could be obtained without having first appealed to the Local Board. See Oxford Properties, Inc. v. Jefferson County, et al., File No. K92-S-201 (KBTA).

(3) [1.86] PERSONAL PROPERTY

Unquestionably, under KRS 134.590, a refund of previously paid ad valorem tax may be claimed in circumstances where no prior action occurred. See Castleton, Inc. v. Revenue Cabinet, 826 S.W.2d 334 (Ky.App. 1992); see also Humana of Kentucky, Inc. v. Revenue Cabinet, KBTA File No. K89-R-225, Order (unnumbered) (9/28/89).

D. [1.87] PENALTIES

There are a multitude of penalties which may be asserted against taxpayers for non-compliance with Kentucky property tax laws, such as the Uniform Civil Penalties Act. KRS 131.180. Failure to file a required return may subject a taxpayer to general tax penalties, such as KRS 131.180 which imposes a 10% of the tax penalty, plus interest, for a failure to "make any tax report or return. . . ." However, this penalty is not to apply should there be another specific civil penalty provided by Kentucky law. As there are specific penalties addressing the failure to list property, this penalty may not apply. For property omitted by a taxpayer in a prior year but subsequently voluntarily listed by the taxpayer, the penalty is 10% of the amount of tax, plus interest, on the omitted property. KRS 132.290(3). However, for property not voluntarily disclosed to the Revenue Cabinet by the taxpayer, the penalty is 20% of the amount of tax, plus interest, due on the property. KRS 132.240(4).

A taxpayer may at any time list personal property with the Revenue Cabinet by reporting to the Revenue Cabinet the details and a description of the omitted property, as well as its value. KRS 132.320. The statute states that the underlying reason of the taxpayer's failure to list the property may be "for any other

reason," which would appear to include a reasonable tax planning position taken by a taxpayer under advice of counsel that the property in issue was not required to be listed due to, e.g., a constitutional exemption. The aforementioned 20% penalty will be waived by the Revenue Cabinet if personal property is assessed by the Revenue Cabinet unless the taxpayer attempts to appeal the assessment and is unsuccessful. KRS 132.320(4). There appears to be no similar provision for the 10% penalty of KRS 132.290(3).

KRS 132.990 imposes a \$500.00 fine upon any person who wilfully fails to supply the Revenue Cabinet with a complete list of property as required by law. This section also fines those taxpayers who violate KRS 132.570, which states that "no person shall wilfully make a false statement . . . or resort to any device to avoid taxation." Id. Both penalty sections have wilfulness as the necessary standard.

Kentucky has a little noticed civil property tax "evasion" statute, KRS 132.570. This statute provides that ad valorem taxes may be subject to treble tax on any taxable property which the taxpayer wilfully attempts to convert into non-taxable or exempt property.

Although property taxes typically attach to the property, KRS 132.220(1) provides that all persons in whose name tax is properly assessed shall remain liable for the tax, notwithstanding the sale or disposition of the underlying property.

KRS 131.445(2) states that its provisions will apply to the underpayment of all taxes administered by the Cabinet, which includes personal property taxes. Accordingly, if a deficiency is due to "intentional disregard of statutes and regulations but without intent to defraud," a 5% of the deficiency penalty may apply. KRS 131.445(2)(a). If fraud or intent to evade tax is present, a 50% of the deficiency penalty will be imposed. If a taxpayer wilfully fails to make a return or wilfully makes a false return, or wilfully fails to pay taxes with the intent to evade payment of the tax, the taxpayer shall be guilty of a Class D felony. KRS 131.445(3). A Class D felony is punishable by at least one year in jail. KRS 532.020(1)(a).

Finally, the Revenue Cabinet may impose a 20% cost of collection fee upon any tax once it becomes final, due and owing, regardless of when originally due. KRS 131.440(1). If a taxpayer failed to file a return for any previous tax period and also failed to file the return when given the opportunity during tax amnesty, the Cabinet may impose an additional 50% cost of collection fee. Id. However, the Secretary of the Revenue Cabinet does have the power to waive any penalty or collection fee when it is shown that the deficiency was not due to negligence, intention disregard of administrative regulations or fraud. Id.

[1.88] APPENDIX

A. [1.89] KENTUCKY REVENUE CABINET OFFICIALS

KENTUCKY
REVENUE CABINET
200 Fair Oaks Drive
Frankfort, KY 40602

General Information & Taxpayer Assistance: (502) 564-4581
State Tax Forms: (502) 564-4581
FAX: (502) 564-3875

NAME	TITLE	ADDRESS	TELEPHONE
Kim Burse	Secretary, Revenue Cabinet	PO Box 930	(502) 564-3226
Alex W. Rose	Commissioner, Dept. of Administrative Services	PO Box 1229	(502) 564-6866
Steven Lenarz	Commissioner, Dept. of Tax Compliance	PO Box 181	(502) 564-3111
Dr. James Coffman	Commissioner, Dept. of Property Taxation	PO Box 1202	(502) 564-8350
Billy Whittaker	Deputy Commissioner, Dept. of Property Taxation	PO Box 1202	(502) 564-8338
Billy Whittaker	Acting Director, Div. Local Valuation, Dept. of Property Taxation	PO Box 1202	(502) 564-8338
Paul Heightchew	Supervisor, Personal Property Systems Management Section, Dept. of Property Taxation	PO Box 1202	(502) 564-8180
Joe Lancaster	Manager, PVA Fiscal & Personnel, Dept. of Property Taxation	PO Box 1202	(502) 564-5620
Jan Bailey	Acting Director, Div. of Tech. Support, Dept. of Property Taxation	PO Box 1202	(502) 564-8334
Greg Bell	Supervisor, Technical Section, Dept. of Property Taxation	Po Box 1202	(502) 564-8340
Jose Bolar	Supervisor, Mineral Valuation Section, Dept. of Property Taxation	PO Box 1202	(502) 564-8368
Ron Wilhoit	Supervisor, Field Mapping Section, Dept. of Property Taxation	PO Box 1202	(502) 564-8338
Jan Bailey	Supervisor, Cartography Section, Dept. of Property Taxation	PO Box 1202	(502) 564-8334
Jim Livers	Acting Director, Div. State Valuation, Dept. of Property Taxation	PO Box 1202	(502) 564-6730
Jim Livers	Supervisor, Central Assessed Property, Dept. of Property Taxation	PO Box 1202	(502) 564-6730
Nancy Moore	Supervisor, Omitted Intangible Sec., Dept. of Property Taxation	PO Box 1202	(502) 564-8160
Betty D. Claycomb	Taxpayer Ombudsman, Office of the Secretary	PO Box 930	(502) 564-7822

B. [1.90] KENTUCKY PROPERTY VALUATION ADMINISTRATORS

COUNTY PVA TELEPHONE NUMBERS AND ADDRESSES

COUNTY	TELEPHONE NUMBER	ADDRESS	CITY	ZIP CODE
Adair	(502) 384-3673	Public Square	Columbia	42728
Allen	(502) 237-3711	Box 397	Scottsville	42164
Anderson	(502) 839-4061	Courthouse, Main Street	Lawrenceburg	40342
Ballard	(502) 335-3400	Box 267	Wickliffe	42087
Barren	(502) 651-2026	Courthouse	Glasgow	42141
Bath	(606) 674-6382	P.O. Box 688	Owingsville	40360
Bell	(606) 248-3715	P.O. Box 255	Pineville	40977
Boone	(606) 334-2181	P.O. Box 388	Burlington	41005
Bourbon	(606) 987-3181	Courthouse	Paris	40361
Boyd	(606) 739-5173	Courthouse	Catlettsburg	41129
Boyle	(606) 238-1104	Courthouse	Danville	40422
Bracken	(606) 735-2228	Box 253	Brooksville	41004
Breathitt	(606) 666-7973	General Delivery	Jackson	41339
Breckinridge	(502) 756-5154	P.O. Box 516	Hardinsburg	40143
Bullitt	(502) 543-7480	P.O. Box 681	Shepherdsville	40165
Butler	(502) 526-3455	Courthouse	Morgantown	42261
Caldwell	(502) 365-7227	Courthouse	Princeton	42445
Calloway	(502) 753-3482	P.O. Box 547	Murray	42071
Campbell	(606) 292-3871	Courthouse	Newport	41071
Carlisle	(502) 628-5498	Box 372	Bardwell	42023
Carroll	(502) 732-5448	Courthouse	Carrollton	41008
Carter	(606) 474-5663	Room 214, Courthouse	Grayson	41143
Casey	(606) 787-7621	P.O. Box 38	Liberty	42539
Christian	(502) 887-4115	P.O. Box 96	Hopkinsville	42240
Clark	(606) 745-0250	34 South Main Street	Winchester	40391
Clay	(606) 598-3832	P.O. Box 462	Manchester	40962
Clinton	(606) 387-5938	P.O. Box 186	Albany	42602
Crittenden	(502) 965-4598	Courthouse	Marion	42064
Cumberland	(502) 864-5161	P.O. Box 431	Burkesville	42717
Daviess	(502) 685-8474	Room 107, Courthouse	Owensboro	42301
Edmonson	(502) 597-2381	P.O. Box 37	Brownsville	42210
Elliott	(606) 738-5090	Courthouse	Sandy Hook	41171

COUNTY	TELEPHONE NUMBER	ADDRESS	CITY	ZIP CODE
Estill	(606) 723-4569	Route 4	Irvine	40336
Fayette	(606) 254-2722	136 Walnut Street	Lexington	40507
Fleming	(606) 845-7571	Box 94	Flemingsburg	41041
Floyd	(606) 886-9622	Box 874	Prestonsburg	41653
Franklin	(502) 875-8780	Courthouse	Frankfort	40601
Fulton	(502) 236-2548	Courthouse	Hickman	42050
Gallatin	(606) 567-5621	P.O. Box 883	Warsaw	41095
Garrard	(606) 792-3291	Courthouse	Lancaster	40444
Grant	(606) 824-6511	Courthouse	Williamstown	41097
Graves	(502) 247-3301	Courthouse	Mayfield	42066
Grayson	(502) 259-4838	100 Public Square	Leitchfield	42754
Green	(502) 932-7518	203 West Court Street	Greensburg	42743
Greenup	(606) 473-9984	Courthouse	Greenup	41144
Hancock	(502) 927-6846	County Administration Building	Hawesville	42348
Hardin	(502) 765-2129	Box 70	Elizabethtown	42701
Harlan	(606) 573-1990	Box 209	Harlan	40831
Harrison	(606) 234-4434	Courthouse Annex	Cynthiana	41031
Hart	(502) 524-2321	Box 566	Munfordville	42765
Henderson	(502) 827-6024	Courthouse	Henderson	42420
Henry	(502) 845-2388	P.O. Box 32	New Castle	40050
Hickman	(502) 653-5521	Courthouse	Clinton	42031
Hopkins	(502) 821-3092	Courthouse	Madisonville	42431
Jackson	(606) 287-7634	P.O. Box 28	McKee	40447
Jefferson	(502) 625-6380	504 Fiscal Court Building	Louisville	40202
Jessamine	(606) 885-4931	101 Court Row	Nicholasville	40356
Johnson	(606) 789-5177	Box 529	Paintsville	41240
Kenton	(606) 491-2728	Room 210, 3rd & Court Streets	Covington	41011
Knott	(606) 785-5569	P.O. Box 322	Hindman	41822
Knox	(606) 546-4113	P.O. Box 532	Barbourville	40906
Larue	(502) 358-4202	Courthouse	Hodgenville	42748
Laurel	(606) 864-2889	Courthouse	London	40741
Lawrence	(606) 638-4743	Courthouse	Louisa	41230
Lee	(606) 464-2440	Box 434	Beattyville	41311
Leslie	(606) 672-2456	Box 583	Hyden	41749

COUNTY	TELEPHONE NUMBER	ADDRESS	CITY	ZIP CODE
Letcher	(606) 633-2182	Courthouse	Whitesburg	41858
Lewis	(606) 796-2622	514 Second Street	Vanceburg	41179
Lincoln	(606) 365-2112	P.O. Box 296	Stanford	40484
Livingston	(502) 928-2524	P.O. Box 145	Smithland	42081
Logan	(502) 726-8334	P.O. Box 307	Russellville	42276
Lyon	(502) 388-7271	P.O. Box 148	Eddyville	42038
McCracken	(502) 444-4712	621 Washington Street	Paducah	42001
McCreary	(606) 376-2514	P.O. Box 609	Whitley City	42653
McLean	(502) 273-3291	P.O. Box 246	Calhoun	42327
Madison	(606) 623-5410	Courthouse	Richmond	40475
Magoffin	(606) 349-6198	P.O. Box 148	Saylorsville	41465
Marion	(502) 692-3401	Courthouse	Lebanon	40033
Marshall	(502) 527-3114	Courthouse	Benton	42025
Martin	(606) 298-2807	P.O. Box 341	Inez	41224
Mason	(606) 564-3700	226 Sutton Street	Maysville	41056
Meade	(502) 422-2178	Fairway Drive	Brandenburg	40108
Menifee	(606) 768-3514	P.O. Box 173	Frenchburg	40322
Mercer	(606) 734-4573	P.O. Box 244	Harrodsburg	40330
Metcalfe	(502) 432-3162	P.O. Box 510	Edmonton	42129
Monroe	(502) 487-6701	P.O. Box 486	Tompkinsville	42167
Montgomery	(606) 498-2642	Courthouse	Mt. Sterling	40353
Morgan	(606) 743-3349	P.O. Box 57	West Liberty	41472
Muhlenberg	(502) 338-4664	Box 546	Greenville	42345
Nelson	(502) 348-1810	113 East Stephen Foster	Bardstown	40004
Nicholas	(606) 289-5460	P.O. Box 2	Carlisle	40311
Ohio	(502) 298-3692	Courthouse	Hartford	42347
Oldham	(502) 222-9320	100 East Main Street	LaGrange	40031
Owen	(502) 484-5172	Box 337	Owenton	40359
Owsley	(606) 593-6265	P.O. Box 266	Booneville	41314
Pendleton	(606) 654-6055	P.O. Box 108	Falmouth	41040
Perry	(606) 436-4914	481 Main Street	Hazard	41701
Pike	(606) 432-6201	Courthouse	Pikeville	41501
Powell	(606) 663-4184	P.O. Box 277	Stanton	40380
Pulaski	(606) 679-1812	P.O. Box 206	Somerset	42501

COUNTY	TELEPHONE NUMBER	ADDRESS	CITY	ZIP CODE
Robertson	(606) 724-5213	Courthouse	Mt. Olivet	41064
Rockcastle	(606) 256-4194	P.O. Box 977	Mt. Vernon	40456
Rowan	(606) 784-5512	Courthouse	Morehead	40351
Russell	(502) 343-4395	P.O. Box 224	Jamestown	42629
Scott	(502) 863-7885	Courthouse, Main Street	Georgetown	40324
Shelby	(502) 633-4403	Courthouse, 501 Main Street	Shelbyville	40065
Simpson	(502) 586-4261	P.O. Box 424	Franklin	42134
Spencer	(502) 477-2250	P.O. Box 425	Taylorsville	40071
Taylor	(502) 465-5811	Courthouse	Campbellsville	42718
Todd	(502) 265-5614	P.O. Box 593	Elkton	42220
Trigg	(502) 522-3271	P.O. Box 629	Cadiz	42211
Trimble	(502) 255-3592	Box 131	Bedford	40006
Union	(502) 389-1933	P.O. Box 177	Morganfield	42437
Warren	(502) 843-3268	429 1/2 East 10th Street	Bowling Green	42101
Washington	(606) 336-7136	Box 189	Springfield	40069
Wayne	(606) 348-6621	P.O. Box 253	Monticello	42633
Webster	(502) 639-5034	P.O. Box 96	Dixon	42409
Whitley	(606) 549-3363	P.O. Box 462	Williamsburg	40769
Wolfe	(606) 668-6923	P.O. Box 155	Campton	41301
Woodford	(606) 873-4101	Courthouse	Versailles	40383

CHAPTER II.

KENTUCKY SALES AND USE TAXATION

Douglas P. Romaine
Stoll, Keenon & Park
Lexington, Kentucky

KENTUCKY SALES AND USE TAXATION

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[2.1] KENTUCKY SALES AND USE TAXATION

By
Douglas P. Romaine

I. INTRODUCTION

A. [2.2] HISTORY OF TAX

At the general election of November 3, 1959, the voters of Kentucky approved a proposed amendment to the Kentucky Constitution providing for the issuance and sale of bonds to pay a bonus to residents of Kentucky who were veterans of certain U.S. wars. The bonds were to be paid over 30 years from the proceeds of the sales tax. After the constitutional amendment was adopted, the General Assembly enacted the "Veteran's Bonus Sales and Use Tax Law, codified in Chapter 139 of the Kentucky Revised Statutes, which levied a 3% sales and use tax effective July 1, 1960. [Ch. 5, Laws 1960.]

The question of the validity of the constitutional amendment was raised, however, in the case of Stovall v. Gartrell, Ky., 332 S.W.2d 256 (1960). The Kentucky Court of Appeals in Stovall held that although the proposed constitutional amendment was not a valid constitutional amendment, its enactment by the legislature and ultimate approval by the electorate constituted a valid legislative act.

In 1968, the General Assembly increased the sales and use tax rate from 3% to 5%. [Ch. 40, Laws 1968.] The tax was expanded to include leases and rentals of tangible personal property by the 1985 Special Session of the General Assembly. [Ch. 6, Laws 1988.] Further, effective July 1, 1990, the sales and use tax rate was increased from 5% to 6%. [Ch. 476, Laws 1990.]

B. [2.3] NATURE OF TAX

The Kentucky sales tax is levied upon a retailer's privilege of making retail sales within Kentucky. Although the tax is imposed upon the seller, who is responsible for the payment of the tax to the state treasury, the seller is required to pass the economic burden of the tax on to the buyer. [KRS 139.210.]

The use tax, on the other hand, is a consumer's tax applying to the use in Kentucky of items purchased out of state that would have been subject to the sales tax if purchased from a Kentucky vendor. The consumer is primarily liable for remittance of the use tax to the Commonwealth; however, in certain instances, the out of state vendor may be required to collect the use tax and remit the tax to the Commonwealth. [Compare, Genex/London v. Kentucky Board of Tax Appeals, Ky., 622 S.W.2d 499 (1981), in which the distinction between the sales and use tax was blurred when the Kentucky Supreme Court reached a rather unique and anomalous conclusion upholding the imposition of use tax on the buyer of tangible personal property from a retailer upon whom the sales tax obligation was imposed by statute. It would appear that the holding of Genex/London concerning imposition of sales or use tax is limited to the factual scenario of an out-of-state retailer making sales to customers within Kentucky.]

Thus, the sales and use taxes are complementary such that when taken together, the scheme provides a uniform tax upon either the sale at retail or the use of tangible personal property irrespective of where it may have been purchased.

C. [2.4] ADMINISTRATION

The sales and use tax law, as codified in Chapter 139 of the Kentucky Revised Statutes, is administered by the Revenue Cabinet. The Revenue Cabinet has the authority to promulgate regulations to effect and

carry out the enactments of the General Assembly. Further, the Revenue Cabinet routinely issues circulars and policies which set forth the Revenue Cabinet's position with respect to the application of the sales and use tax law to certain specific transactions.

D. [2.5] KEY DEFINITIONS

Consistent with the nature of taxing statutes, Chapter 139 of the Kentucky Revised Statutes sets forth definitions of its operative terms so as to render certainty to its reach and impact. [KRS 139.030.] Thus, a determination of one's sales or use tax liability oftentimes focuses upon whether the conditions of a defined term have been satisfied. Certain key definitions are discussed more fully in this outline.

II. [2.6] PERSONS AND SALES SUBJECT TO SALES TAX

A. [2.7] IMPOSITION OF TAX

For the privilege of making "retail sales" or "sales at retail", a tax is imposed upon all "retailers" . . . [upon] the gross receipts of any retailer derived from "retail sales" or "sales at retail" made within this Commonwealth. [KRS 139.200.]

B. [2.8] PERSONS SUBJECT TO TAX

A "retailer" includes: (i) every "seller" who makes any "retail sale" or "sales at retail", or who furnishes any services and facilities included in KRS 139.100, and every person engaged in the business of making retail sales at auction of tangible personal property owned by the person or others; (ii) every person engaged in the business of making sales for storage, use or other consumption, or in the business of making sales at auction of tangible personal property owned by the person or others for storage, use or other consumption; (iii) every person making more than two (2) "retail sales" during any twelve (12) month period, including sales made in the capacity of assignee for the benefit of creditors or receiver or trustee in bankruptcy; or (iv) race tracks conducting claiming races; and (v) any other person the Revenue Cabinet deems it necessary for the efficient administration of the laws to regard as a retailer. [KRS 139.110.]

1. [2.9] AUCTIONEERS

Auctioneers of tangible personal property are the retailers of such property regardless of whether the auctioneers take title to such property or whether the owner would have been entitled to exemption as an occasional sale. [KRS 139.110.]

2. [2.10] BROKERS

Brokers, such as food or produce brokers, grain brokers, lumber brokers and other brokers not having possession of tangible personal property for sale, are *not* retailers. [103 KAR 27:030.]

3. [2.11] FACTORS AND AGENTS

A factor or agent of an owner or former owner or factor to whom property is consigned, entrusted or otherwise delivered for the purpose of selling shall be considered the retailer of such property. [103 KAR 25:050.]

4. [2.12] STALLION SYNDICATE OR MANAGERS

Stallion managers of syndicated stallions standing at stud in Kentucky are *not* retailers liable for sales and use taxes with respect to sales of seasons by shareowners to third parties. [See, Pillar Stud, Inc. v.

Revenue Cabinet, KBTA No. K88-R-26 (1989).]

5. [2.13] **SERVICE ENTERPRISES - GENERALLY**

Persons engaged in the business of rendering services are consumers, not retailers of the tangible personal property which they use individually in rendering the services. The imposition of tax applies to the sale of property to them, for example, banks, advertising agencies, launderers, cleaners, barbers, beauty shop operators, tire repairers, taxidermists, lawyers, architects, engineers and accountants. [103 KAR 26:010.]

a. **Physicians and Surgeons**

Physicians and surgeons are the consumers of the materials, supplies or other items of tangible personal property which they use in performing their services. Drugs, medicines and other tangible personal property personally administered by a physician or surgeon during treatment of a patient or by an assistant under the doctor's supervision are not retail sales. [See, Medicus, Inc. v. Revenue Cabinet, Kenton County Circuit Court No. 90-CI-00438 (1990) upholding Kentucky Board of Tax Appeals decision that sales of otherwise exempt prescription drugs to physicians to be used in the treatment of patients were taxable since they were not "dispensed on prescription by a registered pharmacist in accordance with law" as required by KRS 139.472(1)]. Sales of medicines or drugs, however, by a physician or surgeon for a separate price which would otherwise require a prescription are exempt from tax. [103 KAR 26:020.] [See, Mayer & Karim, PSC and Lloyd Mayer, M.D., PSC v. Revenue Cabinet, KBTA No. K89-R-1113 and 1114 (1991) exempting from tax as prescription drugs, antigen extracts and other allergy medications prescribed, prepared and occasionally administered by physicians].

b. **Artists**

The acquisition of original commissioned works of art are not taxable since such works represent the acquisition of a professional service. [See, Stoner Creek Stud, Inc. v. Revenue Cabinet, Ky., 746 .W.2d 73 (1987).]

c. **Repairers and Reconditioners of Personal Property**

Repairmen are retailers of parts and materials furnished in connection with repair work in which the value of the parts and materials is substantial in relation to the total charge. If the labor and other services are not shown separately from the selling price of the property furnished, it will be presumed that the entire charge represents the sales price of the property and the tax applies to the entire charge. [103 KAR 27:150.]

d. **Construction Contractors**

All sales to contractors, subcontractors, builders or owners of building materials, fixtures and supplies, which are to be incorporated or fabricated into any structure or improvement to real estate by the process of erecting, remodeling or repairing such structure or improvement are subject to tax at the time of sale to the contractor, subcontractor, builder or owner. [See, Revenue Cabinet v. Bryan L. Burnett Co., Ky., 725 S.W.2d 19 (1987) holding that parts and materials used by contractor in repairing, reconditioning or remodeling heating and air conditioning equipment previously installed as fixtures and improvements on real estate were not subject to sales tax.]

e. **Information Retrieval**

An organization that performed research services and provided written reports to individual clients on the pedigrees of certain thoroughbred horses and the racing history of the horses' ancestors was not

subject to sales or use tax on fees since fees were received for services. The research services were specifically tailored to the needs of the clients and the information was not gathered for the purpose of sale to the general public. [The Jockey Club v. Revenue Cabinet, KBTA No. K87-R-36 (1988)].

C. [2.14] SALES SUBJECT TO TAX

1. [2.15] GENERALLY

As previously indicated, the sales tax is imposed upon "retail sales" taking place in Kentucky. A "retail sale" is a "sale" of "tangible personal property" for any purpose other than resale in the regular course of business. [KRS 139.100(1)(a)(1).] The provision of services, other than those specifically prescribed by statute for taxation, are exempt from tax. Every "sale" is presumed to be a "retail sale", the gross receipts of which are subject to tax unless the "seller" proves otherwise. [KRS 139.260.] If a sale is claimed to be exempt from sales tax, the seller is required to secure from the purchaser in "good faith" either: (i) a resale certificate; (ii) a certificate of exemption; or (iii) a direct pay authorization. "Good faith" is presumed if the seller accepts a properly completed resale or exemption certificate at the time of sale, maintains the certificate on file for four (4) years, and determines that the type of property sold is normally offered for resale in the type of business operated by the purchaser. [KRS 139.270.] [See, Pace Membership v. Revenue Cabinet, Ky. App. 306 SW2d 353 (1991) where retailer of household goods was liable for collection of sales tax even though retailer was presented with certificates of resale by purchasers since retailer failed to make good faith determination that the type of property it sold was normally offered for resale in type of business operated by purchaser, i.e., clothes detergent sold to electronics store and after shave, knife sets and plastic wrap to liquor stores].

2. [2.16] LEASES AND RENTALS

After August 1, 1985, all leases and renewal of leases executed prior to that date of tangible personal property located within Kentucky are treated as purchases by the lessor for resale. [KRS 139.532.] Accordingly, no tax is imposed at the time of purchase, but each lease payment is taxable upon receipt, excluding separately stated property taxes, insurance and maintenance agreements. [103 KAR 28:051.]

The term "lease or rental" does not include the lease or rental of real property or a transaction which provides a service. The providing of a service is any transaction which includes both services and tangible personal property for a consideration where the performance of the service is the essence of the transaction. [103 KAR 28:051.] For example, charges made for equipment and an operator to perform work specified by a customer who does not assume physical control of the equipment would obviously meet this test for exclusion. Not all transactions will fall so easily within this distinction.

3. [2.17] HOTEL OCCUPANCY

The rental of any room or rooms, lodgings or accommodations furnished by hotels and the like to transients for a consideration are subject to tax. Provided, however, that if such rental to an individual is for a period of 30 or more consecutive days, no tax shall apply. [KRS 139.100(2)(a).]

4. [2.18] TELEPHONE, TELEGRAPH AND SERVICE COMPANIES

The furnishing of sewer and utility services (except for residential purposes under KRS 139.470(8)(a)) and intrastate telephonic and telegraphic communications and services are subject to tax. [KRS 139.100(2)(b).]

5. [2.19] ADMISSIONS

As a general rule, the sale of admissions to places of amusement or entertainment are subject to tax. The

sale of an admission is the sale of a right to see a display, see or hear a program, witness a sporting event or view a play, movie or other entertainment event. Fees charged, however, for the use of a facility are exempt from tax. [See, J. Sutter's Mill v. Revenue Cabinet, Ky. 793 S.W.2d 838 (1990) holding that a cover charge imposed upon bar patrons was a taxable admissions fee, not an exempt user fee.] The following admission fees are not taxed: (i) admissions to race tracks upon which a special tax is levied under KRS 138.480 (see discussion below at § 2.122); (ii) admissions to historical sites; (iii) admissions sold by qualified nonprofit charitable and educational institutions for services used solely within the organization's exempt function; (iv) camping fees charged by campground owners to rent space to campers [Revenue Policy 51P380 (1983); (v) admissions to boxing and wrestling matches which are subject to special tax [Revenue Policy 51P395 (1986)].

6. [2.20] HORSE INDUSTRY

The following transactions are specifically subjected to tax: (i) stud fees paid with respect to stallions standing at stud in Kentucky [See, Calumet Farm, Inc. v. Revenue Cabinet, Ky., 793 S.W.2d 830 (1990), in which the Kentucky Court of Appeals affirmed the lower court's holding that sales of lifetime breeding rights were subject to tax as payment of breeding fees rather than exempt as a sale of an interest in a horse for breeding purposes only.]; (ii) the sales price for a horse, other than a brood mare or stallion or other than a horse less than two years of age sold to a nonresident to be shipped out of state immediately after the sale or after a temporary stay in Kentucky for training; or (iii) the claiming price of any horse claimed at a Kentucky race track. [KRS 139.531(1).] Further, horse feed is subject to tax [See, Stoner Creek Stud v. Revenue Cabinet, Ky., 746 SW2d 73 (1987)].

7. [2.21] SALES BY AND TO RESIDENT EDUCATIONAL, CHARITABLE AND RELIGIOUS INSTITUTIONS

All sales by or to nonprofit educational, charitable and religious institutions are taxable *except* the following sales by or to *resident* nonprofit educational, charitable or religious institutions which are exempt from income tax pursuant to section 501(c)(3) of the Internal Revenue Code:

- (a) sales to such institutions provided the property or service is to be used solely within the educational, charitable or religious function; [KRS 139.495(1)];
- (b) sales by such institutions of food to students in school cafeterias or lunchrooms; [KRS 139.495(2)];
- (c) sales by school bookstores of textbooks, workbooks and other course material; [KRS 139.495(3)];
- (d) sales by nonprofit, school sponsored clubs and organizations provided such sales do not include tickets for athletic events [KRS 139.495(4)];
- (e) the first \$1,000 of sales by a nonprofit organization from fund raising event not otherwise engaged in the business [KRS 139.496];
- (f) the purchase of textbooks, including related course materials, for use in a course of study conducted by a nonprofit educational institution [KRS 139.480(16)] [See, discussion at §2.97 below]; and
- (g) sales by elementary or secondary schools or school sponsored clubs or affiliated groups provided the net proceeds are used solely for the benefit of the elementary or secondary school or its students [KRS 139.497][See, discussion at §2.116].

8. [2.22] SALES TO MORTICIANS, UNDERTAKERS AND FUNERAL DIRECTORS OF ITEMS USED IN PERFORMING THEIR SERVICES

Morticians, undertakers and funeral directors are consumers of items purchased by them to be used in the performance of their services (including caskets and vaults) such that tax applies at the time of sale of such items to morticians, undertakers or funeral directors. [KRS 139.5313.] Tombstones and other memorial markers are exempt from tax. [KRS 139.480(13).]

9. [2.23] NONSTATUTORY ITEMS

a. Computer Software

The sale of "canned" computer software is the sale of tangible personal property, the receipts from which are subject to tax. [See, Bank of Louisville v. Revenue Cabinet, KBTA Order No. 10316 (1984); Revenue Policy 51P170 (Rev. 12-1-86).] The sale of "customized" computer software, however, is not considered to be a sale of tangible personal property since the transfer of the software is merely incidental to the service being performed. [Revenue Policy 51P171 (12-1-86).] Similarly, charges for the modification of existing computer software is exempt from tax.

b. Word Processing

The Revenue Cabinet takes the position that charges for producing printed material on word processing equipment are subject to tax. [Revenue Policy 51P180 (6-1-83).]

c. Severed Realty

The sale of items which otherwise constitute realty, but when severed constitute tangible personal property, i.e., dirt, sod, buildings and timber, are subject to tax. [Cf., Revenue Policy 51P110 (6-1-83).]

D. [2.24] REGISTRATION OF SELLERS

1. [2.25] PERMITS

Every person engaged or desiring to engage in or conduct business as a retailer within Kentucky shall file with the Revenue Cabinet an application for the issuance of a sales tax permit for each place of business at which transactions relating to sales are customarily negotiated. Permits are nonassignable to persons or businesses. [KRS 139.250.]

2. [2.26] APPLICATION

An application for a Retail Sales and Use Tax Permit shall be made upon Form 10A100, Kentucky Tax Registration Application for Withholding, Corporation, Coal, Sales and Use Taxes. A general license fee of \$10.00 is required. Registration is valid until revoked or surrendered. [KRS 139.240.]

3. [2.27] SECURITY; REVOCATION

The state can require a sales tax permit holder to post a bond to cover any unpaid sales tax. Unless the retailer is habitually delinquent in remitting the tax to the state, the amount of the bond shall not be greater than twice the estimated average tax liability if filing quarterly returns, or three times the estimated average tax liability if filing monthly returns. [KRS 139.660.] The Revenue Cabinet can also revoke a sales tax permit without a prior hearing. [See, Jacobs d/b/a Jacobs Liquors v. Commonwealth, Kentucky Supreme Court (2-6-76) (unpublished opinion).]

E. [2.28] LIABILITY AND COLLECTION OF TAX

1. [2.29] PASSING SALES TAX ON TO CONSUMER

As stated previously, the legal incidence of the sales tax is on the retailer; further, a retailer making retail sales within Kentucky is required to collect the sales tax from the consumer. [KRS 139.210.]

Under prior law which permitted, but did not require, the seller to pass the tax on to the buyer, it was held that if a contract for sale was silent and there was no implied agreement, then the seller could not subsequent to the sale transaction collect the tax from the buyer. [See, ITT Fluid Products Corp. dba ITT Grinnell Corp. v Crane Co., Ky., 793 SW2d 844 (1990).] The precedential value of this case is suspect in light of the statutory change requiring the seller to collect the tax from the buyer.

2. [2.30] FAILURE TO USE PROPERTY IN EXEMPT MANNER

If the purchaser certifies to the retailer that the transaction is exempt from tax, but the purchaser uses the property purchased in other than an exempt purpose or manner, the purchaser, not the seller, is liable for the tax. [KRS 139.290.]

3. [2.31] ADVERTISING ASSUMPTION OR ABSORPTION OF TAX

It is unlawful for any retailer to advertise or hold out or state to the public or to any customer, directly or indirectly, that the tax or any part thereof will be assumed or absorbed by the retailer or that it will not be added to the selling price of the property or if added, that it will be refunded. [KRS 139.220.] Note, however, that a retailer may add the tax to the list price of an article provided it is stated that the price includes the applicable tax. The amount of the tax is determined by the formula: 1 - (list price divided by 106).

4. [2.32] CORPORATE OFFICERS

Effective for taxable periods beginning on or after July 15, 1988, the principal officers of a corporation, i.e., president, vice president, secretary and treasurer, are personally and individually liable, jointly and severally, for any unpaid taxes of the corporation that may have become due during their holding of office. Such liability will continue despite cessation of business by the corporation, whether by liquidation or otherwise, or retirement from corporate office. Provided, however, no corporate officer shall be so liable if such person had no authority in the management of the business or financial affairs of the corporation. [KRS 139.185.]

5. [2.33] SUCCESSOR LIABILITY

A person that purchases an existing Kentucky retail business or a stock of goods from a retail business may become liable for not only that business's unpaid sales and use tax liability incurred prior to the sale, but also any sales taxes arising out of the transfer, unless the purchaser withholds a sufficient amount from the purchase price to satisfy said tax liabilities or obtains a certificate of tax clearance from the Revenue Cabinet with respect to such acquisition. A recent circuit court decision held that the withholding requirement is satisfied so as to relieve the purchaser from successor liability in the case of an installment purchase where the amount of deferred payments to be made to the seller exceeded the prior tax liability of the seller. [See, Triple R Food A Rama v. Revenue Cabinet, Leslie Circuit Court No. 92-CI-034 (1993)]. [KRS 139.670, 139.680.] If the purchaser makes a written request for a certificate of tax clearance and the Revenue Cabinet fails to respond within at most a 90-day period, there is no successor liability imposed upon the purchaser. [KRS 139.680.] The fact that no money is exchanged between the buyer and seller such as the case when a business is transferred for the assumption of outstanding

indebtedness, does not relieve the purchaser from successor liability. [See, In re Western Resources, Inc., U.S. Bankruptcy Court, So. Dist. Ind. 1990).]

Obviously, there are practical reasons why the purchasers may not want to request a certificate of tax clearance, including the limitations triggering of an audit of the seller's business as well as waiting up to 90 days to close an acquisition. Accordingly, a purchaser often seeks an indemnity agreement from the seller with respect to its successor liability. Attorneys advising purchasers of the enforceability of such indemnity agreements should be aware that such agreements do not abrogate the purchaser's liability to the state. Furthermore, there is some question as to the enforceability of such provisions as a matter of public policy in light of the provisions of KRS 139.220 prohibiting a seller from assuming responsibility for the tax of the buyer.

III. [2.34] PERSONS AND PURCHASES SUBJECT TO USE TAX

A. [2.35] IMPOSITION OF TAX

An excise tax is hereby imposed on the storage, use or other consumption in this state of tangible personal property purchased . . . for storage, use or other consumption in this state . . . [KRS 139.310.]

B. [2.36] PRESUMPTIONS

As stated previously, the use tax acts as a "backstop" for the sales tax and generally applies to property that is purchased outside of Kentucky so that Kentucky tax cannot be avoided by making out of state purchases. To carry out this framework, various presumptions as to the applicability of the use tax have been created.

1. [2.37] PRESUMPTION THAT PROPERTY SOLD IS FOR USE IN KENTUCKY

Tangible personal property sold for delivery in Kentucky is presumed to be sold for storage use or other consumption in Kentucky. The seller has the burden of proving otherwise unless a resale certificate, exemption certificate or direct pay authorization is received from the purchaser. [KRS 139.400.]

2. [2.38] PRESUMPTION AS TO PROPERTY SHIPPED OR BROUGHT INTO KENTUCKY

Tangible personal property shipped or brought into Kentucky by the purchaser is presumed to have been purchased from a retailer for storage, use or other consumption in Kentucky. [KRS 139.450.]

3. [2.39] PRESUMPTION AS TO PROPERTY DELIVERED OUTSIDE STATE TO KENTUCKY RESIDENT

Tangible personal property delivered outside of Kentucky to a purchaser known by the retailer to be a Kentucky resident is presumed to have been purchased for use in Kentucky and so used. The retailer may controvert this presumption by either: (i) a written statement signed by the purchaser to the effect that the property was purchased for use outside of Kentucky; or (ii) such other evidence satisfactory to the Revenue Cabinet that the property was not purchased for use in Kentucky. [KRS 139.460.]

4. [2.40] INTERPRETATION BY REVENUE CABINET

The Revenue Cabinet, in Revenue Circular 51C025 (Revised 12-01-86), Use Tax Due in Out-of-State Purchases, states "if the merchandise is brought into Kentucky within ninety (90) days after purchase, it is presumed that it was purchased for storage, use or other consumption in this state."

While the above-referenced statutory presumptions contain no such time constraints, the Revenue Cabinet's interpretation raises the question of what happens if a Kentucky resident purchases property outside of Kentucky and uses that property outside of the state for more than 90 days before bringing the property into Kentucky. The author has been informed by the Revenue Cabinet that its administrative practice is not to impose use tax on items purchased out-of-state which have been used out-of-state for more than 90 days. Consider, however, the effect of Complete Auto Transit v. Brady, 430 U.S. 724, reh'g denied, 430 U.S. 976 (1977), discussed at § 2.64, below, with respect to items purchased out of state, used for more than 90 days and upon which no tax may have been paid.

C. [2.41] SPECIFIC TRANSACTIONS SUBJECT TO TAX

1. [2.42] CONSTRUCTION MACHINERY AND EQUIPMENT

A person who brings machines, machinery, tools or other equipment into Kentucky for the purpose of construction is required to pay the use tax on a proportionate part of the original purchase price of such property, calculated by determining the length of use of the property in Kentucky in comparison to the total useful life of the property. "Use" in this instance includes "standby" time as well as "actual" use. [103 KAR 25:110.] Further, it is presumed that any such property brought into Kentucky will stay in Kentucky for the remainder of its useful life. "Remaining useful life" shall be determined in accordance with the experiences and practices of the building and construction trades. Any useful life other than allowed by the IRS must be substantiated. [103 KAR 25:110.]

2. [2.43] LEASES AND RENTALS

An out-of-state lessor of construction equipment as well as non-construction equipment who leases or rents tangible personal property in Kentucky is liable for tax on the gross receipts from the lease or rental.

3. [2.44] CATALOGS

Sales catalogs printed out-of-state, but delivered to a taxpayer in Kentucky for distribution to both prospective in-state and out-of-state customers are subject to imposition of use tax. [See, Fasig-Tipton, Kentucky, Inc. v. Revenue Cabinet, KBTA Order No. K-10581 (3-13-85).] Note, however, in Fasig-Tipton, that catalogs shipped by out-of-state printers directly to prospective in-state and out-of-state customers were treated as exempt. [Compare, result reached in D. H. Holmes Co. v. McNamara, discussed below at § 2.64.]

D. [2.45] REGISTRATION OF RETAILERS ENGAGED IN BUSINESS IN KENTUCKY

1. [2.46] DEFINITION

"Retailer engaged in business in this state" includes:

(a) Any retailer maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place or other place of business. Property owned by a person who has contracted with a printer for printing, which consists of the final printed product, property which becomes a part of the final printed product, or copy from which the printed product is produced, and which is located at the premises of the printer, shall not be deemed to be an office, place of distribution, sales or sample room or place, warehouse or storage place or other place of business maintained, occupied, or used by the person; or

(b) Any retailer having any representative, agent, salesman, canvasser or solicitor operating in Kentucky under the authority of the retailer or its subsidiary for the purpose of selling, delivering, or the taking of orders for any tangible personal property. An unrelated printer with which a person had contracted for printing shall not be deemed to be a representative, agent, salesman, canvasser or solicitor for the person.

(c) Any retailer soliciting orders for tangible personal property from residents of this state on a continuous, regular, systematic basis in which the solicitation of the order, placement of the order by the customer or the payment for the order utilizes the services of any financial institution, telecommunication system, radio or television station, cable television service, printed media or other facility or service located in this state; or

(d) Any retailer deriving receipts from the lease or rental of tangible personal property situated in this state. [KRS 139.340.]

2. [2.47] PERMITS

Retailers engaging in business in Kentucky and making sales of tangible personal property, the storage, use or other consumption of which is subject to tax must hold a permit. [KRS 139.390.] Retailers who are not engaged in business in Kentucky but wish to collect the use tax for the convenience of their customers may also apply for a permit. Upon issuance of a permit, such retailers are requested to collect the tax from purchasers, give a receipt for and remit the tax to Kentucky in the same manner as retailers engaged in business in Kentucky. [103 KAR 25:010.]

3. [2.48] APPLICATION

See, discussion at § 2.26.

4. [2.49] SECURITY; REVOCATION

See, discussion at § 2.27.

E. [2.50] LIABILITY AND COLLECTION OF TAX

1. [2.51] PURCHASER'S LIABILITY

Every person storing, using or otherwise consuming in Kentucky tangible personal property purchased from a retailer is liable for the use tax. This liability is not extinguished unless the purchaser receives a receipt from a retailer engaged in business in Kentucky reflecting payment of the tax. [KRS 139.330.]

2. [2.52] RETAILER'S LIABILITIES

In addition, every retailer engaged in business in Kentucky is required to collect the use tax from the purchaser and remit the tax to Kentucky. [KRS 139.340.] This obligation constitutes a debt of the retailer to the state. [KRS 139.360.] Further, the tax due shall be displayed separately from the list price or other price on the sales check. [KRS 139.380.]

3. [2.53] FAILURE TO USE PROPERTY IN EXEMPT MANNER

If the purchaser certifies to the retailer that the transaction is exempt from tax, but the purchaser uses the property purchased in other than an exempt purpose or manner, the purchaser, not the seller, is liable for the tax. [KRS 139.490.]

4. [2.54] ADVERTISING ASSUMPTION OR ABSORPTION OF TAX

It is unlawful for any retailer to advertise or hold out or state to the public or to any customer, directly or indirectly, that the tax or any part thereof will be assumed or absorbed by the retailer or that it will not be added to the selling price of the property or if added, that it will be refunded. [KRS 139.370.]

5. [2.55] CORPORATE OFFICERS

See, discussion at § 2.32.

F. [2.56] RECIPROCIITY

The use tax does not apply to the use or consumption of tangible personal property in Kentucky upon which a sales or use tax has already been paid to another state, provided the other state to which a tax has been paid has a reciprocal statute. [KRS 139.510.] Further, if the sales or use tax paid to the other state is less than the tax that would be imposed by Kentucky, the difference is payable to Kentucky. Revenue Circular 51C015 (Revised 10/01/88) lists states having sales and use tax reciprocal statutes. Note that these reciprocity provisions do not apply to construction machinery which is brought into Kentucky for completion of a construction project.

IV. [2.57] LIMITATION ON JURISDICTION TO IMPOSE SALES AND USE TAXES

A. [2.58] INTRODUCTION

In 1967, the U.S. Supreme Court decided in National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967), that states may not impose the duty of use tax collection and payment upon a seller whose only connection with customers in the state is by common carrier or the U.S. mail. Propelled by ever increasing budgetary concerns, many states, including Kentucky, have questioned the vitality of the National Bellas Hess decision, contending that mail order sellers enjoy an unfair competitive advantage over local in-state retailers. The U.S. Supreme Court recently reviewed the basis of its decision in National Bellas Hess, in the case of Quill Corp. v North Dakota, 112 S.Ct. 1904 (1992), which is discussed below at § 2.65.

B. [2.59] CONSTITUTIONAL LIMITATIONS GOVERNING TAXATION OF NONRESIDENT RETAILERS

The U.S. Constitution imposes two significant restrictions on a state's ability to compel an out-of-state retailer to collect and remit use tax on its sales to in-state resident, i.e., the Due Process Clause of the Fourteenth Amendment and the Commerce Clause. The U.S. Supreme Court has stated that "due process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Miller Brothers v. Maryland, 347 U.S. 340, 344-45, reh'g denied, 347 U.S. 964 (1954). This same "nexus" requirement is a critical element of the four-prong test articulated by the Supreme Court in Complete Auto Transit, Inc. v. Brady, 430 U.S. 724, reh'g denied, 430 U.S. 976 (1977), to determine whether a tax violates the Commerce Clause. Under Complete Auto Transit, "[i]f the state tax is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce and is fairly related to the services provided by the State, no impermissible burden on interstate commerce will be found." Thus, the requirement under each of these constitutional provisions turns on the issue of nexus.

C. [2.60] NEXUS REQUIRING PHYSICAL PRESENCE

As a practical matter, the Supreme Court has applied the "nexus" requirement by focusing on the taxpayer. Generally, the taxpayer's presence by means of an in-state office or place of business creates the nexus which will enable the state to impose a tax upon the taxpayer's activities within the state or require tax collection by the taxpayer. [See, Feld & Tarrent Mfg. Co. v. Gallagher, 306 U.S. 62 (1939).]

In Scripto, Inc. v. Carson, 362 U.S. 207 (1960), however, the Court found sufficient nexus despite the lack of an office or place of business within the state. In Scripto, the out-of-state retailer received orders from independent contractors who were residents of the taxing state. The use of such order takers secured "a substantial flow of goods" into the taxing state justifying imposition of the duty to collect the tax.

The Court next considered a state's right to require use tax collection by a foreign corporation in National Geographic Society v. California Board of Equalization, 430 U.S. 551 (1977). National Geographic is a nonprofit corporation headquartered in the District of Columbia. It maintained two offices in California which engaged solely in soliciting advertising copy for the National Geographic magazine. The offices did not participate in activities related to the mail order sale of the National Geographic magazine. All orders for the magazine were instead mailed directly from California subscribers to National Geographic's headquarters in Washington, D.C. on order forms mailed to subscribers or obtained from the magazine itself. Deliveries were made by mail from Washington, D.C. or Maryland. Payment was made either by cash accompanying the order form, or by separate billing following receipt of the merchandise.

In addressing the constitutional issue before it, the Supreme Court restated the controlling standard, which requires "some definite link, some minimum connection between [the state] and the person. . . it seeks to tax." National Geographic, 430 U.S. at 561, (quoting Miller Bros. v. Maryland, 347 U.S. at 344-45). The Supreme Court stated that National Geographic's two offices had the advantage of the same municipal services, fire and police protection, and the like, as they would have had if their activities included assistance to the mail order operations that generated the use taxes. Therefore, the Court affirmed the California Supreme Court's determination that National Geographic must collect the use tax, based upon National Geographic's presence in California.

Taken together, Scripto and National Geographic illustrate that some physical presence by a foreign corporation, even if through its employees, salespeople, or independent contractors, must exist in order to establish "some definite link, some minimum connection" with the taxing state. National Geographic reveals that the establishment of an office in the taxing state or the continuous business of an employee of the nonresident corporation in the taxing state whether or not related to the selling activity will constitute sufficient nexus. Scripto goes even further, providing that physical presence of independent contractors who solicit business for the corporation in a systematic fashion provides sufficient nexus with the taxing state.

D. [2.61] BORDER SALES

Another area in which courts have assessed constitutional limitations on a state's ability to require nonresident retailers to collect tax has involved "border sales." This situation generally arises when out-of-state vendors located near the taxing state's border deliver goods sold out-of-state to in-state residents. In most cases, the nonresident vendor advertises in newspapers and other media which is known to reach residents in the taxing state, although such advertising is not designed to specifically target these customers.

The seminal case in this area is the United States Supreme Court's decision in Miller Brothers v. Maryland, 347 U.S. 340 reh'g denied, 347 U.S. 964 (1954). In Miller Brothers, the Supreme Court held that Maryland could not constitutionally impose a use tax obligation upon a Delaware seller that had no retail outlets

or sales people in Maryland. The seller advertised its merchandise to Maryland residents through newspapers and radio. In addition, the seller mailed sales circulars four times a year to all former customers, including Maryland residents. Residents of nearby Maryland came to the vendor's store and made purchases. Some of these purchases were delivered to them in Maryland by common carrier, and others were delivered in the seller's own trucks.

The Miller Brothers decision holds that states may not constitutionally impose a use tax obligation on sellers whose occasional entry into a state to deliver merchandise is not accompanied by systematic advertising directed to residents of that state. The U.S. Supreme Court has not overruled this decision. Thus, it still stands as the test by which border states must measure tax collection liabilities upon retailers in neighboring states.

E. [2.62] RECENT SUPREME COURT ACTIVITY

1. [2.63] GOLDBERG V. SWEET

In Goldberg v. Sweet, 102 L.Ed. 2d 607 (1989), the U.S. Supreme Court upheld an Illinois tax on telecommunications which was challenged on Commerce Clause grounds. The Illinois tax at issue in Goldberg imposed a 5 percent tax on the gross charges of interstate telephone calls originating from or terminating in Illinois and charged to a service address within Illinois. Although not technically a sales or use tax, the Court found that the tax at issue "has many characteristics of a sales tax" because it is "assessed on the individual consumer, collected by the retailer, and accompanies the retail purchase of an interstate telephone call." (Goldberg, 102 L.Ed. 2d at 618) The Court upheld the tax assessed on the gross charges of the interstate activity, permitting Illinois to tax the entire cost of interstate act which takes place only partially in Illinois.

Although the parties stipulated that adequate nexus existed, the Court did discuss the nexus issue briefly in dicta. In doing so, the Court relied on National Bellas Hess to support its view that termination of an interstate telephone call, by itself, does not provide a substantial enough nexus for a state to tax a call. The Court observed that "receipt of mail provides insufficient nexus" under National Bellas Hess. (Goldberg, 102 L.Ed. 2d at 618).

2. [2.64] D.H. HOLMES CO. V. MCNAMARA

In D.H. Holmes Co. v. McNamara, 100 L.Ed. 2d 21 (1988), the Court unanimously held that Louisiana's imposition of use tax on catalogs delivered primarily to Louisiana residents through the mail did not violate the Commerce Clause. The taxpayer, a retailer which operated thirteen stores in-state, printed the catalogs out-of-state but delivered them to in-state residents. The Court rejected the taxpayer's Commerce Clause challenge to the imposition of use tax on the catalogs, noting that "there is 'nexus' aplenty here." (Holmes, 100 L.Ed. 2d at 29)

However, the facts which created nexus between the retailer and Louisiana qualitatively and quantitatively differ from the facts of National Bellas Hess. Significantly, the Court rejected the retailer's argument that its catalog distribution was analogous to the mail order solicitation in National Bellas Hess. The Court stated that: [t]his argument ignores, however, the taxpayer's significant economic presence in Louisiana, its many connections with the state, and the direct benefit it receives from Louisiana in conducting its business. In making this distinction, the Court restated its National Bellas Hess holding, thereby confirming the vitality of that rule.

3. [2.65] QUILL CORP V. NORTH DAKOTA

In Quill the Supreme Court held that North Dakota's imposition of use tax collection obligations on a mail

order seller who lacked physical ties in the state violated the Commerce Clause but did not violate due process standards. By relying exclusively on Commerce Clause principles, the Court preserved the practical protections afforded by the Commerce Clause against unduly burdensome compliance and payment requirements, yet removed the due process impediments that would otherwise preclude a congressional solution to the problem. The decision requires that some physical presence is necessary to create commerce clause nexus but indicated that customer guarantees, "800" toll free numbers used by in state consumers, and sending catalogs to in state customers was not sufficient. How much physical presence is required will be left to the courts to define in the wake of Quill.

F. [2.66] RESPONSE BY KENTUCKY GENERAL ASSEMBLY

The 1988 Session of the Kentucky General Assembly amended Kentucky's sales and use tax statutes to include within the definition of a "retailer engaged in business in this state:

"Any retailer soliciting orders for tangible personal property from residents of this state on a continuous, regular, or systematic basis in which the solicitation of the order, placement of the order by the customer, or the payment for the order, utilizes services of any financial institution, telecommunication system, radio or television, cable television service, print media, or other facility or service located in this state. [KRS 139.340(2), as amended by H.B. 870, Laws 1988.]

The expanded definition of a "retailer engaged in business" in Kentucky became effective July 15, 1988. To date, there have been no challenges to the constitutionality of this provision.

V. [2.67] EXEMPTIONS FROM SALES AND USE TAXES

A. [2.68] INTRODUCTION

There exist numerous exemptions, exclusions and exceptions to the imposition of Kentucky sales and use tax laws. As a matter of statutory construction, such exemptions are construed strictly against the taxpayer. [See, Delta Airlines v. Revenue Cabinet, Ky., 689 S.W.2d 14 (1985).] The bases of these exemptions are generally founded on (i) limitations imposed by the U.S. and Kentucky Constitutions and (ii) the public policy of the Kentucky General Assembly, which fortunately or unfortunately often times is the result of special interest lobbying efforts. The following is a list and short discussion of each of these statutory exemptions.

B. [2.69] CONSTITUTIONAL RESTRICTIONS

No tax is imposed upon gross receipts from the sale of and the storage use or other consumption in this state of tangible personal property the gross receipts from the sale of which, or the storage, use or other consumption of which within this state is prohibited from being taxed under the constitution or laws of the U.S. or under the constitution of Kentucky. [KRS 139.470(1).]

1. [2.70] SALES TO FEDERAL GOVERNMENT

No tax shall be imposed upon sales to the federal government, including federal agencies, instrumentalities or corporations. This exemption may not be claimed by contractors purchasing property to be used in fulfilling contracts with the federal government. [103 KAR 30:235.]

2. [2.71] INTERSTATE COMMERCE

Pursuant to the Commerce Clause of the U.S. Constitution, transactions in interstate commerce are not subject to state taxation until the property comes to rest. Thus, the sales tax does not apply to gross

receipts from sales in which the seller is obligated, under the terms of an agreement with the purchaser, to make physical delivery of the property sold from a point in this state to a point outside Kentucky, which is not to be returned to a point within the state and provided further that the delivery is actually made. Nor does the tax apply where the seller under the terms of an agreement with the purchaser, delivers the property by carrier or by mail from Kentucky to a destination outside the state which is not to be returned. [103 KAR 30:190.] Moreover, the sales tax does not apply to the gross receipts from sales of personal property to a common carrier shipped by the seller via the purchasing carrier under a bill of lading to a destination outside Kentucky for use by the carrier in the conduct of its business as a common carrier. [KRS 139.470(5).] The fact that title and risk of loss passes in Kentucky at seller's shipping point has no adverse effect. [See, Dept. of Revenue v. Cox Machinery, Ky., 650 S.W.2d 201 (1983).] There is, however, a presumption that personal property delivered outside Kentucky to a purchaser known by the seller to be a resident of Kentucky was purchased for storage, use, or other consumption in Kentucky and is therefore taxable. This presumption may be controverted by a written statement signed by the purchaser and retained by the seller that the property was purchased for use out of state.

C. [2.72] NONRETURNABLE AND RETURNABLE CONTAINERS

No tax is imposed upon "nonreturnable" and "returnable" containers when sold without the contents to persons who place the contents in the container and sell the contents together with the container; and returnable containers when sold with the contents in connection with a retail sale of the contents or when resold for refilling. The term "returnable containers" means containers of a kind customarily returned by the buyer of the contents for reuse. All other containers are "nonreturnable containers". [KRS 139.470(2).]

D. [2.73] PUBLIC WORKS CONTRACTS EXECUTED PRIOR TO FEBRUARY 5, 1960

No tax is imposed upon tangible personal property used for the performance of a lump sum, fixed fee contract of public works executed prior to February 5, 1960. [KRS 139.470(3).]

E. [2.74] OCCASIONAL SALES

No tax is imposed upon gross receipts from occasional sales of tangible personal property and the storage, use or other consumption in Kentucky of tangible personal property, the transfer of which to the purchaser is an occasional sale. [KRS 139.470(4).]

An "occasional sale" includes a sale of property not held or used by a seller in the course of an activity for which he is required to hold a seller's permit, provided such sale is not one of a series of sales sufficient in number, scope and character to constitute an activity requiring the holding of a seller's permit. [KRS 139.070(a).] In general, a person making more than two (2) retail sales during any 12-month period is a "retailer" required to hold a permit. [KRS 139.110.] Further, the Revenue Cabinet considers that once a person meets this 3-retail sale threshold, he is always a retailer and cannot claim the occasional sale exemption even though in a subsequent year he has less than 3 retail sales. [See, 103 KAR 30:200 Section 2.] In a change from prior law, KRS 139.070 was amended effective July 14, 1992, to provide that in the case of a sale of an entire or substantial portion of the nonretail assets of a seller, the number of previous sales of similar assets is to be disregarded.

The term "occasional sale" also includes any transfer of all or substantially all the property held or used by a person in the course of such an activity when after such transfer the real or ultimate ownership of such property is substantially similar to that which existed before such transfer. [KRS 139.070(b).] For this purpose, stockholders, bondholders and partners are treated as having the "real or ultimate ownership" of the property of the entity. [See, Revenue Cabinet v. Myrtlewood Farm, Kentucky Court of Appeals, No. 87-CA-60-5 (7-24-87) (unpublished) holding that the transfer by a taxpayer and his father of all their

interests in thoroughbred horses to a corporation in exchange for 50% each ownership in stock of corporation did not change the ultimate ownership.]

F. [2.75] SALES TO INTERSTATE COMMON CARRIERS

No tax is imposed upon gross receipts from sales of tangible personal property to a common carrier, shipped by the seller via the purchasing carrier under a bill of lading, whether the freight is paid in advance or the shipment is made freight charges collect, to a point outside this state and the property is actually transported to the out-of-state destination for use by the carrier in the conduct of its business as a common carrier. [KRS 139.470(5).] [See, Epsilon Trading Co. v. Revenue Cabinet, Ky., 775 S.W.2d 937 (1989), holding that property was not "shipped out-of-state" where common carrier took title and delivery in Kentucky of aviation fuel and the fuel was already in use before it reached an out-of-state destination.]

G. [2.76] SALES THROUGH VENDING MACHINES

No tax is imposed upon gross receipts from sales of tangible personal property sold through coin-operated bulk vending machines, if such sale amounts to twenty-five cents (\$0.25) or less, provided the retailer is primarily engaged in making such sales and maintains records satisfactory to the cabinet. "Bulk vending machine" means a vending machine containing unsorted merchandise which, upon insertion of a coin, dispenses the same in approximately equal portions, at random and without selection by the customer. [KRS 139.470(6).] Owners and operators of vending machines do not have to issue the purchaser a receipt separately stating the sales tax. [Kentucky Tax Alert (August 1990).]

H. [2.77] SALES TO STATE AND LOCAL GOVERNMENTS

No tax is imposed upon gross receipts from sales to any cabinet, department, bureau, commission, board, or other statutory or constitutional agency of the state and gross receipts from sales to counties, cities or special districts as defined in KRS 65.005. This exemption applies only to purchases of property or services for use solely in the government function. A purchaser not qualifying as a governmental agency or unit is not entitled to the exemption even though such purchaser may be the recipient of public funds or grants. [KRS 139.470(7).] [Note: Exemption applies only to purchases by state government and not to sales by state government.]

I. [2.78] RESIDENTIAL SEWER SERVICES, WATER AND FUEL

No tax is imposed upon gross receipts from the sale of sewer services, water and fuel to Kentucky residents for use in heating, water heating, cooking, lighting, and other residential uses. [KRS 139.470(8).]

J. [2.79] RESIDENTIAL TELEPHONE BILL SURCHARGE

No tax shall be imposed upon any rate increase for school taxes and any other charges or surcharges added to the total amount of a residential telephone bill. [KRS 139.470(9).]

K. [2.80] SALES TO NONRESIDENT TAX-EXEMPT ORGANIZATIONS

No tax shall be imposed upon sales to out-of-state entities exempt from sales and use tax in their state of residence provided the entity submits proof of exemption to the seller. [KRS 139.470(10).]

L. [2.81] TANGIBLE PERSONAL PROPERTY USED IN MANUFACTURING OR INDUSTRIAL PROCESSING AND PURCHASED FOR RESALE

No tax shall be imposed upon tangible personal property to be used in the manufacturing or industrial

processing of tangible personal property which will be for sale. Such property shall be regarded as having been purchased for resale.

"Industrial processing" includes refining, extraction of petroleum and natural gas, mining, quarrying, fabricating and industrial assembling. "Tangible personal property to be used in the manufacturing or industrial processing of tangible personal property which will be for sale" shall mean: (i) materials which enter into and become an ingredient or component part of the manufactured product; (ii) other tangible personal property which is directly used in manufacturing or industrial processing, if such property has a useful life of less than one (1) year, i.e., raw materials, supplies and industrial tools; and (iii) materials and supplies that are not reusable in the same manufacturing process at the completion of a single manufacturing cycle. A single manufacturing cycle is considered to be the period elapsing from the time the raw materials enter into the manufacturing process until the finished product emerges at the end of the manufacturing process.

It should be noted that in none of the three (3) categories is any exemption provided for repair, replacement or spare parts. Repair, replacement or spare parts are not considered to be materials, supplies, or industrial tools directly used in manufacturing or industrial processing. [KRS 139.470(11).]

M. [2.82] LOCOMOTIVES OR ROLLING STOCK

No tax shall be imposed upon locomotives or rolling stock, including materials for the construction, repair, or modification thereof, or fuel or supplies for the direct operation of locomotives and trains, used or to be used in interstate commerce. [KRS 139.480(1).]

N. [2.83] COAL FOR ELECTRICITY

No tax shall be imposed upon coal for the manufacturing of electricity. [KRS 139.480(2).]

O. [2.84] FUELS USED IN MANUFACTURING, MINING OR REFINING

No tax shall be imposed upon energy or energy-producing fuels used in the course of manufacturing, processing, mining, or refining to the extent that the cost of the energy or energy-producing fuels used exceeds 3% of the cost of production. Cost of production shall be computed on the basis of plant facilities which shall mean all permanent structures affixed to real property at one (1) location. [KRS 139.480(3).] [See, Revenue Cabinet v. James B. Beam Distillery Company, Kentucky Supreme Court, No. 89-SC000697-DG (9-27-90) holding that separate and distinct bottling and warehousing operations of taxpayer were not required to be included in computing production cost of distillery operations.]

P. [2.85] LIVESTOCK

No tax shall be imposed upon livestock of a kind the products of which ordinarily constitute food for human consumption provided the sales are made for breeding or dairy purposes and by or to a person regularly engaged in the business of farming. [KRS 139.480(4).] [See, Shadowlawn Farm v. Revenue Cabinet, Ky., 779 S.W.2d 232 (1989) holding that horses are not "livestock" since they are not consumed at the dinner table.]

Q. [2.86] POULTRY

No tax shall be imposed upon poultry for use in breeding or egg production. [KRS 139.480(5).]

R. [2.87] FARM WORK STOCK

No tax shall be imposed upon farm work stock for use in farming operations. [KRS 139.480(6).]

S. [2.88] SEEDS AND FERTILIZER

No tax shall be imposed upon seeds, the products of which ordinarily constitute food for human consumption or are to be sold in the regular course of business, and commercial fertilizer to be applied to land, the products from which are to be used for food for human consumption or are to be sold in the regular course of business; provided such sales are made to farmers regularly engaged in the occupation of raising and feeding livestock or poultry or producing milk for sale. [KRS 139.480(7).]

T. [2.89] FEED

No tax shall be imposed upon feed, including premixes and feed additives, for livestock or poultry of a kind the products of which ordinarily constitute food for human consumption. [KRS 139.480(8).] [See, Stoner Creek Stud. Inc. v. Revenue Cabinet, Ky., 746 S.W.2d 73 (1987) holding that feed purchased for use in horse farm operations are not exempt.]

U. [2.90] MACHINERY USED FOR NEW AND EXPANDED INDUSTRY

No tax shall be imposed upon machinery for new and expanded industry. [KRS 139.480(10).]

"Machinery for new and expanded industry" means that machinery used directly in the manufacturing or processing production, which is incorporated for the first time into plant facilities established in this state, and which does not replace machinery in the plants, or machinery purchased to replace existing machinery which will increase the consumption of recycled materials at the facility by 10% or more. It does not include repair, replacement or spare parts of any kind regardless of whether such items are required by the manufacturer or vendor as a condition of sale or as a condition of the warranty. "Repair, replacement or spare parts" means any tangible personal property used to maintain, restore, mend or repair machinery or equipment; however, it does not include "machine oils, grease or industrial tools". [KRS 139.170(2).]

The term "processing production" shall include "the processing and packaging of raw materials, end process materials, and finished products; the processing and packaging of farm and dairy products for sale; and the extraction of minerals, ores, coal, clay, stone and natural gas."

In applying this exemption, the courts in Kentucky have adopted the "integrated plant theory" which characterizes the manufacturing or processing production as beginning with the movement of raw materials from storage and introduction into a continuous, unbroken, integrated process and ends when the product being manufactured or processed is packaged or ready for sale. [See, Schenley Distillers, Inc. v. Commonwealth ex rel. Lockett, Ky., 467 S.W.2d 598 (1971) holding that a conveyor system which carries empty bottles from a loading point to the bottling lines is machinery used in the manufacturing process; Ross v. Green & Webb Lumber Co., Inc., Ky., 567 S.W.2d 302 (1978) holding that all steps along a continuous manufacturing process constitute steps within the manufacturing process; Revenue Cabinet v. Amax Coal Co., Ky., 718 S.W.2d 947 (1986) (holding: (i) that machinery which is essential to the manufacturing process and required by law in order to perform process is deemed to be used directly in the manufacturing process; (ii) that a roof bolter was an indispensable part of the mining process and therefore exempt; and (iii) that reclamation machinery and equipment was an integral step in the process of extraction; and (iv) that sets of batteries and charges used to power an underground coal mining scoop were used directly in extraction processing; and Revenue Cabinet v. Carpenter Construction Co., Ky., 763 S.W.2d 130 (1988) holding that machinery used in an asphalt plant owned by a highway contractor was part of integrated enterprises and, therefore, exempt even though the asphalt was not sold to third parties

but consumed in the contractor's business.]

V. [2.91] FARM MACHINERY

No tax shall be imposed upon farm machinery which is machinery used exclusively and directly in the occupation of tilling the soil for the production of crops as a business, or in the occupation of raising and feeding livestock or poultry or of producing milk for sale. The term also includes machinery, attachments, and replacements therefor, repair parts, and replacement parts which are used or manufactured for use on, or in the operation of farm machinery and which are necessary to the operation of the machinery, and are customarily so used. This exemption shall not include automobiles, trucks, trailers and truck-trailer combinations. [KRS 139.480(11).] [See, Stoner Creek Stud, Inc., *supra*, holding that horses are not livestock within meaning of statute.]

W. [2.92] POLLUTION CONTROL FACILITY

No tax shall be imposed upon property which has been certified as a pollution control facility. [KRS 139.480(12).] A pollution control facility shall mean and include:

1. Any property designed, constructed, or installed as a component part of any commercial or industrial premises for the primary purpose of eliminating or reducing the emission of, or ground level concentration of, particulate matter, dust, fumes, gas, mist, smoke, vapor, or odorous substances, or any combination thereof which renders air harmful or inimical to the health of persons or to property within Kentucky;

2. Any disposal system or any treatment works, pretreatment works, appliance, equipment, machinery, or installation constructed, used, or placed in operation primarily for the purpose of reducing, controlling, or eliminating thermal pollution or water pollution caused by industrial waste, or what would be industrial waste, if discharged into the waters of Kentucky;

3. Any disposal system or any appliance, equipment, machinery or installation constructed, used or placed in operation primarily for disposing of solid waste or converting solid waste into an item of real economic value;

4. Any property designed, constructed, or installed as a component part of any commercial or industrial premises for the primary purpose of eliminating or reducing the emission of sound which is harmful or inimical to the health of persons or to property, or materially reduces the quality of the environment in Kentucky;

5. Any property designed, constructed, or installed for the primary purpose of removing substances from raw materials, which substances, if permitted to become a component part of the finished product, would have a deleterious effect on the environment when the finished product was utilized. [KRS 224.850.]

The exemption also applies to all materials, supplies and repair and replacement parts purchased for use in the operation or maintenance of a pollution control facility used in the steel making process. This exemption expires June 30, 1994.

X. [2.93] TOMBSTONES

No tax shall be imposed upon tombstones or other memorial grave markers. [KRS 139.480(13).]

Y. [2.94] ON-FARM FACILITIES USED FOR GRAIN OR SOYBEAN STORING, DRYING, PROCESSING OR HANDLING

No tax shall be imposed upon on-farm facilities used exclusively for grain or soybean storing, drying, processing, or handling. The exemption applies to the equipment, machinery, attachments, repair and replacement parts, and any materials incorporated into the construction, renovation, or repair of the facilities. [KRS 139.480(14).]

Z. [2.95] ON-FARM FACILITIES AND EQUIPMENT USED EXCLUSIVELY FOR RAISING CHICKENS

No tax shall be imposed upon on-farm facilities used exclusively for raising chickens. The exemption shall apply to the equipment, machinery, attachments, repair and replacement parts, and any materials incorporated into the construction, renovation, or repair of the facilities. The exemption shall apply, but not be limited to, vent board equipment, water and feeding systems, brooding systems, ventilation systems, alarm systems and curtain systems. In addition, the exemption shall apply whether or not the seller is under contract to deliver, assemble and incorporate into real estate the equipment, machinery, attachments, repair and replacement parts and any materials incorporated into the construction, renovation, or repair of the facilities. [KRS 139.480(15).]

AA. [2.96] GASOLINE, SPECIAL FUELS, AND LPG USED FOR AGRICULTURAL PURPOSES

No tax shall be imposed upon "gasoline", "special fuels" or "liquidated petroleum gas" used to operate or propel stationary engines or tractors for "agricultural purposes". [KRS 139.480(16).]

AB. [2.97] SCHOOL BOOKSTORES AND TEXTBOOKS

No tax shall be imposed upon textbooks, including related course materials, purchase for use in a course of study conducted by a resident nonprofit educational institution exempt under Section 501(c)(3) of the Internal Revenue Code. "Course materials" does not include notebooks, paper, pencils, calculators, tape recorders or similar student aids. [KRS 139.480(17).] Also exempt are sales by school bookstores of textbooks, workbooks and other course materials. [KRS 139.495.]

AC. [2.98] ALCOHOL PRODUCTION FACILITIES

No tax shall be imposed upon any property which has been certified as an alcohol production facility. [KRS 139.480(18).] "Alcohol production facility" shall mean and include any property or any facility which is not fueled by petroleum but fueled by Kentucky coal, or in the process of converting to the use of coal with the completion date to be in two (2) years or less, and designed, installed, or constructed as a component part of any commercial or industrial premises for the primary purpose of producing ethanol derived from agricultural products or by-products for use as a motor fuel. [KRS 247.910(1).]

AD. [2.99] AIRCRAFT USED IN INTERSTATE COMMERCE

No tax shall be imposed upon aircraft, repair and replacement parts therefor, and supplies, except fuel, for the direct operation of aircraft in interstate commerce and used exclusively for the conveyance of property or passengers for hire. Nominal intrastate use shall not subject the property to tax. [KRS 139.480(19).]

AE. [2.100] FLUIDIZED-BED ENERGY PRODUCTION FACILITIES

No tax shall be imposed upon any property which has been certified as a "fluidized bed energy

production facility." [KRS 139.480(20).] A "fluidized bed energy production facility" shall mean any facility or property in Kentucky which is fueled by Kentucky coal and which employs fluidized bed combustion technology installed after July 31, 1986, to burn coal for the production of thermal, mechanical or electrical energy. [KRS 211.390.]

AF. [2.101] BLAST FURNACES - CONSTRUCTION MATERIALS

No tax shall be imposed upon any property to be incorporated into the construction, rebuilding, modification or expansion of a blast furnace or any of its components or appurtenant equipment or structures. The exemption provided in this subsection shall be effective for sales made through June 30, 1992. [KRS 139.480(21).]

AG. [2.102] FOOD STAMP PURCHASES

No sales or use tax shall be imposed upon any food or food items purchased for human consumption with food coupons issued pursuant to the Food Stamp Act of 1977 and required to be exempted by the Food Security Act of 1985. [KRS 139.480(22).]

AH. [2.103] PRESCRIPTION MEDICINE AND PROSTHETIC DEVICES

No tax shall be imposed upon "prescription medicines", "prosthetic devices" and "physical aids". [KRS 139.472.]

"Prescription medicine" includes: (i) any substance or preparation intended for use by external or internal application to the human body in the diagnosis, cure, mitigation, treatment or prevention of disease and which is commonly recognized as a substance or preparation intended for such use which is prescribed for the treatment of a human being by a person authorized to prescribe the medicines and dispensed on prescription by a registered pharmacist in accordance with law; and (ii) medical oxygen when purchased by the patient for private use.

The provision of medical oxygen regardless of the mode of delivery, whether by oxygen concentrator, high pressure cylinder or cryogenic tank is exempt. [103 KAR 30:020(4).]

"Prosthetic devices and physical aids" shall mean and include artificial devices prescribed by a licensed physician, or individually designed, constructed or altered solely for the use of a particular crippled person so as to become a brace, support, supplement, correction or substitute for the bodily structure including the extremities of the individual; artificial limbs, artificial eyes, hearing aids prescribed by a licensed physician, or individually designed, constructed or altered solely for the use of a particular disabled person; crutches, walkers, hospital beds, wheelchairs and wheelchair lifting devices for the use of invalids and crippled persons; colostomy supplies, insulin and diabetic supplies, such as hypodermic syringes and needles, and sugar (urine and blood) testing materials purchased for use by diabetics. [See, Medi-Sell Corporation d/b/a Electro-Med Systems v. Revenue Cabinet, Ky. Ct. App., No. 90-CA-2135 (1991) holding that transcutaneous electrical nerve stimulators (TENS) are exempt; and John W. Bianchi, D.M.D. v. Revenue Cabinet, Harlan Circuit Court, No. 88-X-003 (11-10-89) (currently on appeal) holding that dental prosthetic devices, consisting of dentures, crowns, bridges, braces, inlays, etc., were exempt.]

AI. [2.104] SHIPS OR VESSELS TRANSPORTING PROPERTY OR PERSONS

No tax shall be imposed upon ships and vessels, including property used in the repair or construction of, supplies and fuel consumed in the operation of, and supplies consumed by crew members aboard such ships and vessels which are used principally in the transportation of property or in the conveyance of persons for hire. [KRS 139.483.]

AJ. [2.105] FILMS LEASED OR RENTED BY COMMERCIAL MOTION PICTURE THEATERS

No tax shall be imposed upon monies paid for the lease or rental of films by commercial motion picture theaters when the lease or rental is for the sole purpose of use in the normal course of business if an admission fee is charged and if the commercial motion picture theater collects and remits all other applicable sales and use taxes, including, but not limited to, that on admissions. [KRS 139.484.]

AK. [2.106] FOOD FOR HUMAN CONSUMPTION

No sales or use tax shall be imposed upon food for human consumption. [KRS 139.485.] [NOTE: Prepared meals are taxable.]

AL. [2.107] INDUSTRIAL MACHINERY SOLD FOR OUT-OF-STATE USE

No tax shall be imposed upon "industrial machinery" when delivered to a manufacturer or process or their agent for use out of state. [KRS 139.487.] "Industrial machinery" means machinery manufactured in Kentucky directly used in manufacturing or processing which operations encompass all activities commencing with the receipt of the raw materials through the point at which the finished product is ready for sale and delivery to the purchaser. The term "processing" shall include: the processing and packaging of raw materials, in-process materials and finished products, the processing and packaging of farm and dairy products for sale; and the extraction of minerals, ores, coal, clay stone and natural gas. [KRS 139.486.]

Industrial machinery will be presumed for sale, use, storage or consumption outside the state if: (i) delivery is to a common carrier, whether chosen by the seller or by the purchaser, and whether F.O.B. seller's shipping point or F.O. B. purchaser's destination; provided the shipping documents indicate delivery to a location outside the state; or (ii) delivery is made by the seller's own transportation vehicles to a location outside the state. [KRS 139.488.]

AM. [2.108] HORSE INDUSTRY

No tax shall be imposed upon:

1. Horses or interests or shares in horses, provided the purchase or use is made for breeding purposes only. [Cf., Castleton, Inc. v. Revenue Cabinet, KBTA Order No. R-11025 (4-17-86) holding that taxpayer's purchases of fillies at auction were exempt for breeding purposes even though horses were raced temporarily.]

2. Stallion services, including the trading but not the sale thereof, providing the use or trading is made by the owner of the stallion of an interest or share in the stallion.

3. Horses less than two years of age at the time of sale, provided the sale is made to a non-resident of Kentucky, and the horse is transported out of the state, either immediately following the sale or immediately following training within the state if the horse is kept temporarily within the state for training purposes following the sale. Several questions are presented by this provision, namely, when is a horse more than "2 years old"? What is the definition of a "nonresident"? What constitutes "training" or a "temporary stay" in Kentucky? In that regard, the Revenue Cabinet has informally indicated acceptance of the Jockey Club's determination that a horse is two years old upon the second anniversary of January 1 following the foaling date. Chapter 139 has no definition of nonresident; presumably the definition for income tax purposes will control. [Cf., 103 KAR 17:010.] Lastly, there have been no cases or administrative announcements addressing what constitutes "training" or "temporary stay" within Kentucky.

4. Receipts for boarding and training of horses within this state, nor to the temporary use of horses within this state for purposes of racing, exhibiting, or performing. [KRS 139.531.]

5. In addition to the above statutory exemptions, the author has recently received a ruling from the Revenue Cabinet exempting a foal sharing arrangement from tax whereby the owner of a season to a stallion standing in Kentucky and a mare owner agree to breed the mare to the stallion and sell the resulting foal, splitting the sale proceeds and expenses thereto. This ruling also exempted the leasing of a brood mare in consideration of a share of the proceeds from the sale of the resulting foal.

AN. [2.109] BLOOD OR HUMAN TISSUE

No tax shall be imposed upon the procurement, processing, distribution or use of whole blood, plasma, blood products, blood derivatives and other human tissues such as corneas, bones or organs for the purpose of injecting, transfusing or transplanting any of them into the human body. Such acts are deemed to be the rendition of a service by every person participating therein and, whether or not any remuneration is paid therefor, and are not to be considered a sale of such whole blood plasma, blood products, blood derivatives or other tissues. [KRS 139.125.] [Cf., Revenue Cabinet v. Plasma Alliance, Inc., Ky., 794 S.W.2d 639 (1990) holding that use tax on items of tangible personal property used in the collection and processing of source plasma which was ultimately processed into plasma proteins that were injected into the human body was properly imposed since the activities of the taxpayer constituted a service rather than a sale rendering inapplicable the industrial materials and supplies exemption.]

AO. [2.110] REFUNDABLE CREDIT FOR MOTION PICTURE PRODUCTION EXPENDITURES

Any motion picture production company which films or produces one or more motion pictures in Kentucky during any twelve (12) month period shall, upon making application therefor and meeting certain other requirements, be entitled to a refundable tax credit equal to the amount of Kentucky sales and use tax paid for purchases made in connection with the filming or production of a motion picture. [KRS 139.5383.]

The credit applies only to expenditures made by check drawn on a federally insured Kentucky bank or savings and loan institution. To claim the credit, a motion picture production company must: (i) provide the Revenue Cabinet prior to the commencement of filming with the address of the Kentucky location where records of sales expenditures will be kept and the name of the recordkeeper and (ii) file an application for the tax credit within 60 days after completing filming or production in Kentucky in accordance with regulations promulgated by the Cabinet. [KRS 139.4382.]

AP. [2.111] ENTERPRISES ZONES - CONSTRUCTION MATERIALS AND MACHINERY

No tax shall be imposed upon building materials used in remodeling, rehabilitation or new construction in a zone and new and used equipment and machinery purchased by qualified businesses for use in the zone, certified by the purchaser to be used for these purposes. [KRS 154.690(3).]

AQ. [2.112] GASOLINE AND SPECIAL FUELS

No tax shall be imposed upon sales of gasoline and special fuels otherwise subject to tax by Chapter 138 of the Kentucky Revised Statutes. [KRS 139.050(3)(e).]

AR. [2.113] MOTOR VEHICLES

No tax shall be imposed upon sales of motor vehicles, including motorcycles, that are registered for use on public highways and upon which any applicable motor vehicles used tax levied by KRS 138.460(1) has

been paid. [See, Mountain Ford, Inc. v. Revenue Cabinet, Ky. Ct. App. No. 93-CA-000810-MR (1994) holding that gross receipts from dealer add-ons, such as undercoating and rustproofing, were not subject of sales tax since motor vehicle usage tax applied and was collected even though motor vehicle usage tax was not collected upon such add-ons.) Mobile homes, camper trailers and boat trailers are not motor vehicles and are subject to tax. Trailers and semitrailers having a load capacity over 1,000 pounds designed to be drawn by motor truck or truck tractor are exempt. [103 KAR 27:100.]

AS. [2.114] SALE FOR RESALE

A sale for resale is exempt by virtue of the definition of "retail sale" or "sale at retail". [KRS 139.100(1)(a).]

AT. [2.115] SALES MADE BY PERSONS NOT ENGAGED IN THE BUSINESS OF SELLING

The first \$1,000 of sales made by individuals at garage or yard sales or by nonprofit organizations at fund raising events is exempt from tax. [KRS 139.496.]

AU. [2.116] SALES BY ELEMENTARY OR SECONDARY SCHOOLS AND AFFILIATED ORGANIZATIONS

No tax shall be imposed upon sales by elementary or secondary schools or by affiliated nonprofit organizations, such as booster clubs, whose membership is comprised of individuals other than students, provided the net proceeds from such sales are used for the benefit of such schools or its students. Also exempt are sales made pursuant to agreements with organizations to participate in fund-raising campaigns for a percentage of the gross receipts where students act as salesmen for taking orders for sale of tangible personal property. [KRS 139.497.]

AV. [2.117] SALES TO EDUCATIONAL, CHARITABLE AND RELIGIOUS INSTITUTIONS

See, discussion at § 2.21.

AW. [2.118] SALES OF FOOD TO STUDENTS

See, discussion at § 2.21.

AX. [2.119] SALES BY SCHOOL-SPONSORED ORGANIZATIONS

No tax shall be imposed upon sales by nonprofit, school-sponsored clubs and organizations (other than sales of tickets to athletic events). [KRS 139.495(4).]

AY. [2.120] ADMISSIONS TO HISTORICAL SITES

No tax shall be imposed upon admissions to "historical sites" operated by a nonprofit organization. [KRS 139.482(2).] "Historical site" means "property listed by the U.S. Department of Interior in the National Register as authorized by Title 16, USC § 47(f)." [KRS 139.482(1).] Admissions to historical sites to view plays, performances or other events, however, are taxable.

AZ. [2.121] SALES FOR RESTORATION OR MAINTENANCE OF HISTORICAL SITE

No tax shall be imposed upon sales of materials, supplies and services to a nonprofit organization to be used to restore, maintain or operate a "historical site". [KRS 139.482.]

BA. [2.122] RACE TRACK ADMISSIONS

Amounts paid for a person to enter a race track at which a race track meeting is being conducted under the jurisdiction of the state racing commission requiring payment of the \$0.15 per person race track admission tax are not subject to tax. [KRS 139.100.] In addition, amounts paid to obtain upgraded seating at the race track are not taxable since they are considered to be a result of the admission paid to enter the race track which is subject to the \$0.15 per person admission tax. [Cf., Revenue Cabinet v. Churchill Downs Incorporated, Franklin Circuit Court (Division I) No. 86-CI-1708 (1-1090).] Note, however, that the Revenue Cabinet asserts that sales tax is due upon admission charges to simulcast wagering facilities since such admissions are exempt from the \$0.15 tax on race track admissions. [See, Vol. 8 Kentucky Tax Alert No. 11 (November 1989).]

BB. [2.123] FARM CHEMICALS

No tax shall be imposed upon insecticides, fungicides, herbicides, rodenticides and other farm chemicals purchased for use by farmers regularly engaged in the occupation of tilling the soil for the production of crops as a business or in the occupation of raising and feeding livestock or poultry, the products of which ordinarily constitute food for human consumption. [139 480(8).]

BC. [2.124] MACHINERY FOR RECYCLING

Machinery or equipment purchased or leased primarily for recycling purposes is exempt. [KRS 139.480(22)]

BD. [2.125] RATITE INDUSTRY

No tax is imposed on the purchase of ratite birds and eggs used for breeding and production for sale of ratite by-products, including feed and feed additives, related farm chemicals, equipment and machinery used in connection therewith. [KRS 139.480(24).]

VI. [2.126] BASIS OF TAX

A. [2.127] SALES TAX

1. [2.128] GENERALLY

The sales tax is applied to "gross receipts", meaning the total amount of the sale, lease or rental price, valued in money, whether received in money or otherwise. [KRS 139.060(1); KRS 139.600.]

2. [2.129] TRADE-IN

If as a part of a transaction a purchaser receives credit from a seller for property traded and if the property so traded is of a like kind and character to the property purchased, and if the property traded is held for resale by the seller, the gross receipts of the seller will not include the amount of the credit granted to the purchaser by the seller.

3. [2.130] CASH DISCOUNTS

Cash discounts are not included in "gross receipts," but premium or trading stamps are not considered discounts and are taxable at either stated cash value or upon the fair cash value of merchandise for which the stamps are traded. [KRS 139.050(3)(a); 103 KAR 28:040.]

4. [2.131] FREIGHT CHARGES

"The cost of transportation of the property prior to its sale to the purchaser" is included in gross receipts. [KRS 139.050(1)(c).] If transportation is provided by facilities other than those of the retailer, i.e., independent contractor, common carrier, U.S. Mail, or its equivalent, the cost is not included in gross receipts. The tax applies to charges for transportation of property to a purchaser by facilities of the retailer, unless: (a) the transportation occurs after title to the property has passed to the purchaser; or (b) the charge are separately stated, and are incurred for the transportation from the retailer's place of business or other point from which shipment is made directly to a place specified by the purchaser. In this instance, the charge for the retailer's transportation must be reasonable. [103 KAR 30:070(2).] [See, Revenue Cabinet v. Corum & Edwards, Inc., Ky., 673 S.W.2d 736 (1984) holding that "zone charges" and "trip charges" charged customers by seller of ready-mix concrete were not included in gross receipts since such delivery charges were incurred after title passed to customer, i.e., at seller's plant once ingredients were irretrievably mixed.]

5. [2.132] FINANCE CHARGES

With the exception of leases executed or renewed after August 1, 1985, finance charges, carrying charges, or interest charges are not included in gross receipts if the amount of such charges is in addition to the usual or established cash selling price and is segregated on an invoice, bill of sale, or billed separately to the customer. [103 KAR 30:050.]

6. [2.133] INSTALLATION CHARGE

The price received for labor or services used in installing or applying the property sold is not included in gross receipts. [KRS 139.050(3)(c).]

7. [2.134] GRATUITIES

Charges added to the cost of a product are considered services that are part of the selling price or gross receipts. Voluntary tips left by customers are not taxable. [Revenue Circular 51C001-S2.]

8. [2.135] RETURNED GOODS

The sales price of goods which are returned for a full refund, in cash or credit, are excluded from "gross receipts". [KRS 139.050(3).]

9. [2.136] BAD DEBTS

A retailer is relieved from liability to pay sales tax on accounts which are worthless and written off for income tax purposes. If the tax has been previously paid on the worthless account, the retailer may take a deduction of that amount. If the account is thereafter, in whole or in part, collected by the retailer, the amount collected must be included in the first return filed thereafter. [KRS 139.350.]

B. [2.137] USE TAX

1. [2.138] GENERALLY

The use tax is imposed on the "sales price" of the property used, stored, or consumed in Kentucky. KRS 139.310.

2. [2.139] SELF-PRODUCED GOODS

Use tax is not imposed upon items fabricated by a business for its own use. However, the materials or components utilized in such fabrication are subject to tax at the time of purchase.

3. [2.140] CONSTRUCTION MACHINERY AND EQUIPMENT BROUGHT INTO KENTUCKY FOR TEMPORARY USE

See, discussion at § 2.42.

4. [2.141] CREDIT FOR SALES TAX PAID IN STATES GRANTING RECIPROcity

See, discussion at § 2.56.

VII. [2.142] RATE OF TAX

A. [2.143] STATE RATE

Effective July 1, 1990, the rate of tax for both sales and use tax is 6%.

B. [2.144] GRANDFATHER RULES

The 5% rate of tax shall continue to be imposed upon: (i) tangible personal property purchased for use in the performance of a lump sum, fixed fee contract executed on or before March 9, 1990; (ii) sales made under a fixed price contract executed on or before March 9, 1990 provided the contract specifies a 5% rate of tax; and (iii) lease or rental payments from agreements entered into on or before March 9, 1990.

C. [2.145] LOCAL GOVERNMENT TAXES

A city in Kentucky, depending upon its classification, may impose numerous local taxes. Counties are not permitted to levy sale or use taxes. However, county boards of education may impose occupational taxes, ad valorem taxes or gross receipts utility taxes for education purposes. If the gross receipts utility tax is selected, the utility may increase its rate and pass the tax on to the customer. The rate increase is not subject to sales tax. [KRS 139.470(9).]

VIII. [2.146] ADMINISTRATION

A. [2.147] RESPONSIBLE ADMINISTRATIVE AGENCY

Revenue Cabinet, P.O. Box 3, 200 Fair Oaks Lane, Bldg.#2, Frankfort, Kentucky 40601 (Taxpayer Ombudsman: (502) 564-7822).

B. [2.148] SELLER'S PERMIT

See discussion at § 2.25.

C. [2.149] REPORTING/ PAYMENT PROCEDURES

1. [2.150] FORM

Sales and use taxes are reported on sales and use tax returns provided for each reporting period by the Revenue Cabinet. The accrual basis is normally used; however, receipts may be reported on the cash basis

if the taxpayer's records are maintained on a cash basis and all cash receipts received during the month are included in the total receipts for the month. The Revenue Cabinet may require all taxpayers whose average monthly sales and use tax liability exceeds \$25,000 to remit the tax by electronic funds transfer.

2. [2.151] TIME FOR FILING

Returns are filed monthly and, together with the tax, must be filed with the Revenue Cabinet on or before the 20th days of the next succeeding calendar month. [KRS 139.540, 139.550.] In the discretion of the Cabinet, taxpayers may be permitted to file quarterly. [KRS 139.590.] Effective July 1, 1988, taxpayers whose average monthly sales and use tax liability exceeded \$10,000.00 per month for the calendar year 1987, are requested to file on the 25th day of each month for the period including the 16th of the previous month through the 15th of the current month. [103 KAR 25:131.]

3. [2.152] USE TAX SCHEDULE

In addition to the information required on the monthly return, the Cabinet requires that the taxpayer prepare and retain a schedule of all purchases, the name and address of the vendor, and the purchase price of all amounts subject to the use tax.

4. [2.153] EXTENSION OF TIME FOR FILING

The Revenue Cabinet shall upon written request received on or prior to the due date of any return or tax, for good cause, extend time for filing the return or paying the tax for a period not exceeding 30 days. In addition, interest is payable at the statutory prescribed rate from the date on which the tax would have otherwise been paid. [KRS 139.610.]

D. [2.154] PENALTIES

1. [2.155] CIVIL PENALTIES

Effective for tax returns due on or after August 1, 1992, and all taxes assessed on or after December 31, 1992, sales and use tax civil penalties are assessed under the Uniform Civil Penalty Act.

(a) [2.156] FAILURE TO TIMELY FILE RETURN

Failure to file a timely return by the due date is subject to a 2% of the total tax due for each 30 days it is late, unless the failure is due to reasonable cause.

(b) [2.157] FAILURE TO TIMELY PAY TAX

The failure to withhold or collect as required by law or failure to pay the tax due on a return on or before the due date is subject to a penalty of 2% of the tax not withheld, collected or timely paid for each 30 days the withholding, collection or payment is late, unless the failure is due to reasonable cause.

(c) [2.158] NEGLIGENCE

If an assessment is the result of negligence, a penalty of 10% of the assessment may be imposed. [See, Genex/London, *supra*, which holds under prior law that a penalty for negligence may be avoided if the taxpayer relied upon the opinion of a competent, independent tax advisor to whom all relevant facts were disclosed.]

(d) [2.159] FRAUD

If an assessment is the result of fraud, a penalty of 50% of the assessment may be imposed.

(e) [2.160] REASONABLE CAUSE

The Revenue Cabinet has the power to waive penalties that have accrued for reasonable cause. Reasonable cause means an event, happening or circumstance entirely beyond the knowledge or control of a taxpayer who has exercised due care and prudence.

2. [2.161] COLLECTION FEES

(a) [2.162] GENERAL

If a taxpayer fails to pay the tax assessed and not protested within 45 days of the assessment date, a 2% penalty is added for each 30 days or fraction thereof that the tax is final due and owing yet unpaid.

(b) [2.163] AMNESTY COLLECTION FEE

If the assessment related to a period ending prior to December 1, 1987, a fee of 20% of the deficiency is added, which fee is increased to 50% in the event a return is not filed. Such fees are waivable if the failure to pay or to file is due to reasonable cause. [KRS 131.440.]

3. [2.164] CRIMINAL PENALTIES

The following acts constitute class B misdemeanors punishable by fines of up to \$250 or imprisonment for up to 90 days, or both:

(a) using a resale certificate with knowledge that property acquired is not intended to be held for resale;

(b) using an exemption certificate with knowledge that the property acquired is not exempt;

(c) using a direct pay authorization other than in compliance with 103 KAR 31:030;

(d) representing to the consumer that taxes owed will be absorbed or paid by the retailer;

(e) failing to display the tax owed separately from the price of the goods sold, both in advertising and in billing;

(f) failing to collect taxes for personal property sold or delivered for use within the state;

(g) engaging in business as a seller in the state without the required permit or after one has been suspended; and

(h) failing to comply with the regulations promulgated under KRS 139.230 (dealing with bracket schedules).

E. [2.165] SECURITY FOR PAYMENT OF TAXES

KRS 139.660 describes the circumstances under which the Revenue Cabinet may, within limits, require security for the payment of taxes. See, discussion at § 2.27.

F. [2.166] COMMISSION FOR TIMELY REMITTANCE OF TAX

Taxpayers who timely file and remit taxes due are entitled to a commission equal to 1.75% of the first \$1,000.00 in taxes, and an additional commission of 1% of the excess. The commission can be deducted on the face of the return. [KRS 139.570.]

G. [2.167] CONFIDENTIALITY OF RETURNS

The Revenue Cabinet is required to preserve the confidentiality of tax returns, with certain exceptions provided by statute. [KRS 131.190.]

H. [2.168] ASSESSMENTS

1. [2.169] STATUTE OF LIMITATIONS

Assessments of tax deficiencies must be made by the Cabinet within four years from the date when the return was filed, which is presumed to be the last day prescribed for the filing thereof. Failure to obtain a permit, failure to file a return, or the filing of a fraudulent return, is not subject to any statute of limitations. A taxpayer may waive the statute of limitations and the Revenue Cabinet has treated such waiver as an extension of time for the filing of refund claims as well. [KRS 139.620.] [NOTE: Effective for periods after June 30, 1990, the provision which authorized the Revenue Cabinet to assess additional tax within six years from the date the return was filed was repealed.]

2. [2.170] INTEREST

Effective July 1, 1978, interest accrues at the established "tax interest rate." The rate is adjusted not later than November 1, of each year. If the adjusted prime rate charged by banks during October of each year rounded to the nearest full percent is at least one percentage point more or less than the tax interest rate which was then in effect, the tax interest rate is subject to adjustment. The tax interest rate shall be equal to the prime rate charged by banks rounded to the nearest full percent and becomes effective on January 1 of the immediately succeeding year.

I. [2.171] PROTEST AND SUPPORTING STATEMENT

The taxpayer upon whom deficiency assessments are levied is mailed a Notice of Tax Due reflecting the total amount of the tax claim, any penalties assessed, and interest calculated to a designated date. If the taxpayer wishes to protest the assessment or any part thereof, the taxpayer, or his representative, is required to file a written protest and supporting statement reciting the ground relied upon in opposing the assessment within 45 days from the date of the notice. No extension of time can be granted for the filing of the protest, but upon the taxpayer's request and a demonstration that an extension of time for filing the supporting statement is necessary and unavoidable, the Cabinet, in its discretion, may grant such an extension. [KRS 131.110.] [See, Eagle Machine Co., Inc. v. Commonwealth ex rel. Gilles, Ky., 698 S.W.2d 528 (1985) holding that failure to provide any significant information challenging assessments constitutes attempt to evade assessment on collection of taxes; and Scotty's Construction Company, Inc. v. Revenue Cabinet, Ky., 779 S.W.2d 234 (1989) holding that failure for 8 months to supply supporting statements constituted failure to timely protest assessment.]

J. [2.172] FINAL RULING

After considering the taxpayer's protest, or within thirty days after the receipt of a request by a taxpayer, the Cabinet is required to mail a final ruling on any matters in controversy. The ruling must state on its face that it is a final ruling of the Cabinet, generally describe the issues in controversy, the Cabinet's position, and set forth the procedure for prosecuting an appeal to the Kentucky Board of Tax Appeals. [KRS 131.110(3)-(4).]

K. [2.173] ADMINISTRATIVE APPEALS

1. [2.174] TIME FOR FILING APPEALS

Appeals to the Kentucky Board of Tax Appeals must be filed within 30 days from the date of the Revenue Cabinet's final ruling. [KRS 131.340.] Depositing a petition of appeal in the mail properly addressed within the statutory time to perfect an appeal does not constitute filing. [See, Revenue Cabinet v. JRS Data Systems, Inc., Ky., 738 S.W.2d 828 (1987).]

2. [2.175] FORM OF PETITION OF APPEAL

The petition, while generally informal compared to a complaint in a civil action, is prescribed by regulation. [802 KAR 1:010.]

3. [2.176] KENTUCKY BOARD OF TAX APPEALS

All appeals from final rulings, orders, or other actions by the Revenue Cabinet must be filed in the Kentucky Board of Tax Appeals as constituted pursuant to KRS 131.310-330. The board is comprised of three members, not more than two of whom may be of the same occupation or profession, and are appointed by the Governor for four year terms. One must possess the qualifications of a Circuit Judge—eight years of legal practice and thirty-five years of age. [Kentucky Constitution, § 130.]

4. [2.177] HEARINGS

The board routinely assigns matters on appeal for an evidentiary hearing. The hearings are conducted in accordance with the Kentucky Rules of Civil Procedure and normally, although not required, all members of the board are present. A transcript of the proceedings is made by a court stenographer. The board will normally require briefs of the parties following the filing of the transcript of the hearing by the court reporter. KRS 131.355. Matters are then submitted and the board is required to make findings of fact, conclusions of law, and enter its order respecting the disposition of the appeal. [KRS 131.360.]

5. [2.178] APPEALS

Appeals from orders of the Kentucky Board of Tax Appeals may be perfected by the taxpayer to the circuit court of the county in which he conducts his business or to the Franklin Circuit Court. The Revenue Cabinet may perfect an appeal only to the Franklin Circuit Court. Cross appeals are permitted. Appeals to circuit courts must be filed within 30 days from the date of the board's order from which the appeal is taken. Review by the circuit court is limited to determinations of whether the order of the board was procured by fraud or misrepresentation whether the findings of fact are supported by substantial evidence of probative value, and whether the order is in conformity with law. [KRS 131.370.] Appeals to the Court of Appeals and motions for discretionary review to the Supreme Court are available in accordance with the Kentucky Rules of Civil Procedure.

L. [2.179] REFUNDS

1. [2.180] STATUTE OF LIMITATIONS

All refund claims must be made within four years of the due date of the return or the date taxes were paid, whichever is later. The cabinet provides a form for refunds. [KRS 139.770.] Additionally, the cabinet may offset overpayments received during an audit for a period or periods, together with interest against any assessments for underpayment against assessments for other periods covered in the audit. [KRS 139.620.]

2. [2.181] PROCEDURAL REQUIREMENTS

Claim for refund is not conditioned upon satisfaction of procedural requirements for filing of tax assessment; therefore failure to timely protest tax assessment does not preclude later refund claim if with applicable limitation period. [See, Revenue Cabinet v. Castleton, Inc., Ky., 826 SW2d 334 (1992).]

3. [2.182] INTEREST

Interest on refunds respecting taxes accruing after July 1, 1978, bear interest at 75% of the tax interest rate then in effect on deficiency assessments or late payment of taxes as discussed in § 2.165. [KRS 131.183.]

CHAPTER III.

KENTUCKY INDIVIDUAL INCOME TAXATION

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KENTUCKY INDIVIDUAL INCOME TAXATION

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I. [3.1] KENTUCKY INDIVIDUAL INCOME TAXATION

By
Randy L. Treece

Kentucky Individual Income taxation has been transformed in recent years into a constantly changing area of law. There are two reasons for this transformation. First, the Internal Revenue Code serves as the foundation for Kentucky Individual income taxation and it has been constantly changed by the United States Congress during the past fourteen years. Secondly, the Kentucky General Assembly has made numerous changes to the Kentucky tax statutes in order to raise additional revenue to fund various programs.

The materials that follow were written with the objective of providing a comprehensive overview of Kentucky personal income taxation. While these materials are not intended to be a Kentucky individual income tax return preparation guide, the organization of the materials for the most part mirrors the organization of the Kentucky Individual Income Tax Return, since many of the individual income tax questions arise during the preparation of the individual income tax return.

II. [3.2] INDIVIDUAL INCOME TAX JURISDICTION

A. [3.3] GENERAL

In presenting an overview of the Kentucky individual income taxation, the first question that comes to mind is: Who is subject to the Kentucky individual income tax? The answer: Any individual who has income from this state as a result of providing services, carrying on a trade or profession, or receives income from tangible or intangible property located in this state. See KRS 141.020(1) and 141.020(4). While both resident and nonresident individuals are subject to tax on income earned from activities carried on within Kentucky, the classification as a resident or nonresident has significant implications for Kentucky income tax purposes.

B. [3.4] RESIDENT TAXPAYERS

An individual classified as a resident of the State of Kentucky shall pay Kentucky income tax upon his entire net income. KRS 141.020(1). The foregoing reference to "entire net income" means the taxpayer's income from all sources, both intrastate and out-of-state. In order to avoid double taxation, KRS 141.070 does give an individual credit for income taxes paid to another state. As a result, a resident Kentucky taxpayer could end up being taxed on income earned in another state where the income tax rate is lower than Kentucky or does not have an income tax. Accordingly, many well-to-do Kentucky retirees attempt to establish residency in states which have no personal income taxation, such as Florida, Texas and Tennessee.

KRS 141.010(17) defines a "resident" as an individual domiciled within this state or an individual who is not domiciled in this state, but maintains a place of abode in this state and spends an aggregate of more than 183 days of the taxable year in this state. If an individual wishes to be classified as a nonresident for Kentucky individual income tax purposes, and he is in and out of the state during the course of a year, he must preserve adequate documentation to show his status as a nonresident. Two of the key requirements to a determination of residency are "domicile" and "place of abode." Both of these terms are amorphous and can be applied in a way most favorable to the Revenue Cabinet and the State Treasury.

C. [3.5] NONRESIDENTS SUBJECT TO TAXATION

KRS 141.010(18) defines a nonresident as any individual not a resident of the state. Pursuant to KRS 141.020(4), the income of a nonresident individual which is subject to Kentucky income tax is:

[T]he amount of income received from labor performed, business done, or from other activities in this state, from tangible property located in this state, and from intangible property which has acquired a business situs in this state; provided, however, that the situs of intangible personal property shall be at the residence of the real or beneficial owner and not at the residence of a trustee having custody or possession thereof. The remainder of the income received by such nonresident shall be deemed nontaxable by this state.

This statute makes clear that nonresident individuals are taxed only upon income resulting from services performed or business transacted within the state. Therefore, a nonresident individual can only be taxed upon income earned by him in Kentucky, while a resident taxpayer could be taxed upon income earned in another state. Nonresident taxpayers can only take deductions to the extent they are allocable to income subject to taxation in Kentucky. See KRS 141.010(11).

The taxation of a nonresident with respect to intangible property is somewhat confusing. According to KRS 141.020(4), a nonresident is taxable upon the income from intangible property which has acquired a business situs in Kentucky. Current Kentucky case law is not clear when intangible personal property will acquire a situs in Kentucky. Based upon an old case relating to personal property taxation, it appears that intangible property will acquire a business situs only when the intangible property is being actively used in some type of trade or business. See Kentucky Department of Revenue v. Bomar, 486 S.W. 2d 532 (1972).

D. [3.6] NONRESIDENTS EXEMPT FROM TAXATION

Fortunately, many nonresidents who earn income from Kentucky have been exempted from the Kentucky income tax. KRS 141.070(2) exempts nonresidents of Kentucky from the Kentucky income tax if their state has a similar exemption for residents of Kentucky. The Revenue Cabinet issued Revenue Circular 42C005 (Revised 10/1/88), which lists the states with which Kentucky has entered into agreements whereby Kentucky residents earning income in those states will not be subject to the income tax of those states. The specific states with which Kentucky has entered into agreements are as follows: Illinois, Indiana, Michigan, Ohio, Virginia, West Virginia, and Wisconsin.

In addition to exempting residents of the above states from Kentucky income taxation, and vice versa, Revenue Circular 42C005 provides that the individuals are also exempt from Kentucky withholding tax requirements. Most Kentucky employers who have a significant number of employees who are residents of another state will withhold taxes from the nonresident employee's paycheck based upon the withholding tax tables for that employee's state of residence. The employer then remits the withholding taxes directly to the nonresident employee's state of residence. While this results in additional paperwork for the employer, it prevents the employer from being involved in problems related to a nonresident employee's failure to make adequate tax payments to his state.

E. [3.7] PART-YEAR RESIDENTS

A nonresident who becomes a Kentucky resident during the year (i.e., part-year resident) gets schizophrenic tax treatment. He is treated as a nonresident until he becomes a Kentucky resident. KRS 141.020(6). This means he is taxable only on Kentucky source income before he becomes a resident. After he becomes a resident, he is required to include as Kentucky income all income from whatever source

derived. KRS 141.020(1) With respect to deductions, the taxpayer must prorate them on the basis of the ratio of Kentucky income (as determined above) to federal adjusted gross income. 103 Kentucky Administrative Regulation (hereafter "KAR") 17:060 Sections 2 and 3.

III. [3.8] FILING OF TAX RETURNS

A. [3.9] INCOME THRESHOLD

Once it is determined that an individual is subject to the Kentucky individual income tax, the next question is whether the individual must file a Kentucky income tax return. Under KRS 141.180, every individual subject to the Kentucky income tax laws who has an adjusted gross income of greater than \$5,000.00 must file an income tax return. There are four exceptions to the general rule.

The first two exceptions could be called the marriage exceptions. The first exception, which is set forth in KRS 141.180(1), provides that if the adjusted gross income of two married individuals living together exceeds \$5,000.00, then they must file an income tax return. For example, if they each had \$3,000 of income, they must file a return. The second exception is more favorable. KRS 141.180(2) provides that if two married individuals living together are both age 65 or older, they are required to file an income tax return only if their combined adjusted gross income exceeds \$5,400.00.

The third and fourth exceptions could be called the gross income exceptions. KRS 141.180(5) requires any nonresident individual with gross income from Kentucky sources and a total gross income in excess of \$5,000.00 shall be required to file a Kentucky income tax return. Finally, according to KRS 141.180(4), notwithstanding any other provision of the Kentucky income tax laws to the contrary, an individual shall be required to file an income tax return if his gross income from self-employment exceeds \$5,000.00.

B. [3.10] WHEN IS RETURN DUE

All calendar year taxpayers must file their tax returns by April 15. KRS 141.160(1). The Revenue Cabinet may for good cause grant an extension of time for filing the tax return of six months (one year for taxpayers who are abroad). Id. If the amount of tax paid on an extended return exceeds the amount of tax previously paid or withheld, then the taxpayer must pay interest on the deficiency at the tax interest rate as defined in KRS 131.010(6), until the return is actually filed with the Revenue Cabinet. KRS 141.170(3).

IV. [3.11] FILING STATUS

A. [3.12] UNMARRIED TAXPAYERS

There is no choice to be made for single resident taxpayers with regard to filing status. They simply put down all of their income and deductions and calculate their tax liability and they are solely responsible for the accuracy of their returns.

B. [3.13] MARRIED TAXPAYERS

The choice to be made by married individuals regarding their filing status on Kentucky income tax returns is an important decision. The federal filing status of the taxpayer has no effect upon his available options for Kentucky income tax purposes. KRS 141.016. There are three choices available to the married taxpayer. The first choice is a filing status of filing separately on a combined return. KRS 141.180(6) allows a husband and wife living together to make a joint return or to make separate returns. For administrative convenience, the Revenue Cabinet has designed Form 740 (all references herein to Form 740 are to Kentucky Individual Income Tax Return Form 740) so that spouses can in effect prepare

separate returns within the context of one form to determine the separate taxable income for each spouse. Each spouse is allowed to deduct from his or her income his or her pro rata share of the spouse's total income tax deductions, based upon his or her percentage of adjusted gross income to the couple's total combined adjusted gross income. The tax is then calculated separately on each spouse's separate income. The resulting tax liability of each spouse is then added together to come up with the total tax liability due from the couple.

The second filing status is married filing joint return. When filing under this method, the spouses simply add together their total income and deduct their total deductions. The resulting tax is a joint and several liability of both spouses.

The final filing status available to married couples is married filing totally separate returns. KRS 141.180(6) provides "in the event separate returns are made, neither spouse shall report income nor claim deductions properly attributable to the other." The aforementioned provision can be valuable to spouses in certain situations such as when one spouse has a relatively low amount of income and significant deductions properly attributable to him or her. Such an example would be significant medical expenses. As explained later, medical expenses are only deductible to the extent they exceed 7-1/2% of adjusted gross income. If the income of two spouses were combined, it is possible that the medical expenses would not exceed the 7-1/2% threshold. However, if totally separate returns are prepared, it is more likely that a spouse would be able to deduct some of his or her medical expenses. As will be shown later, there are several other instances where deductions are allowable only to the extent they exceed a certain percentage of adjusted gross income.

There also exists another extremely significant reason for filing separate returns. When separate returns are filed, each spouse is liable only for the accuracy of his or her own return. Additionally, they are liable only for their own individual income tax. In contrast, a significant liability associated with filing a joint return or filing separately on combined returns is that each spouse is jointly and severally liable for the accuracy of the return, as well as being jointly and severally liable for all tax (not just his own) shown on the return. See 103 KAR 17:020. However, the joint and several liability of a spouse can be eliminated in certain circumstances, as explained below.

Kentucky also has some peculiar rules regarding amending married persons returns. If separate returns have been filed, the spouses may elect to file an amended joint return if the Revenue Cabinet is notified in writing that the separate return election is rescinded. 103 KAR 17:020(2)(2). Also, if a joint return was filed, the spouses may elect to file an amended combined or amended separate returns. Id. However, if a married couple has filed a combined return, they cannot rescind such election and file separate returns. 103 KAR 17:020(2)(3).

V. [3.14] INNOCENT SPOUSE RELIEF

The 1994 General Assembly passed an amendment to KRS 141.180 which will reduce the possible joint and several liability of one spouse for the understatement of income by the other spouse. House Bill 121 added new sections (7) and (8) to KRS 141.180, which specifically adopted the "innocent spouse" relief provided by IRC §6013(e).

There is a threshold test which the innocent spouse must meet before they can even be considered for relief under IRC § 6013(e). If the innocent spouse has adjusted gross income of \$20,000 or less, they are eligible for innocent spouse relief only if the liability for understatement of tax (including interest, penalties and other amounts) is greater than 10 percent of such adjusted gross income. IRC § 6013(e)(4)(A). If adjusted gross income is more than \$20,000, the understatement of tax must be more than 25 percent. See IRC § 6013(e)(4)(B). If the amount of the understatement of tax (including interest, penalties, etc.) meets

either of the two above tests, then there is a "substantial underpayment" of tax within the meaning of IRC §6013(e), from which a spouse can seek relief for joint and several liability.

If the threshold test is met, there are then three specific requirements which must be met for relief under IRC § 6013(e). The requirements are:

1. There is a substantial understatement of tax attributable to grossly erroneous items of one spouse;
2. The other spouse can prove that he/she did not know or had no reason to know about the substantial understatement; and,
3. It would be inequitable to hold the other spouse liable for the deficiency in tax attributable to the substantial understatement.

If the innocent spouse can meet the above criteria, they will qualify for relief under IRC § 6013.

Kentucky places one further limitation on innocent spouse relief. If an innocent spouse receives relief from joint and several liability pursuant to KRS 141.180(7), they shall not be entitled to receive a tax refund if they overpaid taxes on their income. KRS 141.180(8).

VI. [3.15] GROSS INCOME

The determination of a Kentucky taxpayer's gross income is the initial step in the long journey to determine his Kentucky taxable income. KRS 141.010(9) states that an individual taxpayer's gross income is determined pursuant to Internal Revenue Code (hereafter abbreviated "IRC") Section 61.

The vast majority of the Kentucky individual income tax law results from incorporation by reference of the IRC. Kentucky incorporates the administrative and judicial interpretations of the IRC except to the extent of differences between the IRC and the Kentucky individual income tax law as set forth in KRS Chapter 141. KRS 141.050.

The reference to IRC Section 61 is to that code section as in effect on December 31, 1993. See KRS 141.010(3). Kentucky statutes DO NOT automatically adopt changes made to the IRC by the Congress, except for changes in accounting methods, which will be discussed later. Given the recent history of Congress in enacting yearly changes in the tax laws, and given the budgetary problems in Washington, it is more than likely that significant changes will be enacted to the IRC. Therefore, any time a person is faced with a Kentucky individual income tax issue which is dependent upon the statutory language of the IRC as of December 31, 1993, they must exercise extreme care to make sure they are using the IRC as in effect on December 31, 1993.

IRC Section 61 is enormous in its breadth and coverage. IRC Section 61 provides: "Except as otherwise provided in this subtitle [concerning income taxes], gross income means all income from whatever source derived... ." The United States Supreme Court has repeatedly held that in defining gross income as broadly as it did, Congress intended to tax all income and all gains except those specifically exempted. Commissioner v. Glenshaw Glass Co., 348 U.S. 426 1430 (1955). A comprehensive treatment, or even a cursory review, of IRC Section 61 is beyond the scope of this work. Any questions regarding whether a particular item is includable in gross income can only be effectively researched by resort to one of the federal tax services.

Kentucky has one specific statutory exclusion from gross income. KRS 141.021 amended by the 1990 legislature exempts all federal retirement annuities and local governmental annuities from gross income. The state had previously exempted state pensions but excluded only federal retirement annuities that met certain specific requirements. The amendment of KRS 141.021 was prompted by the decision of the United States Supreme Court in Michigan v. Davis, 109 S.Ct. 1500 (1989), which held that states could not discriminate between federal and state annuities by taxing federal recipients but exempting the same type

of benefits paid to state retirees. The fact that KRS 141.021 exempted federal and state employees pensions from taxation, but did not exempt private pensions, was challenged as an unconstitutional violation of the equal protection clause by private pension recipients in the case of Commonwealth of Kentucky Revenue Cabinet v. James Richard Cope, et al., 875 S.W. 2d 87 (Ky., 1994). The Kentucky Supreme Court ruled that KRS 141.021 was constitutionally valid. The taxpayers have petitioned the United States Supreme Court for a writ of certiorari. The petition was pending at the time this revision was written.

VII. [3.16] EXCLUSIONS FROM GROSS INCOME

IRC Section 61(b) does refer to certain items specifically excluded from gross income. The items specifically excluded from income are found in IRC Code Sections 101 through 135. It must be noted that many of the items noted as being excluded from gross income are not total exclusions. In many instances, only a certain amount of the particular type of item is excluded from income. In other circumstances, the item excluded must meet certain specific requirements in order for a taxpayer to avail himself of the exclusion. Any questions with regard to the availability of any of these exclusions from income must be answered by resort to the language of the IRC and its related regulations, rulings and case laws as in effect on December 31, 1993.

VIII. [3.17] ACCOUNTING METHODS

A taxpayer's choice of accounting method will have a significant impact upon the gross income that they recognize for income tax purposes. The area of accounting methods is a trap for taxpayers with regard to Kentucky individual income taxation. While the Kentucky individual income tax statutes are based upon the Internal Revenue Code in effect on December 31, 1993, the accounting method to be used by a taxpayer is to be the same method of accounting as used on his federal income tax return. KRS 141.140(1). If in 1994 or subsequent years, Congress makes significant changes in the methods of accounting, then the taxpayer's Kentucky taxable income must be calculated in accordance with those changes.

The provision regarding methods of accounting can have substantial impacts upon taxable income of a taxpayer. For example, the methods of accounting as set forth in IRC Sections 446 through 483 prescribe rules for determining the taxable year in which items of gross income should be included, the taxable year in which deductions can be taken, and prescribes rules for valuing inventories -- which have a significant effect on the determination of profit or loss of any taxpayer whose business involves inventories.

The problem in this area is that there are numerous items within the "methods of accounting" section of the Internal Revenue Code that many taxpayers would not think of as being methods of accounting. For example, Congress has passed legislation aimed primarily at wealthy taxpayers to prevent them from deducting losses and credits they were receiving from tax shelters in which they were not suffering true economic losses. These provisions are part and parcel of the IRC Section on Accounting Methods. Clearly, there is ample opportunity for a taxpayer or a tax practitioner to be tripped up because of the automatic adoption of the IRC Sections on Accounting Methods.

IX. [3.18] KENTUCKY ADJUSTED GROSS INCOME

A. [3.19] OVERVIEW

The concept of Kentucky adjusted gross income (hereafter "KAGI") is a critical step in the calculation of a Kentucky individual taxpayer's tax liability. KAGI is also a critical factor in the calculation of Kentucky itemized deductions.

KRS 141.010(10) defines KAGI as gross income as defined in IRC Section 61 minus the deductions allowed individuals by IRC Section 62, as modified by KRS 141.0101 [Adjustment for Kentucky Depreciation Methods] and further modified for eight specific items set forth in KRS 141.010(10)(a)-(h).

B. [3.20] FEDERAL ADJUSTED GROSS INCOME

The starting point in determining Kentucky adjusted gross income is the Federal adjusted gross income (hereafter "AGI") as defined in IRC Section 62. Any type of in-depth discussion of IRC Section 62 is far beyond the scope of this work. However, since the items that are adjustments to gross income are not as obvious as the possible items of gross income, it is helpful to at least set forth the very broad parameters of IRC Section 62. The term AGI as defined in IRC Section 62 means, in the case of an individual, gross income minus the following deductions:

1. Trade and business deductions attributable to a trade or business carried on by a taxpayer if such trade or business does not consist of the performance of services by the taxpayer as an employee.
2. Certain trade and business deductions of employees - (A) Reimbursed expenses of employees... (B) Certain expenses of performing artists....
3. Deductions allowed as losses from the sale or exchange of property.
4. Deductions attributable to property held for production of rent or royalties.
5. Depreciation and depletion deductions for life tenants and income beneficiaries of property.
6. Pension plan deductions for self-employed individuals.
7. Deduction for IRA contributions and voluntary employee contributions to certain trusts created before January 25, 1959.
8. A certain portion of lump sum distributions from pension plan taxed under IRC Section 402(e).
9. A deduction as a loss pursuant to IRC Section 155 for penalties associated with the premature withdrawal of funds from a time savings account, certificate of deposit or similar class of deposit.
10. A deduction equal to the alimony or separate maintenance payment paid during the taxable year.
11. A deduction allowed by IRC Section 194 for reforestation expenses.
12. A deduction for [certain] required repayments of supplemental unemployment compensation benefits....
13. Jury duty pay remitted to an employer.
14. The deduction allowed by IRC Section 179A for clean-fuel vehicles and certain refueling properties.
15. Moving expense deduction allowed by IRC Section 217.

The above listing of adjustments to gross income pursuant to Section 62 is very broad and general. However, it does allow the reader to identify the major areas of adjustment to gross income. It is very important to understand that the above listing of adjustments to gross income is based upon the IRC as in effect on December 31, 1993. In addressing any issue regarding the federal adjustments to gross income, it is imperative that the researcher verify that he is working with the IRC as in effect on December 31, 1993.

C. [3.21] EXCLUSION OF FEDERAL OBLIGATIONS AND KENTUCKY OBLIGATIONS

KRS 141.010(10)(a) excludes from Kentucky taxation income that is exempt from state taxation by the Kentucky Constitution and the Constitution and Statutory laws of the United States and Kentucky. This provision exempts interest on federal and state obligations. Federal obligations include more than just United States Treasury securities. They also include obligations issued by the Tennessee Valley Authority,

Federal Home Loan Banks, Federal Credit Unions, and other federal governmental entities. Revenue Circular 40C003 (revised 8/1/91) lists various federal or quasi-federal organizations and indicates whether or not the interest on securities issued by the organizations is taxable or tax exempt. This revenue circular is not all inclusive, but simply lists agencies whose status is often questioned.

D. [3.22] INTEREST INCOME FROM OTHER STATES

Kentucky's incorporation by reference of the IRC without modification would result in the exclusion from Kentucky income of interest upon obligations from other states and their political subdivisions. However, KRS 141.010(10)(c) is the current rendition of the theme - "the taxman giveth and the taxman taketh away." It specifically includes in KAGI interest income derived from obligations of sister states and their political subdivisions.

This particular area of the Kentucky tax law has not been as straight forward as it appears. There have been problems in this area during the last several years with regulated investment companies (mutual funds) which invest strictly in the obligations of states and their political subdivisions. For several years the Kentucky Revenue Cabinet took the approach that since a mutual fund which invested in a diverse portfolio of obligations from states and their political subdivisions was totally tax exempt for federal income tax purposes, the income from those mutual funds should also be tax exempt for Kentucky income tax purposes. Given the specific nature of this statute, it seems unlikely that the Revenue Cabinet would have adopted such an interpretation. In any event, the Revenue Cabinet has changed their position on this matter. By Revenue Policy 42P161 dated December 1, 1990, (effective retroactively to taxable years beginning on or after 1/1/88), the Revenue Cabinet now requires a taxpayer to obtain from a mutual fund investing in state tax exempt obligations information regarding the proportion of the income that is attributable to obligations of the State of Kentucky and its political subdivisions. The taxpayer can then only exclude the amount of the income that is attributable to the Kentucky sources.

E. [3.23] SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS

For federal income tax purposes, Social Security benefits may be taxable if a taxpayer's other income exceeds certain thresholds. IRC Section 86. Railroad workers are not included in the Social Security retirement system. They are covered by a basic pension plan known as Tier One Railroad Retirement Benefits. The Tier One benefits are for all intents and purposes, the same type of plan as Social Security. Likewise, Tier One Railroad Retirement Benefits are taxable only if the amount of a railroad retiree's other income exceeds certain thresholds. *Id.* While the Social Security and Tier One Retirement Benefits can be subject to federal income tax, the Kentucky legislature, pursuant to KRS 141.010(10)(e), has chosen to exempt Social Security and Tier One Retirement Benefits completely from Kentucky income taxation.

The Railroad Retirement Act of 1937, as amended, also provides certain railroad employees with supplemental annuities in addition to the Tier One benefits, which are subject to federal income tax by U.S. Public Law 89-699. Kentucky, pursuant to KRS 141.010(10)(b), has chosen to exempt these supplemental annuities from Kentucky income taxation.

F. [3.24] AGENT ORANGE DAMAGES

The Kentucky Income Tax Code has a special provision to benefit some Vietnam veterans. During the Vietnam war, some members of the armed forces of the United States were exposed to a chemical used by the United States Military commonly called "Agent Orange." Some veterans have incurred health problems which can be linked to Agent Orange, while other veterans who were exposed to the chemical have a high probability of resulting health problems linked to the chemical. KRS 141.010(10)(h) specifically excludes from gross income any settlement or judgment in a lawsuit relating to exposure to Agent Orange

by a veteran of the armed forces of the United States who served in Vietnam, or any dependent of such veteran.

G. [3.25] FEDERAL INCOME TAXES

Prior to the 1990 legislative session, the Kentucky Income Tax Code allowed a taxpayer to take a deduction from gross income for the amount of federal income tax withheld or paid during a taxable year. A taxpayer was also required to include as an addition to their gross income the amount of a federal income tax refund received during the taxable year or any amount credited to that taxable year from a prior year. See KRS 141.010(10)(f). The 1990 legislature eliminated the Kentucky income tax law deduction for federal income taxes attributable to tax years beginning after December 31, 1989. See KRS 141.010(g). However, the legislature also exempted from Kentucky taxation federal refunds received for taxable years beginning after December 31, 1990. See KRS 140.010(f).

The taxpayer can take a federal income tax deduction for taxable years ending before January 1, 1991, for federal income tax paid for taxable years ending before January 1, 1990. KRS 141.010(10)(g). The net effect in the treatment of federal income taxes is that for the 1990 taxable year, individual income taxpayers who received a 1989 federal income tax refund in 1990 will be required to pick up the amount of their federal income tax refund as part of their Kentucky adjusted gross income, however, they will not be able to claim any offsetting deduction for federal income taxes paid.

H. [3.26] DEPRECIATION EXPENSE

In the first edition of this monograph, it was noted that the use by Kentucky of a hodge-podge depreciation system different from the one set forth in the IRC, was a needless bookkeeping complexity which should be done away with in order to make the business climate more favorable. The protest of business must have been heard in Frankfort because the 1994 General Assembly adopted House Bill 298 making Kentucky's depreciation rules consistent with the federal rules. New KRS 141.0101(13) provides that for taxable years beginning after December 31, 1993, depreciation deductions, elections to expense assets, the basis of assets and the gain or loss from the sale or other disposition of assets, shall be the same under Kentucky tax law and the IRC.

In order to make the adjusted basis of the assets depreciated under the old system equal to the IRC basis for those assets, the taxpayer will calculate the "Adjusted Kentucky basis" (defined term per KRS 141.0101(12)(b)) of all his property as of the first day of the first taxable year beginning after December 31, 1993, i.e., he will calculate basis under the old Kentucky depreciation system. See KRS 141.0101(11). The taxpayer will then calculate the "Adjusted federal basis" (See KRS 141.0101(12)(c)), i.e., depreciation on the assets under the IRC. The net difference between the Adjusted Kentucky basis and the Adjusted federal basis is called the "Transition Amount." KRS 141.0101(12)(d). If the Transition Amount is less than One Hundred Thousand Dollars (\$100,000), the entire amount shall be either added to or subtracted from gross income (depending upon whether the net effect of the Transition Amount is to increase or decrease previously recorded depreciation expense), in the first taxable year after December 31, 1993. See KRS 141.0101(14)(d). If the Transition Amount is more than One Hundred Thousand Dollars (\$100,000), then Twenty-five percent (25%) of the Transition Amount shall be added to or subtracted from gross income in the first taxable year beginning after December 31, 1993, with the same amount to be added to or subtracted from gross income in each of the next three (3) taxable years. See KRS 141.0101(14)(a). If the Transition Amount is recognized over four (4) taxable years because it exceeds One Hundred Thousand Dollars (\$100,000), the adjusting entry in the first year will have the effect of writing up or down the adjusted basis of assets to their IRS adjusted basis. The first year portion of the Transition Amount will be added to or subtracted from gross income, with the remaining portion of the Transition Amount recorded as either deferred expense or deferred income.

1. [3.27] OTHER DEPRECIATION CONSIDERATIONS

The changeover to the IRC depreciation system will also have a significant impact on several other tax areas. If a taxpayer has losses from some, or all of his activities, the ability to deduct those losses is oftentimes limited by IRC § 465 "At-Risk" rules, IRC § 469 "Passive Activity" rules and the IRC § 169 Net Operating loss deduction. The change in the depreciation rules will probably have a significant impact upon the application of these rules, since depreciation is many times a key component to these calculations. The effect will have to be determined upon a case-by-case basis, but it is a matter which needs to be looked at closely in applicable cases.

2. [3.28] SPECIAL FARMING CONSIDERATIONS

House Bill 483 passed by the 1994 General Assembly, added KRS 141.0101(16) to the Kentucky tax code. This new provision provides that any "qualified farming operation" which purchased new buildings and equipment to participate in a "networking project", can take an accelerated depreciation deduction at two (2) times the rate that would otherwise be permitted. See KRS 141.0101(16). A "qualified farming operation" is defined in KRS 141.410(5), as "[A]n individual, sole proprietorship...engaged in farming in Kentucky that provides raw materials for food-producing facilities in Kentucky, and that purchases new buildings or equipment, or that incurs training expenses, to support its participation in a networking project."

In the interest of brevity, the gist of the above provision is that the Cabinet of Economic Development will approve "networks" which farmers can join, to enable them to pool assets and resources for the purpose of producing food to supply establishments that manufacture food and beverages for human consumption. There will no doubt be forthcoming regulations from the Cabinet for Economic Development and the Revenue Cabinet to implement these provisions.

I. [3.29] FEDERAL JOBS CREDIT ADJUSTMENT

IRC Section 51 allows a jobs credit for 40 percent of the amount of qualified wages paid to members of certain targeted groups. An employer's wage expense is reduced by the amount of the job credit they are able to claim. Kentucky law does not provide for a jobs credit. The wage expense would be part of an employer's trade or business expense which is an adjustment to gross income pursuant to IRC Section 62. For Kentucky income tax purposes, the amount of the jobs credit which was subtracted from wage expense, should be added back as an additional deduction from gross income for Kentucky income tax purposes. This results in an employer deducting the total amount of wage expense he incurred with respect to a targeted job program, but he will not receive any type of tax credit.

X. [3.30] KENTUCKY STANDARD DEDUCTION

In lieu of itemizing deductions, KRS 141.081(1) allows an individual to claim a standard deduction of \$650 from his adjusted gross income. In the case of a husband and wife living together, KRS 141.081(3) provides a rule of consistency with regard to the standard deduction. If one spouse itemizes deductions, then the other spouse cannot claim the standard deduction. Accordingly, when two married persons are living together, in determining their taxable incomes, they both either have to itemize deductions or they both have to claim the standard deduction. They cannot mix and match.

XI. [3.31] KENTUCKY ITEMIZED DEDUCTIONS

A. [3.32] OVERVIEW

The reference in KRS 141.010(11) to the "deductions allowed individuals by Chapter 1 of the Internal Revenue Code" refers to the so-called itemized deductions under the IRC, with one exception. The only deduction referred to above under Chapter 1 of the IRC that is not an itemized deduction is the deduction for the personal exemption. KRS 141.010(11)(c). There are seven broad categories of itemized deductions. The seven categories are:

1. Medical and dental expenses;
2. Taxes;
3. Interest expense;
4. Contributions;
5. Casualty and theft losses;
6. Miscellaneous itemized deductions subject to two percent limit; and,
7. Other itemized deductions.

As noted above, if one spouse itemizes deductions, the other must itemize. Pursuant to KRS 141.180(6), married couples who file separate Kentucky returns can only claim income and deductions properly attributable to them. The Revenue Cabinet allows married couples filing separate returns to file one Schedule A and divide the total deductions between them based on the percentage of each spouse's income to total income.

The remainder of this chapter will discuss key issues with respect to the seven categories of itemized deductions. The chapter will not provide a detailed listing of the specific itemized deductions. If there is a question regarding whether a certain expense qualifies as an itemized deduction, an excellent reference source is the detailed instructions to Kentucky Schedule A. These instructions are quite thorough and also have references to specific federal publications where additional information is available.

B. [3.33] MEDICAL AND DENTAL EXPENSES

The basic rule regarding medical and dental expenses is set forth in IRC Section 213 which provides: "There shall be allowed as a deduction the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent (as defined in IRC Section 152) to the extent that such expenses exceed 7.5 percent of [federal] adjusted gross income."

The first important principal regarding the deductibility of medical and dental expenses is that a taxpayer cannot deduct an expense if the expense was covered by insurance, or if he was otherwise reimbursed for his outlay of medical expense. IRC Section 213. Amounts which are subject to insurance, but are not paid by insurance, such as deductibles paid by the individual, co-pay amounts paid by an individual, etc., are deductible by the taxpayer as a medical and dental expense.

The amount of health insurance premiums are deductible as a medical and dental expense. Also, it should be noted that the portion of health insurance premiums paid by a self-employed person, which are not deducted as an adjustment to gross income pursuant to IRC Section 162(l) would be allowable as an itemized deduction.

A taxpayer can take a deduction for medical and dental expenses paid on behalf of a dependent for whom the taxpayer provided over half of their support. The term "dependent" is defined in IRC Section 152 and is very broad. Generally, it includes ancestors, descendants, and immediate blood relatives. It could also include an individual whose principal place of abode is the home of the taxpayer. Any questions

regarding whether someone qualifies as a dependent must be thoroughly researched under the federal rules.

IRC Section 213(e)(d)(5) allows divorced parents to claim as a deduction any medical expenses they incur on behalf of their child.

Once a taxpayer has determined his total amount of itemized medical and dental expenses, he must then determine the amount of allowable medical and dental expenses. IRC Section 213(a) quoted previously allows a taxpayer to deduct medical and dental expenses only to the extent the expenses exceed 7.5 percent of federal AGI. Because of differences between federal AGI and KAGI, KRS 141.010(11) provides that a taxpayer's medical and dental expenses must be reduced by 7.5 percent of KAGI.

C. [3.34] TAXES

The taxes deductible as Kentucky itemized deductions are local income taxes, real estate taxes, and other taxes such as the tangible and intangible personal property taxes. A Kentucky taxpayer's itemized deduction for taxes will be the same as shown on his federal return, with one exception. The IRC allows a taxpayer to deduct state income taxes. KRS 141.010(11)(a) specifically disallows any deduction for state income taxes, except that taxes paid to foreign countries may be deducted.

D. [3.35] INTEREST EXPENSE

The same amount of interest expense will be deductible on both the federal Schedule A and the Kentucky Schedule A. A taxpayer is allowed to deduct as interest expense deductible points paid to obtain a home loan mortgage. The instructions to Kentucky Schedule A set out four requirements that must be met for points to be currently deductible:

1. The loan was used to buy or improve your principal home;
2. The loan was secured by the home;
3. In the area where the loan was made it is customary to charge points; and
4. The points you paid did not exceed the number of points usually charged in that area.

If these criteria are not met, then the points may only be deducted pro rata over the life of the loan.

The Kentucky instructions state that points paid to refinance a mortgage are generally deductible only over the life of the mortgage. There has been a recent tax case which liberalizes the current deductibility of points on refinancing of mortgages. In the case of Huntsman v. Commissioner, 905 F.2d 1182 (8th Cir. 1990), the taxpayer obtained a three-year loan with a balloon payment at the end. The taxpayer paid off this three-year loan and obtained a permanent loan. Id. at 1183. The IRS disallowed the current deduction for the points on the permanent loan. The tax court upheld the IRS in Huntsman v. Commissioner, 91 T.C. 917 (1988). The 8th Circuit reversed the tax court, holding, "The short-term financing was merely an integrated step in securing the permanent financing to purchase the home," Huntsman v. Commissioner, 905 F.2d at 1185. If a taxpayer can lay an appropriate evidentiary trail that a loan was merely a temporary loan until such time as permanent financing is obtainable, he could deduct the points paid on the permanent loan pursuant to the holding in the above case. Of course, the IRS is likely to litigate this position in the other circuits.

One important item to note in the area of interest expense is personal interest (e.g. charge cards, life insurance loan, automobile loan, consumer loans, etc.). A taxpayer can not deduct any personal interest.

E. [3.36] CONTRIBUTIONS

1. [3.37] ARTISTIC CONTRIBUTIONS

The deductions allowed by Kentucky for charitable contributions are determined in the same manner as contributions on the federal return, with three exceptions.

The first exception regards artistic contributions. KRS 141.0201 provides as follows:

"[A] deduction shall be allowed individuals against adjusted gross income in arriving at net income for 'qualified artistic charitable contributions' in an amount equal to the fair market value of the property contributed as determined at the time of such contribution."

According to KRS 141.0201(2) a "Qualified Artistic Charitable Contribution" is a charitable contribution of any literary, musical, artistic or scholarly composition, any letter or memorandum or similar property, but only if the following conditions are met:

- a. The property was created by the personal efforts of the taxpayer within one year prior to its contribution;
- b. Within one year of the date of the contribution the taxpayer has received a written appraisal of the fair market value of such property by a qualified appraiser within the meaning of IRC Section 168(e)(4)(D);
- c. A copy of the appraisal is attached to the taxpayer's income tax return;
- d. The donee is a charitable organization as described in IRC Section 170(b)(1)(A);
- e. The donee's use of the property is related to the purpose or function constituting the basis of the donee's exemption from federal taxation; and,
- f. The donee provides the taxpayer with a written statement representing that the donee's use of the property will be related to the donee's tax exempt purpose or function.

After a taxpayer has complied with these burdensome requirements for claiming a qualified artistic charitable contribution, the taxpayer must then determine if his contribution is subject to any of the limitations upon artistic charitable contributions.

KRS 141.0202(3) limits the amount of a taxpayer's qualified artistic charitable contributions to the taxpayer's artistic adjusted gross income for the taxable year. This section then defines artistic adjusted gross income as "That portion of the adjusted gross income of the taxpayer for the taxable year attributable to: (a) income with respect to the property...that is created by the taxpayer; and (b) income from teaching, lecturing, or similar activity with respect to such property or to similar property created by individuals other than the taxpayer."

If the fair market value of the property being contributed does exceed the artistic adjusted gross income, an interesting issue arises as to whether or not this excess contribution can be carried over and deducted in a subsequent year when the taxpayer has additional artistic adjusted gross income. IRC Section 170(d) has a specific rule allowing for the carryover of charitable contributions to the extent that they exceed 50 percent of the taxpayer's adjusted gross income computed without regard to any net operating loss carry back. The federal contribution carryover rule would not apply unless the amount of the artistic charitable contribution, when combined with other charitable contributions, exceeded 50 percent of the contribution base. Accordingly, the excess artistic charitable contribution can be deducted in a subsequent year only if specifically permitted by KRS 141.0201. There is no language in the statute which permits a carryover of any excess contribution. Therefore, it appears that the amount of any excess artistic charitable contribution above the artistic adjusted gross income will not be available for carryover unless it could be carried over pursuant to the general charitable contribution carryover rules of IRC Section 170(d).

2. [3.38] CHARITABLE CONTRIBUTION OF LEASEHOLD INTEREST

The second exception in the charitable contribution area involves a deduction for a leasehold interest of property contributed as living quarters for homeless persons. KRS 141.0202 is a new statute enacted by the 1990 legislature that provides for a charitable deduction for property leased to a charitable organization to be used by it to provide temporary living quarters for a homeless family. KRS 141.0202(1) sets forth the following requirements that must be met for a leasehold interest to qualify for a charitable deduction:

- a. The homeless family has demonstrated a need for a fixed, regular and adequate nighttime residence; and,
- b. The contribution of a leasehold interest in a dwelling for any term to be used by the donee to provide living quarters does not exceed one year for a homeless family selected by the donee."

While the legislature's passage of this deduction for charitable leasehold interest is commendable, it is fraught with administrative difficulties for both the donor and the donee. First of all, after the donor has made a contribution of a leasehold interest, he does not know if his contribution will be qualified deduction, since its deductibility will be based upon how the property is utilized by the donee organization. Secondly, KRS 141.0202(2) provides that the deduction shall be calculated for each taxable year during which the donee holds the interest. Furthermore, the deduction for each year is equal to the value of the interest computed on a monthly basis, multiplied by the number of months that it is occupied for a substantial portion of the month by a homeless family and that the dwelling meets all appropriate habitability standards. Therefore, a donee must keep detailed records regarding the use of the property and provide the donor with sufficient information to calculate his charitable deduction. Finally, KRS 141.0202(3) limits the value of the leasehold interest in the property to the lesser of the established rental value of the property if it has been leased during one or more of the six months immediately preceding the date of contribution, or the fair market rental value of other similar property.

3. [3.39] CONTRIBUTIONS TO DISCRIMINATORY ORGANIZATIONS

The 1990 legislature added KRS 141.010(11)(d) which denies a charitable contribution to any organization which does not give full and equal membership or equal use of its services and facilities because of race, color, religion, natural origin, or sex. A determination that an organization is discriminating must have been made by the courts or a Kentucky agency charged with enforcing the civil rights laws. *Id.* However, the law does not apply to any religious or denominational organization which restricts membership to persons of the same religion or denomination in order to promote its religious principles. *Id.* This statute goes beyond the current state of federal tax law, which bars tax-exempt educational institutions from maintaining racially discriminatory policies. See *Bob Jones University v. United States*, 461 U.S. 574 (1983). However, the IRC does not prohibit men's clubs from barring women members. See *McCoy v. Schultz*, 73-1 USTC ¶9233.

4. [3.40] CHARITABLE CONTRIBUTION LIMITATIONS

As noted previously, IRC Section 170(d) limits the amount of deductible charitable contributions to 50 percent of federal adjusted gross income. As a result of KRS 141.010(11), the limitation for charitable contributions for Kentucky income tax purposes would be 50 percent of Kentucky adjusted gross income as opposed to federal adjusted gross income.

F. [3.41] CASUALTY AND THEFT LOSSES

The amount of any deduction for casualty and theft losses that a Kentucky individual income taxpayer could claim might be different from the deduction he could claim on his federal income tax return. For federal income tax purposes, the amount of a taxpayer's casualty or theft loss must be reduced by 10

percent of his federal AGI. A Kentucky individual income taxpayer would reduce the amount of his casualty and theft losses by 10 percent of his Kentucky AGI.

G. [3.42] MISCELLANEOUS ITEMIZED DEDUCTIONS

The distinguishing characteristic of this particular category is that the amount of expenses incurred are reduced by two percent of adjusted gross income. As noted above with respect to other itemized deductions, the amount of the reduction for Kentucky income tax purposes will be based upon two percent of KAGI; whereas, for federal income tax purposes the amount of the reduction is based upon federal AGI.

1. [3.43] JOB EXPENSES

The itemized deductions under this category consist of job expenses incurred by an employee for which he was not reimbursed. The instructions to the 1994 Form 740 lists numerous examples of these types of expenses. Note that Kentucky law limits rural mail carriers claiming the standard mileage deduction to a rate of 28 cents per mile, whereas, the IRC allows 42 cents per mile.

2. [3.44] MISCELLANEOUS ITEMIZED DEDUCTIONS SUBJECT TO TWO PERCENT REDUCTION

The other major category of miscellaneous itemized deductions subject to the two percent (2%) reduction are amounts that were paid or incurred by a taxpayer to produce or collect taxable income, manage or protect property held for earning income and tax preparation fees. See IRC Section 217. The gross deductions will be the same under both federal and Kentucky income tax law. However, the net amount of the allowable deductions will probably be different because federal deductions are reduced by two percent of AGI, while Kentucky deductions are reduced by two percent of KAGI.

H. [3.45] OTHER MISCELLANEOUS DEDUCTIONS

This is the last category of Kentucky itemized deductions. It consists of miscellaneous deductions that are not subject to the two percent adjusted gross income limit. The instructions to the 1994 Kentucky Form 740 give some specific examples of items that are deductible under this category. The amount of the other miscellaneous deductions should be the same under the IRC and Kentucky income tax law.

XII. [3.46] KENTUCKY TENTATIVE TAX LIABILITY

A taxpayer's Kentucky taxable income equals his KAGI minus either his standard deduction or total itemized deductions, whichever is applicable. His tentative Kentucky tax liability is determined by applying the following graduated tax rates set forth in KRS 141.020(2) against his Kentucky taxable income:

- A. Two percent of the amount of taxable income less than \$3,000;
- B. Three percent on the amount of Kentucky taxable income in excess of \$3,000, but less than \$4,000;
- C. Four percent of Kentucky taxable income in excess of \$4,000, but less than \$5,000;
- D. Five percent of Kentucky taxable income in excess of \$5,000, but less than \$8,000;
- E. Six percent of Kentucky taxable income in excess of \$8,000.

The sum of the amounts resulting from applying the applicable Kentucky income tax brackets against Kentucky tax income results in the gross Kentucky individual income tax liability.

There is one exception to this simplistic tax calculation. The exception kicks in when a taxpayer has income attributable to a lump sum distribution from a pension plan. IRC Section 402(e) permits a special 5 or 10 year averaging method for qualifying lump sum distributions. The taxpayer will be required to calculate the tax attributable to the lump sum on a special schedule. (Schedule 4972-K in prior years.) The taxpayer will then calculate the amount of tax attributable to other income on Schedule TC. The two separate tax calculations will then be combined to determine the tentative Kentucky tax liability.

Schedule TC must also be used to calculate Kentucky income tax liability when the taxpayer is entitled to claim certain credits which can not be claimed on Form 740 itself.

XIII. [3.47] KENTUCKY TAX CREDITS

A. [3.48] GENERAL

Kentucky tax law has numerous tax credits which, depending upon the circumstances, may be claimed on an individual's tax return. The 1994 General Assembly passed a new section designated KRS 141.0205, which sets forth the order in which tax credits are to be utilized. Following is the portion of the statute which relates to individual taxpayers:

1. The nonrefundable credits against the tax imposed by KRS 141.020 shall be taken in the following order:
 - a. The individual credits permitted by KRS 141.020(3);
 - b. The economic development credits computed under KRS 141.347, 141.400, 141.403, and 141.407;
 - c. The health insurance credit permitted by KRS 141.062;
 - d. The tax paid to other states credit permitted by KRS 141.070;
 - e. The credit for hiring the unemployed permitted by KRS 141.065;
 - f. The recycling or composting equipment credit permitted by KRS 141.390;
 - g. The Commonwealth Venture Fund credit permitted by KRS 154.20-340;
 - h. The low income credit permitted by KRS 141.066; and
 - i. The household and dependent care credit permitted by KRS 141.067.
2. After the application of the nonrefundable credits in subsection (1) of this section, the refundable credits against the tax imposed by KRS 141.020 shall be taken in the following order:
 - a. The individual withholding tax credit permitted by KRS 141.350; and
 - b. The individual estimated tax payment credit permitted by KRS 141.305.

B. [3.49] INDIVIDUAL CREDITS

1. [3.50] TAX CREDITS FOR UNMARRIED INDIVIDUALS

A determination of available personal and dependent tax credits for an unmarried individual is the least complex of all of the filing statuses. KRS 141.020(3)(a) allows the unmarried individual a \$20 tax credit. In the event that an unmarried individual has any dependents (as defined per the IRC), then the unmarried individual can take a \$20 credit for each dependent. KRS 141.020(3)(d) allows the taxpayer an additional \$40 credit if he has attained the age of 65 before the close of the taxable year. Finally, KRS 141.020(3)(f) allows a taxpayer an additional \$40 credit if the taxpayer is blind at the close of the tax year. KRS 141.020(3)(l) allows an additional \$20 tax credit if the taxpayer is a member of the Kentucky National Guard at the close of the taxable year. However, this additional tax credit is not available for members of the military reserve.

2. [3.51] MARRIED FILING JOINT RETURN

In the case of married individuals filing joint returns, the amount of available tax credits for the taxpayer and his dependents would be determined in much the same manner as set forth immediately above for single individuals, with two exceptions. First of all, KRS 141.020(3)(b) allows a \$40 tax credit for married individuals filing a joint return (i.e., \$20 tax credit per person). Secondly, the taxpayer would be allowed to claim, if applicable, the additional tax credits of \$40 each that would be allowed if his spouse had attained age 65, or was blind, at the close of the taxable year. See KRS 141.020(3)(d)&(f).

3. [3.52] MARRIED FILING SEPARATE

The calculation of the individual dependent tax credits for married individuals filing separate returns are then determined in the same manner as an unmarried individual, with two notable exceptions. The first exception deals with the allocation of tax credits for dependents of the married taxpayers. While married spouses filing separately must each claim all of their own personal tax credits (including the age and blindness credits), Kentucky Revenue Cabinet Regulation 103 KAR 17:070 Section 4 provides that the spouses may divide tax credits for dependents between themselves in whatever manner they desire.

The second difference in determining tax credits between an unmarried individual and a married individual filing separately, concerns the situation in which a spouse of a married individual filing separately had no Kentucky gross income and is not the dependent of another taxpayer. In such a situation, KRS 141.020(3)(b) allows the married individual with income filing a separate return to claim his spouse as a dependent upon his income tax return, provided, she is not the dependent of another taxpayer. Similarly, KRS 141.020(3)(e) & (g) allow the married individual filing separately whose spouse has no Kentucky income to claim the additional tax credits attributable to his spouse for having attained age 65 before the close of the taxable year and/or being blind at the close of the taxable year.

4. [3.53] PART-YEAR RESIDENTS

Pursuant to KRS 141.020(3)(i), a part-year resident can claim Kentucky individual and dependent tax credits based upon the ratio of his Kentucky adjusted gross income to his total federal adjusted gross income (without adjustment for any federal income tax refunds received or federal income tax paid).

5. [3.54] NONRESIDENTS

In the case of single nonresident taxpayers, KRS 141.020(h) provides that the individual and dependent tax credits allowable shall be equal to the ratio of the taxpayer's KAGI (without adjustment for any federal income tax refunds received or federal income tax paid) to his federal AGI. In the case of a married nonresident taxpayer whose spouse does not have income from Kentucky sources, KRS 141.020(3)(h) provides that the individual and dependent tax credits can be calculated as set forth immediately above in this paragraph -excluding credits for his spouse and dependents, or the tax credits can be determined by prorating the taxpayer's total credits (including the tax credits for his spouse and dependents) by the ratio of his KAGI (without the federal income tax received and paid adjustment) to the total joint federal AGI.

C. [3.55] ECONOMIC DEVELOPMENT CREDITS

In an effort to promote economic development in Kentucky, the General Assembly has passed four distinct economic development measures. These four initiatives are as follows:

1. Rural Economic Development. KRS 154.22 - 010 through 154.22 - 070. This was designed to offer inducements to businesses to locate or expand in rural counties who have had a

- countywide rate of unemployment exceeding the statewide unemployment rate in the most recent five (5) consecutive calendar years.
2. Service and Technology. KRS 154.24 - 010 through 154.24 - 160. These provisions offer inducements to businesses to establish "back office" administrative functions in Kentucky. In order to avail itself of incentives under this act, seventy-five percent (75%) of the services provided by the eligible company from the proposed project shall be provided for persons located outside the Commonwealth.
 3. Existing Industry. KRS 154.26 - 101 through 154.26 - 010. The purpose of these incentives are to provide economic assistance to existing industries in Kentucky which need to undertake a major reinvestment in order to remain in existence and be competitive.
 4. New Industry. KRS 154.28 - 010 through 154.28 - 090. Inducement to businesses to start a totally new business in Kentucky.

The individual income tax significance of the above economic development initiatives are that an individual through either a sole proprietorship, partnership or S Corporation, could qualify for these inducements for a new or existing business. Furthermore, one of the ways in which these inducements are passed on is via tax credits. Each of the above economic development measures has a provision whereby the owner of the business receives a tax credit equal to the amount of income generated by the project which was the beneficiary of the special economic inducements. There are limits as to the amount of tax credit that can be received. Depending upon the type of incentive program involved, the tax credit is limited in varying degrees, based upon the amount of incentive financing that the company received.

The actual tax credit calculations for the above four (4) economic development incentive areas are set forth in KRS 141.347, KRS 141.407, KRS 141.403 and KRS 141.400, respectively. Amendments to the above statutes by the 1994 General Assembly provide that the business can elect annually that in lieu of the taxpayer receiving the tax credit, the amount of the tax credit will be considered as an estimated tax payment on the taxpayer's behalf.

D. [3.56] HEALTH INSURANCE TAX CREDIT

The 1990 legislature enacted an incentive tax credit to employers to provide health insurance to their employees. KRS 141.062 allows an employer to receive income tax credits for premiums paid to a health care trust established pursuant to KRS 304.18-025. In order for any premiums paid to qualify as an income tax credit, KRS 141.062(2) sets forth the following requirements:

1. Premiums are paid into the trust before July 1, 1992;
2. The employer must employ fewer than 50 employees;
3. The employer has not provided health insurance benefits during the three years preceding the date premiums are initially paid to the trust;
4. The employer must participate in the trust for a period of four consecutive years for all employees; and
5. The employer must pay at least 50 percent of the premium.

If the employer meets the above requirements, KRS 141.062(1) allows the following income tax credits:

- a. Twenty percent of the first year premium;
- b. Fifteen percent of the second year premium;
- c. Ten percent of the third year premium; and
- d. Five percent of the fourth year premium.

This tax credit will effectively expire June 30, 1996. However, there might be some individuals who qualified in time in 1992 and are still eligible to receive tax credits pursuant to this section.

E. [3.57] CREDIT FOR TAXES PAID TO OTHER STATES

In some situations, individuals who are residents of Kentucky become liable for income tax to other states upon income attributable to sources outside Kentucky. Because a person is a resident of Kentucky, this outside of Kentucky income is also taxed by Kentucky. In these situations, KRS 141.070(1) allows a person a tax credit against Kentucky income tax for the amount of income tax paid to the other state. However, the amount of the tax credit can not reduce the amount of Kentucky tax below the amount that would be paid, if the income from the other state were ignored.

F. [3.58] KENTUCKY UNEMPLOYMENT TAX CREDIT

KRS 141.065(2) allows a taxpayer to claim a credit equal to \$100 for each person hired by the taxpayer who has been classified as unemployed by the Cabinet for Human Resources for at least 60 days prior to his employment and such person has been an employee of the taxpayer for at least 180 consecutive days during the taxable year in which the credit is claimed. KRS 141.065(3) provides certain circumstances under which the credit will not be allowed:

1. The taxpayer received federally funded payments for on-the-job training for the employee; or,
2. The employee could be classified as a dependent of the taxpayer pursuant to IRC Section 152(a)(9).

For purposes of calculating this particular tax credit only, the reference to the IRC is a reference to the IRC as in effect on December 31, 1981, not the IRC as in effect on December 31, 1993.

G. [3.59] RECYCLING OR COMPOSTING EQUIPMENT CREDIT

KRS 141.390(2) provides that a taxpayer shall be allowed to receive a tax credit of up to fifty percent (50%) of the installed cost of recycling or composting equipment which is to be used exclusively within Kentucky for recycling or composting post-consumer waste materials. The amount of the tax credit claimed during the year in which the recycling equipment is purchased shall not exceed ten percent (10%) of the amount of the allowable credit and twenty-five percent (25%) of the total tax liability before the credit. KRS 141.390(2). The taxpayer must make an application to the Revenue Cabinet on or before July 1 of the year following the year the equipment was purchased. KRS 141.390(3). The Revenue Cabinet shall review the application and advise the taxpayer of the amount of eligible credit. Id.

H. [3.60] COMMONWEALTH VENTURE FUND TAX CREDIT

KRS 155.440 entitles an individual to a tax credit of 40 percent of the purchase price of their qualified investment in the Commonwealth Venture Fund. The Commonwealth Venture Fund is a venture capital fund which has been established to promote venture capital investments in Kentucky owned corporations. Any unused credit may be carried over the next taxable year.

I. [3.61] LOW INCOME CREDIT

The low income tax credit provides tax relief to low income taxpayers. According to KRS 141.066(1), the low income tax credit shall be applied against the taxpayer's tax liability after deducting the above credits. With respect to married taxpayers living together, KRS 141.066(2) provides that the low income tax credit will be computed on the basis of their combined adjusted gross income and shall be deductible from their combined tax liability. The low income tax credit is computed pursuant to KRS 141.066(3) as follows:

AMOUNT OF ADJUSTED GROSS INCOME	PERCENT OF TAX LIABILITY ALLOWED AS LOW INCOME TAX CREDIT
Not over \$5,000	100%
Over \$5,000 but not over \$10,000	50%
Over \$10,000 but not over \$15,000	25%
Over \$15,000 but not over \$20,000	15%
Over \$20,000 but not over \$25,000	5%
Over \$25,000	0%

J. [3.62] HOUSEHOLD AND DEPENDENT CARE CREDIT

The 1990 legislature enacted KRS 141.067 which allows a resident individual to deduct from his individual Kentucky tax liability a credit for household and dependent care services necessary for gainful employment. The statute provides that the credit shall be equal to 20 percent of the federal dependent care credit allowed under IRC Section 21. IRC Section 21(b) lists three categories of individuals for which a taxpayer can claim dependent care expenses.

1. A dependent of the taxpayer who is under age 13 with respect to whom the taxpayer is entitled to a ... [personal exemption];
2. A dependent of the taxpayer who is physically or mentally incapable of caring for himself;
or,
3. The spouse of the taxpayer, if he is physically or mentally incapable of caring for himself.

XIV. [3.63] OVERPAYMENT OF TAX LIABILITY

KRS 141.350 allows an individual a credit against his tax liability for the amount of Kentucky income tax withheld from his wages. Furthermore, KRS 141.305(4) allows the taxpayer a credit against his tax liability for the amount of estimated tax payments made by him. If the amounts paid by or withheld on behalf of the taxpayer are more than the total tax liability, KRS 141.355 and IRC Section 66 give the taxpayer three options with respect to the overpayment:

- A. He can request the entire amount of the overpayment to be refunded to him,
- B. He can request that the entire amount of the overpayment be credited to his future estimated taxes,
- C. He could credit part of the overpayment to his next year's estimated tax and request that the balance be refunded to him.

Before pursuing any of the options presented in a, b, or c, above, the taxpayer can request that part or all of his overpayment be applied as a contribution for one of the following organizations:

1. The Kentucky Nature and Wildlife Fund, KRS 141.455;

2. Child Victims' Trust Fund, KRS 141.440;
3. Bluegrass State Games and U.S. Olympic Committee Fund, KRS 141.442.

XV. [3.64] UNDERPAYMENT OF TAX

If the amount of wages withheld and estimated tax payments made by or on behalf of a taxpayer are less than the amount of their total tax liability, then the excess must be paid to the Kentucky State Treasurer. According to KRS 141.990(2), the taxpayer will be liable for a penalty for underpayment of income tax if the total amount income tax withheld on his behalf plus estimated tax payments by him do not exceed 70 percent of the total tax liability as shown on his individual income tax return.

KRS 131.180(3) sets the penalty at 10 percent of the amount of any underpayment. KRS 141.990(2) provides that the underpayment penalty shall not apply to the taxable year in which the death of the taxpayer occurs, nor in the case of a farmer whose estimated gross income from farming is at least two-thirds of his total estimated income from all sources and he files his income tax return on or before March 1 of the succeeding taxable year. Additionally, IRC Section 6654(e)(2) provides that the underpayment of estimated tax penalty does not apply if the amount of total tax withheld and paid equals or exceeds the prior year's income tax liability, provided, the prior year's return covered a full 12-month period.

If a taxpayer reasonably expects his gross income from sources other than wages to exceed \$5,000 for a taxable year, then he must make and file a declaration of tax with the Revenue Cabinet on or before April 15 of the taxable year. See KRS 141.300. The taxpayer must then pay the estimated tax in four equal installments as follows: (1) April 15; (2) June 15; (3) September 15; and (4) January 15 of the following year. A taxpayer who is not required to make a declaration by April 15 could be required to make one if he subsequently receives substantial income not subject to withholding. See KRS 141.300(3).

XVI. [3.65] PENALTIES

KRS 131.180 sets forth numerous penalties applicable to both individual and corporate taxpayers. Civil penalties which are of interest to an individual taxpayer are as follows:

1. Taxpayer failure or refusal to file a return or furnish information -- penalty of two percent (2%) of the total tax due for each thirty (30) days that the return is late, with a total penalty not to exceed twenty percent (20%). KRS 131.180(1);
2. Failure to withhold or collect any tax or pay any tax -- penalty of two percent (2%) of the tax not withheld, collected, or timely paid for each thirty (30) days or fraction thereof that the payment is late. KRS 131.180(2);
3. Failure to pay within forty-five (45) days of the due date of any tax assessed by the Cabinet, which is not protested in accordance with KRS 131.110 -- shall result in a penalty equal to two percent (2%) of the unpaid tax for each thirty day period it is unpaid. KRS 131.180(5);
4. Penalty of ten percent (10%) of any deficiency due to negligence or intentional disregard of rules and regulations but without intent to defraud. KRS 131.180(7)
5. In addition to the other penalties provided above, a penalty of 50 percent for the amount of any deficiency due to fraud with intent to evade tax. KRS 131.180(8).

In addition to the above penalties, KRS 141.990(5) makes it a felony for any taxpayer to wilfully fail to make a return or make a false return or wilfully fails to pay taxes with intent to evade payment of the tax. KRS 141.990(6) provides that any person who wilfully aids or assists in, procures, counsels or advises the preparation or presentation of a document or claim under KRS Chapter 141, which is fraudulent or false as to any material matter, is also guilty of a felony. Conviction of either felony shall result in a fine of not

less than \$500 nor more than \$5,000, or confinement in the penitentiary for not less than 12 months or more than 5 years, or both.

XVII. [3.66] CONCLUSION

Since the IRC is the foundation of Kentucky income tax law, it is imperative that any time a Kentucky income tax law issue is being researched, the researcher ascertain which version of the IRC is applicable. Use of the wrong version of the IRC in researching a Kentucky individual income tax issue is probably the biggest trap for tax practitioners.

CHAPTER IV.

CORPORATE INCOME TAXATION

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CORPORATE INCOME TAXATION

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[4.1] CORPORATE INCOME TAXATION

By
C. Christopher Muth

I. [4.2] CORPORATIONS SUBJECT TO TAX-KRS 141.040

Every corporation organized under the laws of the Commonwealth of Kentucky, or having its commercial domicile in the state (as defined in KRS 141.120(1)(b)), and every foreign corporation owning or leasing property located in the state or having one or more individuals receiving compensation in the state (as defined in KRS 141.120(8)(b)), shall pay for each taxable year a tax to be computed by the taxpayer on taxable net income at the specified rate. Corporations specifically excepted from taxation are:

- (a) S corporations;
- (b) State and national banks and trust companies, except bankers banks organized under KRS 287.135;
- (c) Savings and loan associations organized under the laws of the state and under the laws of the United States and making loans to members only;
- (d) Banks for cooperatives;
- (e) Production credit associations;
- (f) Insurance companies, including farmers or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;
- (g) Corporations exempt under Section 501 of the Internal Revenue Code (non-profit corporations);
- (h) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit; and,
- (i) Corporations having no individuals receiving compensation as defined in KRS 141.120(8)(b) in the state, and whose only owned or leased property located in the state is located at the premises of a printer with which it has contracted for printing, if such property consists of the final printed product, property which becomes a part of the final printed product, or copy from which the printed product is produced.

II. [4.3] COMPUTATION OF INCOME AND INCOME TAX

A. [4.4] GROSS INCOME

Gross income, in the case of corporations, means "gross income" as defined in Section 61 of the Internal Revenue Code and as modified by KRS 141.0101, with the following adjustments:

- (a) The exclusion of income that is exempt from state taxation by the Kentucky Constitution and the Constitution and statutory laws of the United States (i.e. Kentucky municipal bond interest and interest on federal obligations);
- (b) The exclusion of all dividend income;
- (c) The inclusion of interest income derived from obligations of other states and political subdivisions thereof;
- (d) The exclusion of 50% of gross income derived from any disposal of coal covered by IRC Section 631(c) if the corporation does not claim any deduction for percentage depletion, or for expenditures attributable to the making and

- administering of the contract under which such disposition occurs or to the preservation of the economic interests retained under such contract;
- (e) The inclusion of income tax payments made by lessees to lessors, under the provisions of IRC Section 110, and the exclusion of such payments from the gross income of lessees;
- (f) The inclusion of any amount calculated pursuant to KRS Section 141.205;
- (g) Ignoring the provisions of IRC Section 281; and,
- (h) The exclusion of income from "safe harbor leases" under IRC Section 168(f)(8).

B. [4.5] NET INCOME

Net income, in the case of corporations, means "gross income" less the deduction allowed by KRS 141.0202 and less all the deductions from gross income allowed corporations by Chapter 1 of the Internal Revenue Code as modified by KRS 141.0101, except the following:¹

- (a) Any deduction for a state tax which is computed, in whole or in part, by reference to gross or net income and which is paid or accrued to any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or to any foreign country or political subdivision thereof. However, the following taxes have been held to be deductible:
 - (i) The New York tax levied on subsidiary investment;²
 - (ii) The Massachusetts net worth tax;³
 - (iii) The Indiana gross receipts tax is deductible for the following:
 - (a) Contractors' sale of materials;
 - (b) Sales at retail;
 - (c) Laundering;
 - (d) Dry cleaning and industrial processing;
 - (e) Sales of agricultural products; and,
 - (f) Manufacturer sales at wholesale, and other sales at wholesale;⁴
 - (iv) The West Virginia Business and Occupation tax based on the gross receipts of a business;⁵
 - (v) The windfall profit tax;⁶ and,
 - (vi) The Ohio franchise tax computed on the basis of a corporation's net worth, rather than its net income.⁷

¹ See also Revenue Policy 41P070 and Department of Revenue v. Refiners Oil Corp., K., 612 S.W. 2d 337 (1981).

² Revenue Policy 41P100; Kroger Company v. Department of Revenue, 556 S.W.2d 156 (1977).

³ Revenue Policy 41P110; Kroger, Supra.

⁴ Revenue Policy 41P120, Kroger, Supra.

⁵ Revenue Policy 41P121.

⁶ Revenue Policy 41P125.

⁷ Armco, Inc. v. Kentucky Revenue Cabinet, 748 S.W.2d 372 (1988).

Taxes which have been deemed nondeductible for Kentucky income tax purposes include:

- (i) The New York franchise tax based upon income base, business and investment capital base, or income and salary base;⁸
- (ii) The Indiana gross receipts tax on:
 - (a) Adjusted gross income;
 - (b) Commissions and fees;
 - (c) Interest and dividends;
 - (d) Rent, leases, and sale of real property, and sale of securities and other personal property;
 - (e) Gross earnings;
 - (f) Contractor's and other service receipts; and,
 - (g) Other incidental receipts.⁹
- (b) The deductions contained in IRC Sections 243, 244, 245 and 247;
- (c) The provisions of IRC Section 281 shall be ignored in computing net income;
- (d) Any deduction directly or indirectly allocable to income which is either exempt from taxation or otherwise not taxed;¹⁰
- (e) Exclusion of expenses related to "safe harbor leases", defined in IRC Section 168(f)(8); and,
- (f) Any deduction for amounts paid to any club, organization, or establishment which has been determined to discriminate against individuals.

C. [4.6] TAXABLE NET INCOME-KRS 141.010(14)

"Taxable net income", with respect to corporations having property or payroll only in the state (intra-state corporations), is the same as "net income" as defined in KRS 141.010(13).

With respect to multi-state corporations, those having property or payroll both within and without the state, "taxable net income" means "net income" as defined in KRS 141.010(13) as allocated and apportioned under KRS 141.120.

"Property" means either real property or tangible personal property which is either owned or leased. "Payroll" means compensation paid to one or more individuals, as described in KRS 141.120(8)(b). Property and payroll are deemed to be entirely within the state if all other states are prohibited by Public Law 86-272, as it existed on December 31, 1975, from enforcing income tax jurisdiction.

D. [4.7] DEPRECIATION METHODS AND TRANSITIONAL RULES-KRS 141.0101

For depreciable property placed in service prior to January 1, 1990, in lieu of the depreciation and expense deductions allowed under IRC Sections 168 and 179, a deduction for a reasonable allowance for depreciation, exhaustion, wear and tear, and obsolescence of property used in a trade or business shall be allowed.

For property placed in service after December 31, 1989, the depreciation and expense deductions allowed under IRC Sections 168 and 179, in effect on December 31, 1989, shall be permitted. For property placed in service prior to January 1, 1990, several adjustments pertaining to the amount of depreciation, basis,

⁸ Revenue policy 41P100; Kroger, supra

⁹ Revenue policy 41P120; Kroger, supra.

¹⁰ See also Revenue Policy 41P150.

gain, and depreciation recapture must be made in accordance with the statute. Taxpayers must be aware that the basis of property disposed of, and any subsequent gain on the disposition of depreciable assets, may be different under Kentucky and federal law due to differences in permissible depreciation under the respective statutes.

The Revenue Cabinet has interpreted the difference to mean that for property placed in service after December 31, 1989, the depreciation deduction, the Section 179 "election to expense", and the basis of the property must be the same for both Kentucky and federal income tax purposes. This interpretation raises two issues.

First, may an "election to expense" deduction create a net operating loss (NOL) for Kentucky income tax purposes. The "election to expense depreciable assets" deduction allowed by IRC Section 179 is limited to the lesser of \$10,000 or an amount not to exceed taxable income for the year. Therefore, for federal tax purposes the "election to expense" deduction cannot create a net operating loss.

However, for Kentucky tax purposes, a NOL may result. The amount of the "election to expense" deduction claimed may equal the amount claimed for federal tax purposes, even though the deduction exceeds Kentucky net income. Thus, a Kentucky NOL may result.

For example, if the taxpayer had federal net income, before the Section 179 deduction, of \$11,000 and Kentucky net income before the deduction of \$8,000, the taxpayer would be entitled to the same \$10,000 deduction for Kentucky tax purposes as he would be for federal tax purposes, even though the deduction would create a \$2,000 NOL for Kentucky tax purposes. If the facts were reversed, the deduction would be limited to \$8,000 for federal tax purposes, and, consequently, the taxpayer would be entitled to only an \$8,000 deduction for Kentucky tax purposes.

The second issue involves the determination of basis of property placed in service after December 31, 1989, which is acquired by trading in property placed in service prior to January 1, 1990. Generally, no gain or loss is recognized for tax purposes on like-kind exchanges. The basis of the new property is determined by adding to the adjusted basis of the old property the cash difference paid for the new property. Therefore, the Kentucky basis of new property acquired through like-kind exchanges after December 31, 1989, will be different from the federal basis where the adjusted basis of the old property is different for Kentucky and federal tax purposes. This is an exception to the rule that the basis of property for Kentucky and federal tax purposes must be the same for any property placed in service after December 31, 1989.

E. [4.8] CASUALTY LOSSES; NET OPERATING LOSSES-KRS 141.011; 141.012

The net operating loss carryback - carryforward deduction, including casualty loss, allowed under IRC Section 172 shall apply only to such losses incurred in taxable years beginning after December 31, 1979 and no loss shall be carried back to taxable years beginning before January 1, 1980. A corporation may carry forward and deduct net operating loss for its first year of operations. Any corporation engaging in business for the first time in Kentucky and employing within the state a minimum permanent investment of \$100,000 in real property owned or leased, which incurs a net operating loss during its first year of operations, may carry the loss forward to the next succeeding taxable year and deduct it from the net income for that year as determined under the provisions of this chapter.¹¹

¹¹ See also 103 KAR 16:030, and Revenue Policy 41P160.

III. [4.9] ALLOCATION AND APPORTIONMENT OF INCOME

**A. [4.10] DIVISION OF INCOME OF INTERSTATE BUSINESS FOR TAX PURPOSES;
APPORTIONMENT-KRS 141.120**

KRS 141.120 contains numerous definitions, specifies the types of income which are to be either allocated specifically within or without the Commonwealth of Kentucky or apportioned to the state and other states, and outlines the formula to be utilized for apportionment.

A corporation which has property or payroll both within and without the Commonwealth of Kentucky, pursuant to KRS 141.010(14)(b), must allocate and apportion its net income in accordance with this provision. "Business Income" means income received by the taxpayer in the regular course of its trade or business and includes income from tangible and intangible property if the acquisition, management, or disposition of the property constitutes an integral part of the taxpayer's regular trade or business operations. "Nonbusiness Income" means all income other than business income. Rents and royalties from real, intangible, or tangible personal property, capital gains and losses, interest, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as set forth in the statute.¹²

B. [4.11] RENTS AND ROYALTIES

Net rents and royalties from real property located in the state are allocable to Kentucky.

Net rents and royalties from tangible personal property are allocable to Kentucky if and to the extent that the property is utilized in the state, or in their entirety if the taxpayer's commercial domicile is in the state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in Kentucky during the rental or royalty period in the taxable year, and the denominator of which is the number of days of physical location of the property everywhere during all rental and royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, the tangible personalty is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

Net rents and royalties from intangible personal property located in Kentucky are allocable to the state. For purposes of this provision, royalties from property leased in Kentucky shall be considered as royalties from intangible personal property.

C. [4.12] CAPITAL GAINS AND LOSSES

Capital gains and losses from sales or other dispositions of real property located in Kentucky are allocable to the state.

Capital gains and losses from sales or other dispositions of tangible personal property are allocable to Kentucky if the property had a situs in Kentucky at the time of the sale, or the taxpayer's commercial domicile is in Kentucky and the taxpayer is not taxable in the state in which the property had a situs.

¹² See also KAR 16:060.

Capital gains and losses from sales or other dispositions of intangible personal property are allocable to Kentucky if the taxpayer's commercial domicile is in Kentucky.

D. [4.13] INTEREST

Interest is allocable to Kentucky if the taxpayer's commercial domicile is in Kentucky.

E. [4.14] PATENT AND COPYRIGHT ROYALTIES

Patent and copyright royalties are allocable to Kentucky if and to the extent that the patent or copyright is utilized by the payer in Kentucky, or if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in Kentucky.

A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

F. [4.15] APPORTIONMENT FORMULA

All business income shall be apportioned to Kentucky by multiplying the income by an apportionment figure composed of a sales factor representing 50% of the figure, a property factor representing 25% of the figure, and a payroll factor representing 25% of the figure.

G. [4.16] THE PROPERTY FACTOR

The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in Kentucky during the tax period. The denominator of the property factor is the average value of all of the taxpayer's real and tangible personal property owned or rented and used during the tax period; however, property which has been certified as a pollution control facility under KRS 224.850 shall be excluded from the property factor.¹³

Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at 8 times the net annual rental rate.¹⁴ Net annual rental rate is the annual rental rate paid by the taxpayer less income received from sub-rentals, provided that such rental and sub-rentals are reasonable. The average value of property shall be determined by averaging property values at the beginning and end of the tax period.

¹³ See also 103 KAR 16:080.

¹⁴ See also Revenue Policy 41P180.

H. [4.17] THE PAYROLL FACTOR

The payroll factor is a fraction, the numerator of which is the total amount paid or payable in Kentucky during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid or payable everywhere during the tax period.¹⁵

Compensation is paid or payable in Kentucky if:

- (i) The individual's service is performed entirely within the state;
- (ii) The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or,
- (iii) Some of the service is performed in the state and the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in the state.

I. [4.18] THE SALES FACTOR

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in the state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.¹⁶ Sales of tangible personal property occur in Kentucky if:

- (i) The property is delivered or shipped to a purchaser, other than the United States government, or to the designee of the purchaser within Kentucky regardless of the f.o.b. point or other conditions of the sale; or,
- (ii) The property is shipped from an office, store, warehouse, factory, or other place of storage in Kentucky and the purchaser is the United States government.

Sales, other than sales of tangible personal property, occur in Kentucky if the income-producing activity is performed in the state or the income-producing activity is performed both in and outside Kentucky and a greater proportion of the income-producing activity is performed in Kentucky than in any other state, based on costs of performance.¹⁷

J. [4.19] OTHER METHODS OF APPORTIONMENT

If the allocation and apportionment provisions of the statute do not fairly represent the extent of the taxpayer's business activity in Kentucky, the taxpayer may petition for or the cabinet may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (i) Separate accounting;
- (ii) The exclusion of any one or more of the apportionment formula factors;

¹⁵ See also 103 KAR 16:090.

¹⁶ See also Revenue Policy 41P170.

¹⁷ See also 103 KAR 16:070.

- (iii) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in the state; or,
- (iv) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.¹⁸

IV. [4.20] CREDITS AGAINST TAX

A. [4.21] PREMIUMS PAID FOR HEALTH INSURANCE TO BE TREATED AS INCOME TAX CREDIT-KRS 141.062

The amount of premiums paid for health insurance may be treated as an income tax credit on a declining basis for the payment of certain health insurance premiums. In order to qualify, premiums must have been paid before July 1, 1992, into a health care trust created by an area development district pursuant to Senate Bill 239. The employer must have 50 or fewer employees and have provided no health insurance benefits to employees during the three years preceding the date the premiums were initially paid to the trust. Employers must maintain participation in the trust for all full-time and part-time employees for a period of four continuous years and must have paid at least 50% of the premium. The income tax credit is an amount equal to 20% of the first year premium, 15% of the second year premium, 10% of the third year premium, and 5% of the fourth year premium.

B. [4.22] CREDIT ALLOWED FOR HIRING PERSON CLASSIFIED AS UNEMPLOYED-KRS 141.065

A credit shall be allowed for any taxpayer against tax in an amount equal to \$100 for each person hired by the taxpayer, provided such person has been classified as unemployed by the Department for Social Insurance of the Cabinet for Human Resources, and has been so classified for at least 60 days prior to his employment by the taxpayer.¹⁹ Furthermore, the person must have remained in the employ of the taxpayer for at least 180 consecutive days during the taxable year in which the taxpayer claims the credit. The credit shall not be allowed to a taxpayer for an employee hired if the taxpayer receives federally funded payments for on-the-job training for the employee, or if the employee is related to the employer.

V. [4.23] CORPORATE DISTRIBUTIONS, LIQUIDATIONS AND REORGANIZATIONS

For distributions, liquidations and reorganizations occurring before August 1, 1985, Kentucky corporations were permitted to report income or loss and to use the basis of property involved in such transactions based on Subchapter C of the IRC in effect at the time of the distribution, liquidation or reorganization. After July 31, 1985, and before January 1, 1990, a corporation taxable in Kentucky must determine income or loss and the basis of property involved in such transactions under the provisions of Subchapter C of the IRC in effect on December 31, 1980. For distributions, liquidations and reorganizations occurring after December 31, 1989, a corporation taxable in Kentucky must determine income or loss and the basis of property involved in such transactions in accordance with the provisions of Subchapter C of the IRC in effect on December 31, 1989.

For tax years ending before August 1, 1985, Kentucky income tax law required corporations to use the same basis for property as used for federal income tax purposes. The 1985 Extraordinary Session of the Kentucky General Assembly enacted statutory law setting forth, for property placed in service after July

¹⁸ See also Revenue Policy 41P220, and Ruby Construction Co. v. Department of Revenue, Ky. App., 578 S.W. 2d 248 (1979).

¹⁹ See also Revenue Policy 41P090.

31, 1985, a depreciation expense allowance for Kentucky income tax purposes, and recognized a Kentucky basis for such property determined by the IRC in effect on December 31, 1980.

The 1990 Regular Session of the Kentucky General Assembly repealed the Kentucky depreciation system for property placed in service after December 31, 1989, and restricted the use of the IRC in effect on December 31, 1980, in determining a Kentucky basis of property, to property placed in service before January 1, 1990. Thus, for distributions, liquidations and reorganizations occurring after December 31, 1989, the provisions of Subchapter C of the IRC in effect on December 31, 1989, must be used to determine the income or loss for Kentucky purposes from the transaction, and the basis after completion of the transaction, will be the same for both Kentucky and federal purposes. However, if distributions, liquidations and reorganizations occurring after December 31, 1989, involve property originally placed in service before January 1, 1990, the amount of income or loss determined for Kentucky purposes will be different than the amount determined for federal purposes because of the differences in basis and depreciation of property under Kentucky and federal law for property placed in service before January 1, 1990.

VI. [4.24] COMPLIANCE

A. [4.25] TAX RATES-KRS 141.040

For tax years beginning on and after January 1, 1990, the following tax rates shall apply:

<u>TAXABLE NET INCOME</u>	<u>TAX RATE</u>
The first \$25,000	4%
25,001 - 50,000	5%
50,001 - 100,000	6%
100,001 - 250,000	7%
250,001 - And Up	8.25%

B. [4.26] CORPORATIONS REQUIRED TO FILE RETURNS-KRS 141.200

Every corporation doing business in Kentucky, except those exempt from taxation under KRS 141.040, shall file a return stating specifically the items of income and the items claimed as deductions. Affiliated corporations must each make a separate return. Each return must be signed by one of the following officers of the corporation: the president, vice president, secretary, treasurer, assistant secretary, assistant treasurer, or chief accounting officer.

In the case of a corporation conducting business in Kentucky that carries on transactions with stockholders or with other corporations related by stock ownership, by interlocking directorates, or by some other method, the cabinet shall require information necessary to make possible an accurate assessment of the income derived by the corporation from sources within the state, including information respecting the business of any or all individuals and corporations related by one or more of these methods to the corporation and detail regarding transactions between the corporation and any or all other related corporations or individuals.

C. [4.27] EXTENSION OF TIME FOR FILING RETURNS-KRS 141.170

A corporation may be granted an extension of not more than six months for filing its income tax return provided it timely requests the extension before the due date of the return and pays, on or before the date

the return was due, the amount properly estimated as its tax. In addition, KRS 131.081(11) provides that a valid federal extension will constitute an extension for Kentucky corporation income tax purposes for returns. Interest will be charged on any amount of tax which may ultimately be due which was not previously paid by the return's due date.

D. [4.28] FILING OF RETURNS BY, AND LIABILITY OF, PARTNERSHIPS AND S CORPORATIONS-KRS 141.206

Every S corporation owning property or engaging in business in Kentucky shall, on or before the 15th day of the 4th month following the close of its annual accounting period, file a copy of its federal S corporation return with the form prescribed and furnished by the revenue cabinet. Essentially, S corporations are taxed for Kentucky corporate income tax purposes as they are for federal tax purposes.

Resident and nonresident individuals who are S corporation shareholders must report and pay tax on the distributive share of net income, gain, loss, deduction, or credit. Nonresident individuals and corporations which are partners in a partnership or shareholders in an S corporation which does business within and without Kentucky are taxable on their proportionate share of the distributive income passed through the partnership or S corporation attributable to "business done in Kentucky". "Business done in Kentucky" is determined by the ratio of gross receipts from sales to purchasers or customers in Kentucky or services performed in Kentucky to the total gross receipts from sales or services everywhere.

Resident shareholders in a multi-state S corporation are taxable on 100% of the distributive share of income, gains, losses, deductions or credits.

Resident shareholders in an S corporation which does not carry on business in Kentucky are subject to tax under KRS 141.020 on federal net income, gain, deduction, loss or credit passed through the S corporation.

The term "S corporation" for purposes of this section means a corporation which has elected for federal tax purposes to be taxed as an S corporation. An election for federal tax purposes is a binding election for Kentucky tax purposes.

E. [4.29] INTEREST ON TAX NOT PAID BY DUE DATE-KRS 141.985

If the tax imposed by this chapter, whether assessed by the department, or the taxpayer, or any installment or portion of the tax is not paid on or before the date prescribed for its payment, there shall be collected, as a part of the tax, interest upon the unpaid amount at the tax interest rate contained in KRS 131.010(6) from the date prescribed for its payment until payment is actually made to the department. Interest shall be assessed, collected, and paid in the same manner as if it were a deficiency.

F. [4.30] PENALTIES-KRS 141.990

G. [4.31] FAILURE TO FILE

A penalty shall be imposed for failure or refusal to file a return or failure to furnish any information requested by the revenue cabinet in the amount of 25% of the amount of any deficiency assessed pertaining to the failure or refusal to file a return or furnish information. This penalty shall be in addition to all other applicable penalties.

H. [4.32] FAILURE TO TIMELY FILE

A penalty shall be imposed for failure to file a timely return by the due date, including extensions, in the amount of 5% per month up to 25% of the amount of the tax, unless it is shown to the satisfaction of the cabinet that such failure is due to reasonable cause.

I. [4.33] FAILURE TO PAY

A penalty shall be imposed for failure to timely pay the amount of tax due as shown on the return in the amount of 1/2 of 1% (0.5%) of the amount of the tax due each month, provided that the total penalty shall not exceed 25% of the total tax due, unless it is shown to the satisfaction of the revenue cabinet that such failure was due to reasonable cause.

A penalty shall be imposed upon any corporation granted an extension to file its income tax return which fails to pay any remaining balance shown on the return by the extended due date, or fails to pay, prior to the granting of the extension, an amount equal to either:

- (i) The tax shown on the return of the corporation for the preceding taxable year, if a return showing a liability for tax was filed by the corporation for the preceding taxable year and the preceding taxable year was a taxable year of 12 months; or,
- (ii) 90% of its liability for the taxable year after the liability is reduced by any estimated tax payments, overpayments from prior years or other prepayments which may be properly claimed as a credit.

The penalty may be avoided if the taxpayer shows that failure to pay is due to reasonable cause.

J. [4.34] NEGLIGENCE

If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, a penalty in the amount of 5% of the total amount of the deficiency shall be assessed, in addition to the deficiency and other penalties.

K. [4.35] FRAUD

If any part of any deficiency is due to fraud with intent to evade tax, 50% of the total amount of the deficiency shall be assessed, in addition to the deficiency and other applicable penalties.

L. [4.36] UNDERPAYMENT BY A CORPORATION

Any corporation required by KRS 141.042 to file a declaration of estimated tax and required to pay such declaration of estimated tax by the installment method, may be subject to a penalty of 10% of any installment underpayment or any installment not timely made.²⁰

²⁰ See also Revenue Policy 41P040.

M. [4.37] DECLARATION AND PAYMENT OF ESTIMATED CORPORATION TAX-KRS 141.042 AND 141.044

Every corporation subject to taxation under KRS 141.040 must make a declaration of estimated tax if the tax imposed by KRS 141.040 for the taxable year can reasonably be expected to exceed \$5,000. The declaration must contain the following information:

- (a) The amount which is estimated as the amount of tax under KRS 141.040 for the taxable year;
- (b) The excess of the amount estimated over \$5,000 which excess shall be considered the estimated tax for the taxable year; and,
- (c) Such other information as the department by forms or regulations may prescribe (i.e. name, address and account numbers of the taxpayer, tax year end, and due date of installment).

There is a statutory exemption of \$5,000 of income tax. Therefore, only the amount in excess of that figure must be provided. The estimated tax will be paid in the following manner. If the declaration is filed on or before June 15 of the taxable year, the estimated tax shall be paid in three installments. The due dates and amount of payments are outlined below.

Declaration and First Installment	June 15	1/2 estimated tax due
Second Installment	September 15	1/4 estimated tax due
Third Installment	December 15	1/4 estimated tax due

If the declaration is filed after June 15 but not after September 15 of the taxable year and is not required by KRS 141.042 to be filed on or before June 15 of the taxable year, the estimated tax shall be paid in two installments. The first installment, in an amount equal to 75% of the estimated tax, shall be paid at the time of the filing of the declaration and the second installment, in an amount equal to 25% of the estimated tax, on December 15 of the taxable year.

If the declaration is filed after September 15 of the taxable year and is not required to be filed on or before September 15 of the taxable year, the estimated tax shall be paid in full at the time of the filing of the declaration.

Revisions to estimates are required if income changes. Corresponding adjustments are made to subsequent installment payments.

N. [4.38] LIABILITY FOR TAX ON DISCONTINUATION OF BUSINESS-KRS 141.130

If any corporation dissolves or withdraws from the state during any taxable year, or if any corporation in any manner surrenders or loses its charter during any taxable year, the dissolution, withdrawal or loss or surrender of charter shall not defeat the filing of a return and the assessment and collection of income taxes for the period of the taxable year during which the corporation had income in the state.²¹

O. [4.39] ACCOUNTING PERIOD FOR COMPUTATION OF INCOME-KRS 141.140

A taxpayer required to file a federal income tax return shall compute his income for purposes of Kentucky taxation on the basis of the same calendar or fiscal year required by the federal government, and shall

²¹ 103 KAR 15:040.

employ the same methods of accounting required for federal income tax purposes.²² The income of a corporation for a period of less than one year shall be annualized.

P. [4.40] WHEN RETURNS FOR INCOME TAX ARE DUE; FORMS, COPY OF FEDERAL RETURN MAY BE REQUIRED-KRS 141.160

Corporate income tax returns are due on or before the 15th day of the fourth month following the end of the taxable year, or April 15 for calendar year taxpayers. The department may require copies of a taxpayer's federal income tax return, and all statements and schedules in support thereof. Additionally, it may require copies of reports of adjustments made by the Internal Revenue Service.

Q. [4.41] CONSOLIDATED OR COMBINED RETURNS FROM CORPORATIONS-KRS 141.205

The Revenue Cabinet may require either a consolidated return or a combined return from any or all corporations engaged in inter-corporate transactions whenever it finds that such transactions reduce taxable net income, as defined in KRS 141.010(14), of the corporation(s) below the amount which would result if the transactions were at arm's length. The cabinet is also authorized to assess the tax against any of the corporations whose income is included in the consolidated or combined return in such a manner as it may determine necessary to prevent the avoidance of income tax.

R. [4.42] PAYMENT OF TAX; WHEN DUE-KRS 141.220

The full amount of the unpaid tax payable by any taxpayer, as it appears on the return, shall be paid to the department at the time fixed for filing returns.

S. [4.43] AUDITING OF RETURNS-KRS 141.210

The Revenue Cabinet shall examine and audit a taxpayer's return as soon as practicable after it is received. If the amount of tax computed by the cabinet is greater than the amount returned by the taxpayer, the excess shall be assessed by the cabinet within four years from the date the return was filed. In the case of a failure to file a return or the filing of a fraudulent return, the additional tax may be assessed at any time. A notice of the assessment shall be mailed to the taxpayer.

In the case of a corporation which understates its taxable net income or omits from taxable net income an amount properly includible therein, or both, which understatement or omission or both is in excess of 25% of the amount of taxable net income stated in the return, the excess may be assessed at any time within six years after the return was filed.²³

A taxpayer is required to notify the department of any pending examination by the Internal Revenue Service within 30 days after the taxpayer has or should have had knowledge of the commencement of the examination, and must submit a copy of the final determination of such federal audit within 30 days of its conclusion. Failure by a taxpayer to notify the department of a federal examination within the time prescribed will automatically suspend the limitations set forth in this section for assessments directly related to federal examinations until 90 days after the department receives notice from the taxpayer.²⁴

²² See also Revenue Policy 40P030.

²³ See also Revenue Policy 41P030.

²⁴ See also Revenue Policy 41P050.

Execution of a waiver of the statute of limitations pursuant to 6501(c)(4) of the Internal Revenue Code shall constitute an extension of the statute of limitations for assessments pursuant to KRS 141.235. All such extensions or waivers must be submitted to the department within 30 days from the date the agreement is signed by the taxpayer.²⁵

²⁵ See also Revenue Policy 41P060.

APPENDIX 4-A

***Selected Kentucky Revised Statutes**

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141.010 Definitions

As used in this chapter, unless the context requires otherwise:

- (1) "Secretary" means the secretary of revenue;
- (2) "Cabinet" means the Revenue Cabinet;
- (3) "Internal Revenue Code" means the Internal Revenue Code in effect on December 31, 1989, exclusive of any amendments made subsequent to that date and as modified by KRS 141.0101;
- (4) "Dependent" means those persons defined as dependents in the Internal Revenue Code;
- (5) "Fiduciary" means "fiduciary" as defined in Section 7701(a)(6) of the Internal Revenue Code;
- (6) "Fiscal year" means "fiscal year" as defined in Section 7701(a)(24) of the Internal Revenue Code;
- (7) "Individual" means a natural person;
- (8) For taxable years beginning on or after January 1, 1974, "federal income tax" means the amount of federal income tax actually paid or accrued for the taxable year on taxable income as defined in Section 63 of the Internal Revenue Code, and taxed under the provisions of this chapter, minus any federal tax credits actually utilized by the taxpayer;
- (9) "Gross income" in the case of taxpayers other than corporations means "gross income" as defined in Section 61 of the Internal Revenue Code;
- (10) "Adjusted gross income" in the case of taxpayers other than corporations means gross income as defined in subsection (9) of this section minus the deductions allowed individuals by Section 62 of the Internal Revenue Code and as modified by KRS 141.0101 and adjusted as follows, except that deductions shall be limited to amounts allocable to income subject to taxation under the provisions of this chapter, and except that nothing in this chapter shall be construed to permit the same item to be deducted more than once:
 - (a) Exclude income that is exempt from state taxation by the Kentucky Constitution and the Constitution and statutory laws of the United States and Kentucky;
 - (b) Exclude income from supplemental annuities provided by the Railroad Retirement Act of 1937 as amended and which are subject to federal income tax by Public Law 89-699;
 - (c) Include interest income derived from obligations of sister states and political subdivisions thereof;
 - (d) Exclude employee pension contributions picked up as provided for in KRS 6.505, 16.545, 21.360, 61.560, 65.155, 67A.320, 67A.510, 78.610, and 161.540 upon a ruling by the Internal Revenue Service or the federal courts that these contributions shall not be included as gross income until such time as the contributions are distributed or made available to the employee;
 - (e) Exclude Social Security and tier I railroad retirement benefits subject to federal income tax;
 - (f) Include, for taxable years ending before January 1, 1991, all overpayments of federal income tax refunded or credited for taxable years;
 - (g) Deduct, for taxable years ending before January 1, 1991, federal income tax paid for taxable years ending before January 1, 1990; and
 - (h) Exclude any money received because of a settlement or judgment in a lawsuit brought against a manufacturer or distributor of "Agent Orange" for damages resulting from exposure to Agent Orange by a member or veteran of the

armed forces of the United States or any dependent of such person who served in Vietnam.

(11) "Net income" in the case of taxpayers other than corporations means adjusted gross income as defined in subsection (10) of this section, minus the standard deduction allowed by KRS 141.081, or, at the option of the taxpayer, minus the deduction allowed by KRS 141.0202 and minus all the deductions allowed individuals by Chapter 1 of the Internal Revenue Code as modified by KRS 141.0101 except those listed below, except that deductions shall be limited to amounts allocable to income subject to taxation under the provisions of this chapter and that nothing in this chapter shall be construed to permit the same item to be deducted more than once:

(a) Any deduction allowed by the Internal Revenue Code for state taxes measured by gross or net income, except that such taxes paid to foreign countries may be deducted;

(b) Any deduction allowed by the Internal Revenue Code for amounts allowable under KRS 140.090(1)(h) in calculating the value of the distributive shares of the estate of a decedent, unless there is filed with the income return a statement that such deduction has not been claimed under KRS 140.090(1)(h);

(c) The deduction for personal exemptions allowed under section 151 of the Internal Revenue Code and any other deductions in lieu thereof; and

(d) Any deduction for amounts paid to any club, organization, or establishment which has been determined by the courts or an agency established by the General Assembly and charged with enforcing the civil rights laws of the Commonwealth, not to afford full and equal membership and full and equal enjoyment of its goods, services, facilities, privileges, advantages or accommodations to any person because of race, color, religion, national origin, or sex, except nothing shall be construed to deny a deduction for amounts paid to any religious or denominational club, group, or establishment or any organization operated solely for charitable or educational purposes which restricts membership to persons of the same religion or denomination in order to promote the religious principles for which it is established and maintained;

(12) "Gross income," in the case of corporations, means "gross income" as defined in Section 61 of the Internal Revenue Code and as modified by KRS 141.0101 and adjusted as follows:

(a) Exclude income that is exempt from state taxation by the Kentucky Constitution and the Constitution and statutory laws of the United States;

(b) Exclude all dividend income received after December 31, 1969;

(c) Include interest income derived from obligations of sister states and political subdivisions thereof;

(d) Exclude fifty percent (50%) of gross income derived from any disposal of coal covered by Section 631(c) of the Internal Revenue Code if the corporation does not claim any deduction for percentage depletion, or for expenditures attributable to the making and administering of the contract under which such disposition occurs or to the preservation of the economic interests retained under such contract;

(e) Include in the gross income of lessors income tax payments made by lessees to lessors, under the provisions of Section 110 of the Internal Revenue Code, and exclude such payments from the gross income of lessees;

(f) Include the amount calculated under KRS 141.205;

(g) Ignore the provisions of Section 281 of the Internal Revenue Code in computing gross income; and

(h) Exclude income from "safe harbor leases" (Section 168(f)(8) of the Internal Revenue Code);

(13) "Net income," in the case of corporations, means "gross income" as defined in subsection (12) of this section minus the deduction allowed by KRS 141.0202 and minus all the deductions from gross income allowed corporations by Chapter 1 of the Internal Revenue Code and as modified by KRS 141.0101, except the following:

(a) Any deduction for a state tax which is computed, in whole or in part, by reference to gross or net income and which is paid or accrued to any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or to any foreign country or political subdivision thereof;

(b) The deductions contained in Sections 243, 244, 245, and 247 of the Internal Revenue Code;

(c) The provisions of Section 281 of the Internal Revenue Code shall be ignored in computing net income;

(d) Any deduction directly or indirectly allocable to income which is either exempt from taxation or otherwise not taxed under the provisions of this chapter, and nothing in this chapter shall be construed to permit the same item to be deducted more than once;

(e) Exclude expenses related to "safe harbor leases" (Section 168(f)(8) of the Internal Revenue Code); and

(f) Any deduction for amounts paid to any club, organization, or establishment which has been determined by the courts or an agency established by the General Assembly and charged with enforcing the civil rights laws of the Commonwealth, not to afford full and equal membership and full and equal enjoyment of its goods, services, facilities, privileges, advantages, or accommodations to any person because of race, color, religion, national origin, or sex, except nothing shall be construed to deny a deduction for amounts paid to any religious or denominational club, group, or establishment or any organization operated solely for charitable or educational purposes which restricts membership to persons of the same religion or denomination in order to promote the religious principles for which it is established and maintained;

(14) (a) "Taxable net income," in the case of corporations having property or payroll only in this state, means "net income" as defined in subsection (13) of this section;

(b) "Taxable net income," in the case of corporations having property or payroll both within and without this state means "net income" as defined in subsection (13) of this section and as allocated and apportioned under KRS 141.120;

(c) "Property" means either real property or tangible personal property which is either owned or leased. "Payroll" means compensation paid to one (1) or more individuals, as described in KRS 141.120(8)(b). Property and payroll are deemed to be entirely within this state if all other states are prohibited by Public Law 86-272, as it existed on December 31, 1975, from enforcing income tax jurisdiction; and

(d) "Taxable net income" in the case of homeowners' associations as defined in Section 528(c) of the Internal Revenue Code, means "taxable income" as defined in Section 528(d) of the Internal Revenue Code. Notwithstanding the provisions of subsection (3) of this section, the Internal

Revenue Code sections referred to in this paragraph shall be those code sections in effect for the applicable tax year;

(15) "Person" means "person" as defined in Section 7701(a)(1) of the Internal Revenue Code;

(16) "Taxable year" means the calendar year or fiscal year ending during such calendar year, upon the basis of which net income is computed, and in the case of a return made for a fractional part of a year under the provisions of this chapter or under regulations prescribed by the secretary, "taxable year" means the period for which such return is made;

(17) "Resident" means an individual domiciled within this state or an individual who is not domiciled in this state, but maintains a place of abode in this state and spends in the aggregate more than one hundred eighty-three (183) days of the taxable year in this state;

(18) "Nonresident" means any individual not a resident of this state;

(19) "Employer" means "employer" as defined in Section 3401(d) of the Internal Revenue Code;

(20) "Employee" means "employee" as defined in Section 3401(c) of the Internal Revenue Code;

(21) "Number of withholding exemptions claimed" means the number of withholding exemptions claimed in a withholding exemption certificate in effect under KRS 141.325, except that if no such certificate is in effect, the number of withholding exemptions claimed shall be considered to be zero;

(22) "Wages" means "wages" as defined in Section 3401(a) of the Internal Revenue Code and includes other income subject to withholding as provided in Section 3401(f) and Section 3402(k), (o), (p), and (q) of the Internal Revenue Code;

(23) "Payroll period" means "payroll period" as defined in Section 3401(b) of the Internal Revenue Code;

(24) "Corporations" means "corporations" as defined in Section 7701(a)(3) of the Internal Revenue Code;

(25) "S corporations" means "S corporations" as defined in Section 1361(a) of the Internal Revenue Code. Stockholders of a corporation qualifying as an "S corporation" under this chapter may elect to treat such qualification as an initial qualification under Subchapter S of the Internal Revenue Code Sections.

141.0101 Depreciation methods and transitional rules

(1) For property placed in service prior to January 1, 1990, in lieu of the depreciation and expense deductions allowed under Internal Revenue Code Sections 168 and 179, a deduction for a reasonable allowance for depreciation, exhaustion, wear and tear, and obsolescence of property used in a trade or business shall be allowed and computed as set out in subsections (2) to (10) of this section. For property placed in service after December 31, 1989, the depreciation and expense deductions allowed under Sections 168 and 179 of the Internal Revenue Code in effect on December 31, 1989 shall be allowed.

(2) Effective August 1, 1985, "reasonable allowance" as used in subsection (1) of this section shall mean depreciation computed in accordance with Section 167 of the Internal Revenue Code and related regulations in effect on December 31, 1980, for all property placed in service on or after January 1, 1981, except as provided in subsections (5) to (7) of this section.

(3) Depreciation of property placed in service prior to January 1, 1981, shall be computed under Section 167 of the Internal Revenue Code, and the method elected thereunder at the time the property was first placed in service or as changed with the approval of the Commissioner of Internal Revenue Service or as required by changes in federal regulations.

(4) Taxpayers other than corporations shall be allowed to deduct as depreciation on recovery property placed in service before August 1, 1985, an amount calculated under Section 168 of the Internal Revenue Code subject to the provisions of subsections (5) and (7) of this section. Corporations with a taxable year beginning on or after July 1, 1984, and before August 1, 1985, shall calculate a deduction for depreciation on recovery property placed in service prior to August 1, 1985, using either of the following alternative methods:

(a) Dividing the total of the deductions allowed under Internal Revenue Code Section 168 by one and four tenths (1.4); and

(b) Calculating the deduction that would be allowed or allowable under the provisions of Section 167 of the Internal Revenue Code.

(5) Recovery property placed in service on or after January 1, 1981, and before August 1, 1985, and subject to transition under subsection (7) of this section, shall be subject to depreciation under Section 167 of the Internal Revenue Code, restricted to the straight line method therein provided over the remaining useful life of such assets.

(6) Depreciation of property placed in service on or after August 1, 1985, shall be computed under Section 167 of the Internal Revenue Code.

(7) Transition from Section 168 of the Internal Revenue Code, Accelerated Cost Recovery System (ACRS) depreciation, to the depreciation allowed or allowable under this section shall be reported in the first taxable year beginning on or after August 1, 1985. To implement the transition, the following adjustments shall be made:

(a) Taxpayers other than corporations shall use the adjusted Kentucky basis for property placed in service on or after January 1, 1981. "Adjusted Kentucky basis" means the basis used for determining depreciation under Section 168 of the Internal Revenue Code less the allowed or allowable depreciation and adjustment for election to expense an asset (Section 179 of the Internal Revenue Code);

(b) Corporations shall adjust the federal unadjusted basis by increasing such basis by the ACRS depreciation not allowed as a deduction in determining Kentucky net income for tax years beginning after June 30, 1984, less allowed or allowable ACRS depreciation for federal income tax purposes. Corporations will not be permitted to adjust the basis by the ACRS depreciation not allowed for Kentucky income tax purposes in tax years beginning on or before June 30, 1984.

(8) A taxpayer may elect to treat the cost of property placed in service on or before July 31, 1985, as an expense as provided in Section 179 of the Internal Revenue Code in effect on December 31, 1981, except that the aggregate cost which may be expensed for corporations shall not exceed five thousand dollars (\$5,000). A taxpayer may elect to treat the cost of property placed in service on or after August 1, 1985, as an expense as provided in Section 179 of the Internal Revenue Code in effect on December 31, 1980. Computations, limitations, definitions, exceptions, and other provisions of Section 179 of the Internal Revenue

Code and related regulations shall be construed to govern the computation of the allowable deduction.

(9) Upon the sale, exchange, or disposition of any depreciable property placed in service on or after January 1, 1981, capital gains or losses and the amount of ordinary income determined under the provisions of the Internal Revenue Code shall be computed for Kentucky income tax purposes as follows:

(a) Compute the Kentucky unadjusted basis which is the cost of the asset reduced by any basis adjustment made by the taxpayer under Section 48(q)(1) of the Internal Revenue Code and any expense allowed and utilized under Section 179 of the Internal Revenue Code (First Year Expense) in determining Kentucky net income in prior years, and

(b) Compute the adjusted basis by subtracting the depreciation allowed or allowable for Kentucky income tax purposes from the unadjusted basis, except corporations will not be permitted to adjust the basis of assets by the ACRS depreciation not allowed for Kentucky income tax purposes in the tax years beginning on or before June 30, 1984, and

(c) Compute the gain or loss by subtracting the adjusted basis from the value received from the disposition of the depreciable property, and

(d) Compute the recapture of depreciation required under Sections 1245 through 1256 of the Internal Revenue Code and related regulations, and

(e) Unless otherwise provided in this subsection the provisions of the Internal Revenue Code and related regulations governing the determination of capital gains or losses shall apply for Kentucky income tax purposes.

(10) Unless otherwise provided by this chapter, the basis of property placed in service prior to January 1, 1990, for purposes of Kentucky income tax shall be the basis, adjusted or unadjusted, required to be used under Section 167 of the Internal Revenue Code in effect on December 31, 1980.

141.011 Casualty losses; net operating losses

Notwithstanding any other provision of this chapter, the net operating loss carryback-carryforward deduction, including casualty loss, allowed under Section 172 of the Internal Revenue Code shall apply only to such losses incurred in taxable years beginning after December 31, 1979 and no such loss shall be carried back to taxable years beginning before January 1, 1980. Any casualty loss carryforward authorized by this section as it existed before January 1, 1980 may be carried forward as an itemized deduction until it has been fully deducted.

141.012 Corporation may carry forward and deduct net operating loss for first year of operations

Notwithstanding the provisions of paragraph (b) of subsection (13) of KRS 141.010, any corporation engaging in business for the first time in this state and employing within this state a minimum permanent investment of \$100,000 in real property owned or leased, which incurs a net operating loss during its first year of operations, may carry the loss forward to the next succeeding taxable year and deduct it from the net income for that year as determined under the provisions of this chapter.

141.040 Corporation income tax; exemption; rate

(1) Every corporation organized under the laws of this state, every corporation having its commercial domicile as defined in KRS 141.120(1)(b) in this state, and every foreign corporation owning or leasing property located in this state or having one (1) or more individuals receiving compensation as defined in KRS 141.120(8)(b) in this state, except those corporations listed in paragraphs (a) to (i) of

this subsection, shall pay for each taxable year a tax to be computed by the taxpayer on taxable net income at the rates specified in subsections (2), (3), and (4) of this section:

(a) S corporations;

(b) State and national banks and trust companies, except bankers banks organized under KRS 287.135;

(c) Savings and loan associations organized under the laws of this state and under the laws of the United States and making loans to members only;

(d) Banks for cooperatives;

(e) Production credit associations;

(f) Insurance companies, including farmers or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;

(g) Corporations exempt under Section 501 of the Internal Revenue Code;

(h) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit; and

(i) Corporations having no individuals receiving compensation as defined in KRS 141.120(8)(b) in this state, and whose only owned or leased property located in this state is located at the premises of a printer, with which it has contracted for printing, if such property consists of the final printed product, property which becomes a part of the final printed product, or copy from which the printed product is produced.

(2) For tax years ending before January 1, 1990, the following rates shall apply:

(a) Three percent (3%) of the first twenty-five thousand dollars (\$25,000) of taxable net income;

(b) Four percent (4%) of the amount of taxable net income in excess of twenty-five thousand dollars (\$25,000), but not in excess of fifty thousand dollars (\$50,000);

(c) Five percent (5%) of the amount of taxable net income in excess of fifty thousand dollars (\$50,000), but not in excess of one hundred thousand dollars (\$100,000);

(d) Six percent (6%) of the amount of taxable net income in excess of one hundred thousand dollars (\$100,000), but not in excess of two hundred fifty thousand dollars (\$250,000); and

(e) Seven and twenty-five one hundredths percent (7.25%) of the amount of taxable net income in excess of two hundred fifty thousand dollars (\$250,000).

(3) For tax years beginning after December 31, 1989, the following rates shall apply:

(a) Four percent (4%) of the first twenty-five thousand dollars (\$25,000) of taxable net income;

(b) Five percent (5%) of the amount of taxable net income in excess of twenty-five thousand dollars (\$25,000) but not in excess of fifty thousand dollars (\$50,000);

(c) Six percent (6%) of the amount of taxable net income in excess of fifty thousand dollars (\$50,000), but not in excess of one hundred thousand dollars (\$100,000);

(d) Seven percent (7%) of the amount of taxable net income in excess of one hundred thousand dollars (\$100,000), but not in excess of two hundred fifty thousand dollars (\$250,000); and

(e) Eight and twenty-five one hundredths percent (8.25%) of the amount of taxable net income in excess of two hundred fifty thousand dollars (\$250,000).

(4) For tax years beginning before January 1, 1990, and ending after December 31, 1989, the tax shall be the sum of the amounts determined in paragraphs (a) and (b) as follows:

(a) Apply the tax rates in subsection (2) of this section to the taxable net income for the year and multiply the result by a fraction, the numerator of which is the number of days from the first day of the taxable year through December 31, 1989, and the denominator of which is the total number of days of the taxable year; and

(b) Apply the tax rates in subsection (3) of this section to the taxable net income for the year and multiply the result by a fraction, the numerator of which is the number of days from January 1, 1990, through the last day of the taxable year and the denominator of which is the total number of days of the taxable year.

(5) Every S corporation shall pay the tax imposed under subsection (1) of this section whenever the net capital gain of such corporation exceeds twenty-five thousand dollars (\$25,000), and exceeds fifty percent (50%) of its taxable income for the taxable year and its taxable income for such year exceeds twenty-five thousand dollars (\$25,000). The tax imposed by this subsection shall be the lower of:

(a) The tax determined by applying the rates in this section to the capital gains, in excess of twenty-five thousand dollars (\$25,000), determined under the Internal Revenue Code; or

(b) The tax determined by applying the rates in this section to the taxable income, in excess of twenty-five thousand dollars (\$25,000);

In no event shall the tax levied by this subsection apply if Section 1374 of the Internal Revenue Code would exempt such capital gains from federal income tax.

141.041 Tax credit for corporations for installing, modifying or utilizing coal for manufacturing or heating

(1) There shall be allowed a credit against the tax imposed on any corporation subject to taxation under KRS 141.040 and which, on or after January 1, 1984, installs, modifies, and utilizes facilities located in Kentucky for generating steam or hot water for space-heating or materials processing or for providing direct heat for industrial processes in the following ways:

(a) Replacement of an existing heat-generating facility not capable of using coal as a fuel with one in which coal can be used;

(b) Erection of a heat-generating facility additional to any existing heat-generating facility or facilities and capable of using coal as a fuel;

(c) Refurbishment for coal utilization of heat-generating facilities which were at one time capable of using coal but which had been altered to allow use of other fuels;

(d) Alteration of an existing heat-generating facility not capable of utilizing coal in such ways as to allow the use of coal;

(e) Substitution of coal for other fuels in any heat-generating facility which on January 1, 1984, was in existence

and capable of utilizing coal and other fuels. Substitution means the increased heat input in BTU from coal matched by equal decreases of heat input in equivalent measures to BTU from other fuels, based upon relative fuel usage in the calendar year preceding the year in which the substitution occurred.

(2) The amount of the allowable credit shall be equal to four and one-half percent (4½%) of the purchase price of the coal subject to taxation under KRS Chapter 143 consumed or substituted in each eligible heating facility as described in subsection (1) of this section, minus any transporting cost included in the purchase price.

(3) The credit shall be allowed for ten (10) years consecutive from the date of the initial installation, modification or utilization of any heat-generating facility installed or modified on and after January 1, 1984, as defined in subsection (1)(a), (b), (c) and (d) of this section or ten (10) years consecutive from the filing of a fuel-switching credit claim in subsection (1)(e) of this section.

(4) The amount of the tax credit allowable under this section in any year may not exceed the amount of the tax imposed by KRS 141.040 for that year less any other tax credit allowed under KRS Chapter 141, and no part of the credit shall be applicable to the tax imposed by KRS 141.040 for any other taxable year.

(5) A corporation claiming the credit under this section must submit proof of the installation, modification, utilization or substitution as required by regulations issued by the revenue cabinet prior to the claiming of such credit.

141.042 Declaration of estimated corporation tax

(1) For all taxable years beginning on or after July 1, 1966, every corporation subject to taxation under KRS 141.040 shall make a declaration of estimated tax if the tax imposed by KRS 141.040 for the taxable year can reasonably be expected to exceed \$5,000.

(2) The declaration required under subsection (1) shall contain the following information:

(a) The amount which is estimated as the amount of tax under KRS 141.040 for the taxable year;

(b) The excess of the amount estimated under paragraph (a) over \$5,000 which excess for purposes of this section and KRS 141.044 and 141.205 shall be considered the estimated tax for the taxable year;

(c) Such other information as the cabinet by forms or regulations may prescribe.

(3) The declaration required under subsection (1) shall be filed with the cabinet on or before June 15 of the taxable year, except that if the requirements of subsection (1) are first met:

(a) After June 1 and before September 2 of the taxable year, the declaration shall be filed on or before September 15 of the taxable year;

(b) After September 1 of the taxable year, the declaration shall be filed on or before December 15 of the taxable year.

(4) A corporation may make amendments of a declaration filed during the taxable year in accordance with regulations prescribed by the cabinet. An amendment of a declaration may be filed in any interval between the installment dates prescribed for that taxable year but only one amendment may be filed in each such interval. If any amendment

of a declaration is filed, the remaining installments, if any, shall be ratably increased or decreased as the case may be, to reflect the increase or decrease of the estimated tax by reason of such amendment. If any amendment is made after September 15 of the taxable year, any increase in the estimated tax by reason thereof shall be paid in full at the time of making such amendment.

(5) A corporation with a taxable year of less than twelve months shall make a declaration in accordance with regulations prescribed by the cabinet.

(6) The cabinet may grant a reasonable extension of time for filing declarations and paying the estimated tax under such rules and regulations as it may prescribe. If any extension operates to postpone a payment of estimated tax, interest at the rate of eight percent per annum shall be collected.

141.044 Payment of estimated corporation tax

(1) The estimated tax provided for in KRS 141.042 shall be paid as follows:

(a) If the declaration is filed on or before June 15 of the taxable year, the estimated tax shall be paid in three (3) instalments. The first instalment, in an amount equal to fifty percent (50%) of the estimated tax, shall be paid at the time of the filing of the declaration. The second and third instalments, each in an amount equal to twenty-five percent (25%) of the estimated tax, shall be paid on September 15 and December 15, respectively, of the taxable year;

(b) If the declaration is filed after June 15 and not after September 15 of the taxable year and is not required by KRS 141.042 to be filed on or before June 15 of the taxable year, the estimated tax shall be paid in two (2) instalments. The first instalment, in an amount equal to seventy-five percent (75%) of the estimated tax, shall be paid at the time of the filing of the declaration and the second instalment, in an amount equal to twenty-five percent (25%) of the estimated tax, on December 15 of the taxable year;

(c) If the declaration is filed after September 15 of the taxable year and is not required to be filed on or before September 15 of the taxable year, the estimated tax shall be paid in full at the time of the filing of the declaration;

(d) If the declaration is filed after the time prescribed in KRS 141.042, including cases where extensions of time have been granted, paragraphs (a), (b), and (c) of this subsection shall not apply, and there shall be paid at the time of such filing all instalments of estimated tax which would have been payable on or before such time if the declaration had been filed within the time prescribed in KRS 141.042, and the remaining instalments shall be paid at the times at

which, and in the amounts in which, they would have been payable if the declaration had been so filed.

(2) In the case where the tax computed under this chapter is less than the amount which has been declared and paid as estimated tax for the same taxable year, a refund shall be made upon the filing of a return, together with interest on such overpayment at the tax interest rate as defined in KRS 131.010(6) from the fifteenth day of the seventh month following the close of the taxable year for which the return is filed, or from the fifteenth day of the fourth month following the filing of the return if the return is filed later than the normal filing date.

(3) (a) Overpayment resulting from the payment of estimated tax in excess of the amount determined to be due upon the filing of a return for the same taxable year may be credited against the amount of estimated tax determined to be due on any declaration filed for the next succeeding taxable year or for any deficiency or nonpayment of tax for any previous taxable year;

(b) No refund shall be made of any estimated tax paid unless a complete return is filed as required by this chapter.

(4) At the election of the taxpayer, any instalment of the estimated tax may be paid prior to the date prescribed for its payment.

(5) In the application of this section and KRS 141.042 to the case of a taxable year beginning on any date other than January 1, there shall be substituted for the months specified therein the relative months and dates which correspond thereto.

141.050 Federal interpretations applicable, when; taxpayer record; subpoenas; forms; regulations

(1) Except to the extent required by differences between this chapter and its application and the federal income tax law and its application, the administrative and judicial interpretations of the federal income tax law, computations of gross income and deductions therefrom, accounting methods, and accounting procedures, for purposes of this chapter shall be as nearly as practicable identical with those required for federal income tax purposes.

(2) Every person subject to the provisions of this chapter shall keep such records, render under oath such statements, make such returns, and comply with such rules and regula-

tions as the cabinet from time to time may prescribe. Whenever the cabinet judges it necessary, it may require such person, by notice served upon him, to make a return, render under oath such statements, or keep such records, as the cabinet deems sufficient to show whether or not such person is liable for tax, and the extent of such liability.

(3) The secretary or his authorized agent or representative, for the purpose of ascertaining the correctness of any return or for the purposes of making an estimate of the taxable income of any taxpayers, may require the attendance of the taxpayer or of any other person having knowledge in the premises.

(4) The cabinet shall prescribe the forms and reports necessary to the proper administration of any and all provisions of this chapter, and shall promulgate such rules and regulations necessary to effectively carry out the provisions of this chapter.

141.062 Premiums paid for health insurance to be treated as income tax credit

(1) The amount of premiums paid for health insurance shall be treated as an income tax credit for state income tax purposes, as follows:

- (a) Twenty percent (20%) of the first year premium;
- (b) Fifteen percent (15%) of the second year premium;
- (c) Ten percent (10%) of the third year premium; and
- (d) Five percent (5%) of the fourth year premium.

(2) No employer or employee shall be eligible for the income tax credits enumerated in this section unless:

(a) Premiums are paid into the trust prior to July 1, 1992;

(b) Fifty (50) or fewer employees are employed;

(c) No health insurance benefits have been provided by the employer during the three (3) years preceding the date premiums are initially paid to the trust;

(d) Employers maintain participation in the trust for all full-time and part-time employees for a period of four (4) continuous years; and

(e) Employers pay at least fifty percent (50%) of the premium.

141.065 Credit allowed for hiring person classified as unemployed

(1) For the purposes of this section, "code" or "Internal Revenue Code" means the Internal Revenue Code in effect as of December 31, 1981.

(2) There shall be allowed as a credit for any taxpayer against the tax imposed by this chapter for any taxable year, an amount equal to one hundred dollars (\$100) for each person hired by the taxpayer, provided such person has

been classified as unemployed by the department for social insurance of the cabinet for human resources, and has been so classified for at least sixty (60) days prior to his employment by the taxpayer, and further provided that such person has remained in the employ of the taxpayer for at least one hundred eighty (180) consecutive days during the taxable year in which the taxpayer claims the credit.

(3) No credit shall be allowed to any taxpayer for any person hired under any of the following circumstances:

(a) A person for whom the taxpayer receives federally funded payments for on-the-job training; or

(b) For any person who bears any of the relationships to the taxpayer described in paragraphs (1) through (8) of section 152(a) of the Internal Revenue Code, or, if the taxpayer is a corporation, to an individual who owns, directly or indirectly, more than fifty percent (50%) in value of the outstanding stock of the corporation as determined with the application of section 267(c) of the code; or

(c) If the taxpayer is an estate or trust, to any person who is a grantor, beneficiary, or fiduciary of the estate or trust, or is an individual who bears any of the relationships described in paragraphs (1) through (8) of section 152(a) of the code to a grantor, beneficiary, or fiduciary of the estate or trust; or

(d) To any person who is a dependent of the taxpayer as described in code section 152(a)(9), or, if the taxpayer is an estate or trust, of a grantor, beneficiary, or fiduciary of the estate or trust.

(4) For purposes of this section, all employees of all corporations which are members of the same controlled group of corporations shall be treated as employed by a single employer. In no instance shall the credit, if any, allowable by subsection (2) of this section for any employee qualified thereunder be claimed more than once for any taxable year by such a controlled group of corporations. For purposes of this subsection, the term "controlled group of corporations" has the meaning given to such term by code section 1563(a), except that "more than fifty percent (50%)" shall be substituted for "at least eighty percent (80%)" each place it appears in code section 1563(a)(1), and the determination shall be made without regard to subsections (a)(4) and (e)(3)(c) of code section 1563.

(5) For purposes of this section, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer, and in no instance shall the credit, if any, allowable by subsection (2) of this section for any employee qualified thereunder be claimed more than once for any taxable year.

(6) No credit shall be allowed under subsection (2) of this section to any organization which is exempt from income tax by this chapter.

(7) In the case of an electing small business corporation, the amount of the credit determined under this section for any taxable year shall be apportioned pro rata among the persons who are shareholders of such corporation on the last day of the taxable year, and any person to whom such an amount is so apportioned shall be allowed, subject to code section 53, a credit under subsection (2) of this section for such amount.

(8) In the case of an estate or trust, the amount of the credit determined under this section for any taxable year shall be apportioned between the estate or trust and the beneficiaries on the basis of income of the estate or trust allocable to each, and any beneficiary to whom any amount

has been apportioned under this subsection shall be allowed, subject to code section 53, a credit under subsection (2) of this section for such amount.

(9) In no event shall the credit allowed, pursuant to this section, for any taxable year exceed the tax liability of the taxpayer for the taxable year.

141.120 Division of income of interstate business for tax purposes; apportionment

(1) As used in this section, unless the context requires otherwise:

(a) "Business income" means income arising from transactions and activity in the regular course of a trade or business of the taxpayer and includes income from tangible and intangible property if the acquisition, management, or disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations;

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is managed;

(c) "Compensation" means wages, salaries, commissions, and any other form of remuneration paid or payable to employees for personal services;

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, investment company, or any type of insurance company;

(e) "Nonbusiness income" means all income other than business income;

(f) "Public service company" means any business entity subject to taxation under KRS 136.120;

(g) "Sales" means all gross receipts of the taxpayer not allocated under subsections (3) through (7) of this section;

(h) "State" means any state of the United States, the District of Columbia, the commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(2) Any corporation which is required by KRS 141.010(14)(b) to allocate and apportion its net income shall allocate and apportion its net income as provided in this section.

(3) Rents and royalties from real, intangible or tangible personal property, capital gains and losses, interest, or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in subsections (4) through (7) of this section.

(4) (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible personal property are allocable to this state if and to the extent that the property is utilized in this state; or in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, the tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

(d) Net rents and royalties from intangible personal property located in this state are allocable to this state. For purposes of this section, royalties from property leased in Kentucky shall be considered as royalties from intangible personal property.

(5) (a) Capital gains and losses from sales or other dispositions of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales or other dispositions of tangible personal property are allocable to this state if the property had a situs in this state at the time of the sale, or the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales or other dispositions of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

(6) Interest is allocable to this state if the taxpayer's commercial domicile is in this state.

(7) (a) Patent and copyright royalties are allocable to this state if and to the extent that the patent or copyright is utilized by the payer in this state; or if and to the extent that the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located.

(8) All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three (3);

provided, however, that effective with taxable years beginning after July 31, 1985, in lieu of the equally weighted three (3) factor apportionment fraction based on property, payroll, and sales, an apportionment fraction composed of a sales factor representing fifty percent (50%) of the fraction, a property factor representing twenty-five percent (25%) of the fraction, and a payroll factor representing twenty-five percent (25%) of the fraction shall be used.

(a) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period; provided, however, that property which has been certified as a pollution control facility as defined in KRS 224.850 shall be excluded from the property factor.

1. Property owned by the taxpayer is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero such property shall be valued by the cabinet under regulations promulgated by the cabinet. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals, provided that such rental and such sub-rentals are reasonable. If the cabinet determines that the annual rental or sub-rental rate is unreasonable, or if a nominal or zero rate is charged, the cabinet may determine and apply such rental rate as will reasonably reflect the value of the property rented by the taxpayer.

2. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the cabinet may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(b) The payroll factor is a fraction, the numerator of which is the total amount paid or payable in this state during the tax period by the taxpayer for compensation, and the denominator of which is the total compensation paid or payable everywhere during the tax period. Compensation is paid or payable in this state if:

1. The individual's service is performed entirely within the state; or

2. The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

3. Some of the service is performed in the state and the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

(c) The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period. Sales of tangible personal property are in this state if:

1. The property is delivered or shipped to a purchaser, other than the United States government, or to the designee of the purchaser within this state regardless of the f.o.b. point or other conditions of the sale; or

2. The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the purchaser is the United States government.

3. Sales, other than sales of tangible personal property, are in this state if the income-producing activity is performed in this state; or the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

(9) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the cabinet may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting;

(b) The exclusion of any one or more of the factors;

(c) The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

(10) Public service companies and financial organizations required by KRS 141.010(14)(b) to allocate and apportion net income shall allocate and apportion such income as follows:

(a) Nonbusiness income shall be allocated to this state as provided in subsections (4) through (7) of this section.

(b) Business income shall be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three (3); provided, however, that effective with taxable years beginning after July 31, 1985, in lieu of the equally weighted three (3) factor apportionment fraction based on property, payroll, and sales, an apportionment fraction composed of a sales factor representing fifty percent (50%) of the fraction, a property factor representing twenty-five percent (25%) of the fraction, and a payroll factor representing twenty-five percent (25%) of the fraction shall be used. The payroll factor shall be determined as provided in subsection (8)(b) of this section. The property factor and sales factor shall be determined as provided by regulations promulgated by the cabinet.

141.130 Liability for tax on discontinuation of business

If any corporation or partnership dissolves or withdraws from this state during any taxable year, or if any corporation in any manner surrenders or loses its charter during any taxable year, the dissolution, withdrawal or loss or surrender of charter shall not defeat the filing of returns and the assessment and collection of income taxes for the period of that taxable year during which the corporation or partnership had an income in this state.

141.140 Accounting period for computation of income

(1) If the taxpayer makes, or is required to make, a federal income tax return, his income shall be computed for the purposes of this chapter on the basis of the same calendar or fiscal year required by the federal government, and he shall employ the same methods of accounting required for federal income tax purposes.

(2) If a return is made by an individual for a period of less than one (1) year, the net income, computed on the basis of the period for which a separate return is made, shall be placed on an annual basis by multiplying the amount thereof by the number of days in the year and dividing by the number of days included in the period for which the separate return is made. The tax payable shall be such part of the tax computed on the annual basis as the number of days in the period is of the number of days in the year.

(3) If a return is made by a corporation for a period of less than one (1) year, the taxable net income, computed on the basis of the period for which a separate return is made, shall be placed on an annual basis by multiplying the amount thereof by the number of days in the year and dividing by the number of days included in the period for which the separate return is made. The tax payable shall be such part of the tax computed on the annual basis as the number of days in the period is of the number of days in the year.

141.160 When returns for income tax are due; forms; copy of federal return may be required

(1) All returns of income for the preceding taxable year shall be made by April 15 in each year, except returns made on the basis of a fiscal year, which shall be made by the fifteenth day of the fourth month following the close of the fiscal year. Blank forms for returns of income shall be supplied by the cabinet.

(2) Whenever, in the opinion of the cabinet, it is necessary to examine the federal income tax return or a copy thereof of any taxpayer in order to audit his return, the cabinet may compel the taxpayer to produce for inspection a copy of his federal return and all statements and schedules in support thereof. The cabinet may also require copies of reports of adjustments made by the federal government.

141.170 Extension of time for filing returns

(1) The revenue cabinet may grant a taxpayer other than a corporation a reasonable extension of time for filing his income return whenever in its judgment good cause exists, and shall keep a record of every such extension. Except in case of a taxpayer who is abroad, no extension shall be granted for more than six (6) months, and in no case for more than one (1) year.

(2) A corporation may be granted an extension of not more than six (6) months for filing its income return provided it timely requests the extension before the due date of the return and pays, on or before the date the return was due, the amount properly estimated as its tax.

(3) If the time for filing a return is deferred, the taxpayer shall pay, as part of the tax, an amount equal to the tax interest rate as defined in KRS 131.010(6) on the tax ultimately assessed, but not previously paid, from the time the return was due until it is actually filed in the office of the cabinet.

(a) Resident and nonresident individuals who are partners or S corporation shareholders must report and pay tax on the distributive share of net income, gain, loss, deduction, or credit, as determined in subsection (2) of this section, except as provided in subsections (4) and (5) of this section. Partnerships and S corporations may be required to withhold Kentucky income tax on the distributive share under administrative regulations issued by the cabinet.

(b) Corporations which are partners must include their distributive share of net income, gain, loss, deduction or credit, as determined under subsection (2) of this section, except as provided in subsections (4) and (5) of this section.

(4) Resident and nonresident individuals and corporations which are partners in a partnership or shareholders in a S corporation carrying on business only in Kentucky are taxable on all items of income gain, loss, deduction or credit determined under subsection (2) of this section and reported as their distributive share from the partnership or S corporation.

(5) Nonresident individuals and corporations which are partners in a partnership or shareholders in an S corporation which does business within and without Kentucky are taxable on their proportionate share of the distributive income passed through the partnership or S corporation attributable to business done in Kentucky.

(a) Business done in Kentucky is determined by the ratio of gross receipts from sales to purchasers or customers in Kentucky or services performed in Kentucky to the total gross receipts from sales or service everywhere.

(6) Resident partners, S corporation shareholders and corporations which are partners in a multi-state partnership or shareholders in a multi-state S corporation are taxable on one hundred percent (100%) of the distributive share of income, gains, losses, deductions or credits.

(7) Resident individuals who are partners in a partnership or shareholders in a S corporation which does not carry on business in Kentucky are subject to tax under KRS 141.020 on federal net income, gain, deduction, loss or credit passed through the partnership or S corporation.

(8) S corporation for purpose of this section means a corporation which has elected for federal tax purposes to be taxed as a S corporation. An election for federal tax purposes is a binding election for Kentucky tax purposes.

141.200 Corporation returns; supplementary returns

(1) Every corporation doing business in this state, except those exempt from taxation under KRS 141.040, shall make a return stating specifically the items of income and the items claimed as deductions allowed by this chapter. Corporations that are affiliated must each make a separate return.

(2) Every corporation return or report required by this chapter shall be executed by one (1) of the following officers of the corporation: the president, vice president, secretary, treasurer, assistant secretary, assistant treasurer, or chief accounting officer. The revenue cabinet may require a further or supplemental report of further information and data necessary for computation of the tax.

(3) In the case of a corporation doing business in this state that carries on transactions with stockholders or with other corporations related by stock ownership, by interlocking directorates, or by some other method, the cabinet shall require information necessary to make possible accurate assessment of the income derived by the corporation from sources within this state. To make possible such assessment, the cabinet may require the corporation to file supplementary returns showing information respecting the business of any or all individuals and corporations related by one or more of these methods to the corporation. The cabinet may require the return to show in detail the record of transactions between the corporation and any or all other related corporations or individuals.

141.205 Consolidated or combined returns from corporations

(1) The cabinet may require either a consolidated return or a combined return from any or all corporations con-

ducting inter-corporate transactions whenever the cabinet finds that such inter-corporate transactions reduce taxable net income, as defined in KRS 141.010(14), of the corporation(s) below the amount which would result if the transactions were at arm's length.

(2) The cabinet is authorized and empowered to assess the tax against any of the corporations whose income is included in the consolidated or combined return in such manner as it may determine necessary to prevent the avoidance of income tax.

(3) In the case of corporations not required to file a consolidated or combined return under subsection (1) of this section that carried on transactions with stockholders or affiliated corporations directly or indirectly, the cabinet shall adjust the net income of such corporations to an amount that would result if such transactions were carried on at arm's length.

141.206 Filing of returns by, and liability of, partnerships and S corporations

(1) Every partnership or S corporation owning property or engaging in business in Kentucky, shall, on or before the fifteenth day of the fourth month following the close of its annual accounting period, file a copy of its federal partnership return or S corporation return with the form prescribed and furnished by the cabinet.

(2) Partnerships and S corporations shall determine taxable income in the same manner as in the case of an individual under KRS 141.010(9) to (11) and the adjustment required under Sections 703(a) and 1363(b) of the Internal Revenue Code. Computation of taxable income under this section and the computation of the partners or shareholders distributive share shall be computed as nearly as practicable identical with those required for federal income tax purposes except to the extent required by differences between this chapter and the federal income tax law and regulations.

(3) Individuals or corporations carrying on a business as a partnership or S corporation shall be liable for income tax only in their individual or corporate capacities, and no income tax shall be assessed upon the income of any partnership or S corporation except as prescribed in KRS 141.040(5).

141.210 Auditing of returns; assessment of excess; duty of taxpayer to notify cabinet of examination of books and records with respect to federal income tax returns; suspension of limitations

(1) As soon as practicable after each return is received, the cabinet shall examine and audit it. If the amount of tax computed by the cabinet is greater than the amount returned by the taxpayer, the excess shall be assessed by the cabinet within four (4) years from the date the return was filed, except as hereinafter provided. A notice of the assessment shall be mailed to the taxpayer.

(a) In the case of a failure to file a return or of a fraudulent return the excess may be assessed at any time;

(b) In the case of a return where a taxpayer other than a corporation understates his net income or omits from net income an amount properly includible therein or both which understatement or omission or both is in excess of twenty-five percent of the amount of net income stated in the return the excess may be assessed at any time within six (6) years after the return was filed;

(c) In the case of a return wherein a corporation understates its taxable net income or omits from taxable net income an amount properly includible therein or both which understatement or omission or both is in excess of 25 percent of the amount of taxable net income stated in the return, the excess may be assessed at any time within six (6) years after the return was filed.

(d) If any excess is assessed on account of any income which has been returned for taxation by any other taxpayer, the cabinet, with the consent of such other taxpayer, his personal representatives or heirs, shall reduce the amount of the excess assessed for each year by the amount of the income tax paid for that year by such other taxpayer on account of the income in question.

(2) For the purpose of subsection (1) of this section a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day. The times provided for in subsection (1) of this section may be extended by agreement between the taxpayer and the cabinet.

(3) It shall be the duty of every taxpayer to:

(a) Notify the cabinet in writing of every examination of his books and records with respect to his net income as reported on his federal income tax return within thirty (30) days after he has or should have had knowledge of the beginning of such examination by the internal revenue service, and

(b) Submit a copy of the final determination of such federal audit within thirty (30) days of its conclusion.

Failure by a taxpayer to notify the cabinet within the time prescribed of a federal examination shall automatically suspend the limitations set forth in subsection (1) of this section for assessments directly related to the federal examination, until ninety (90) days after the cabinet receives notice in writing of the above actions from the taxpayer.

(4) (a) When any taxpayer extends by agreement the statute of limitations on deficiencies of federal income taxes as provided in section 6501(c)(4) of the Internal Revenue Code, a copy of such extension shall be submitted to the cabinet within thirty (30) days from the date such agreement is signed by the taxpayer.

(b) Any extension by agreement of the statute of limitations on deficiencies of federal income taxes shall constitute

an extension of the statute of limitations, for assessments under this section or overpayments under KRS 141.235, for a like period.

(c) Notwithstanding the provisions of (a) and (b) above, the cabinet shall have ninety (90) additional days to either make an assessment or authorize an overpayment after the cabinet is notified in writing by the taxpayer of the final determination of any federal audit.

141.220 Payment of tax; when due

The full amount of the unpaid tax payable by any taxpayer, as appears from the face of the return, shall be paid to the cabinet at the time fixed for filing returns.

141.347 Computation of income tax credit

State income tax that would otherwise be owed by the corporation to the Commonwealth, except for KRS 152.278(3)(a), by an approved company on the income generated or arising from an approved company operation or activity as an economic development project, shall be determined as follows:

(1) A corporation which is an approved company subject to income tax under KRS 141.040 shall compute the income tax due pursuant to KRS 141.010(13) to 141.010(14) including net income from the economic development project, subject to the applicable tax rate on taxable income.

(2) The corporation shall then compute the net income of the approved company as defined in subsection (1)(a) of this section excluding the net income from the economic development project subject to the applicable tax rate on taxable income.

(3) The difference between the tax computed in subsections (1) and (2) of this section equals the income tax to be permitted to be applied as a credit by an approved company toward income tax owed, such credit not to exceed the total debt service under the respective financing agreement.

(4) Net income excluded from taxable income in computing the tax due under subsection (2) of this section shall be determined under a separate accounting method reflecting only the gross income, deductions, expenses, gains and credits allowed under KRS Chapter 141.

(5) The revenue cabinet may issue administrative regulations and require the filing of forms designed by the revenue cabinet to reflect the intent of KRS 152.262 to 152.298 and the allowable income tax which an approved company may retain under KRS 152.262 to 152.298.

141.375 Definitions relating to qualifying energy property

As used in KRS 141.380, "qualifying energy property" means property used to generate power from solar radiation, wind, or geothermal energy. The term includes the components of active solar systems, passive solar systems, wind energy systems and geothermal energy systems, as defined in subsections (1) through (4) of this section.

(1) "Active solar system" means a system of equipment capable of collecting and converting solar radiation into thermal, mechanical or electrical energy, and of transferring these forms of energy to storage or the point of use. It includes water heating, space heating or cooling, and the generation of electrical or mechanical energy. Transfer or storage components are included, except for those which would be required regardless of the energy source being used.

(2) "Passive solar system" means a direct thermal system which utilizes the structure of a building and its operable components to collect, store and distribute heating or cooling during the appropriate times of the year, by utilizing the climate resources available at the site. It includes

those portions or components of a building that are expressly designed and required for the collection, storage and distribution of solar energy. Structural components of a building which also are used as part of the energy system, such as supporting walls used also for heat storage, are included only if and to the extent that their cost exceeds that of conventional construction. Multi-purpose components shall include but not be limited to windows or attached greenhouses, if designed as part of a solar system and if south facing. Multi-purpose components shall be included for half of their cost.

(3) "Wind energy system" means a system of equipment capable of intercepting and converting wind energy into mechanical or electrical energy and of transferring these forms of energy to the point of use or storage. It does not include those storage or transfer components which would be required regardless of the energy source being used. Wind equipment used to produce power for transportation is excluded.

(4) "Geothermal energy system" means a system of equipment necessary to transmit or use natural heat from the earth to provide hot water, produce electricity or generate heating or cooling for use within a building. This includes hydrothermal energy systems. It does not include those storage or transfer components which would be required regardless of the energy source being used.

141.380 Tax credit for expenditures for qualifying energy property installed by taxpayer

(1) There shall be allowed as a credit against the taxes imposed by KRS 141.020 and 141.040 an amount equal to fifteen percent (15%) of the expenditures, including installation cost, but excluding any finance charges, for qualifying energy property installed on premises in Kentucky which are owned or controlled by the taxpayer. The maximum credit which may be claimed by any taxpayer shall be fifteen hundred dollars (\$1,500) during the period specified in subsection (13) of this section. A system or component or piece of equipment shall not be eligible more than once for the credit provided in this section.

(2) The credit in this section may be claimed for the taxable year in which the installation is completed. The credit may be claimed only for expenditures made during the taxable year for which the credit is claimed or during the immediately preceding taxable year, but not for expenditures made before January 1, 1983.

(3) In the case of a husband and wife who file separate returns, the credit may be taken by either, or divided equally, but the combined credit shall not exceed fifteen hundred dollars (\$1,500).

(4) In the case of a partnership, of which one (1) or more of the partners are liable for the tax imposed under KRS 141.020, the amount of the credit each partner may claim shall be allocated in the same ratio as profits and losses are shared in the partnership, but the combined credit shall not exceed fifteen hundred dollars (\$1,500).

(5) A builder who installs qualifying energy property in a building constructed for resale may elect himself to claim

the credit allowed in this section, or may provide the purchaser with necessary documentation or certification so that the purchaser may claim the credit. The credit shall not be claimed by both the builder and the purchaser.

(6) In the case where the credit allowed in this section exceeds the tax due for the taxable year, that portion of the credit which exceeds the tax due may be carried over to the succeeding taxable years until the allowable credit has been fully exhausted, or until the credit has been claimed for three (3) successive years, whichever comes first.

(7) This tax credit shall not apply to trusts or estates.

(8) Before any tax credit can be claimed under the provisions of this section, the Natural Resources and Environmental Protection Cabinet must certify that the taxpayer's system is a viable system for using solar, wind or geothermal energy and documentation must be provided that the system has been completely installed. Any fee charged by the cabinet for review and certification of a system shall not exceed ten dollars (\$10.00).

(9) The Natural Resources and Environmental Protection Cabinet may promulgate such rules and regulations as necessary to maintain commonly accepted energy equipment standards, to effectively conform to the definition of qualifying energy property in KRS 141.375 and to administer the certification requirements in this section. The regulations, including those describing the application procedure, shall be written in nontechnical language understandable to lay citizens untrained in engineering, architecture, or other technical fields.

(10) With the exception of the certification requirements delegated to the Natural Resources and Environmental Protection Cabinet by this section, the Revenue Cabinet may promulgate such rules and regulations as necessary to effectively administer the requirements of KRS 141.375 and this section.

(11) All regulations necessary to implement KRS 141.375 and this section shall be filed with the Legislative Research Commission in accordance with KRS Chapter 13A by September 1, 1984.

(12) The Revenue Cabinet shall report as to the impact of KRS 141.375 and this section to the 1986 General Assembly and to the appropriate interim committee preceding the 1986 General Assembly. The report shall include the number and amount of the qualifying energy credits claimed, an estimate of the distribution by income group, the net revenue gain or loss to the Commonwealth attributable to the credits, and such other information as the Revenue Cabinet deems pertinent to an analysis of KRS 141.375 and this section.

(13) The provisions of KRS 141.375 and this section shall apply to the taxable years beginning on or after January 1, 1984, and ending on or before December 31, 1986, and no credit shall be allowed for any taxable year ending after December 31, 1986.

141.990 Penalties

(1) If any taxpayer fails or refuses to file a return or furnish any information requested in writing by the cabinet, the cabinet may make an estimate of the net income from any information in its possession, assess the tax at not more than twice the amount estimated to be due and add a penalty of twenty-five percent (25%) of the amount of any deficiency tax assessed concerning the failure or refusal to file a return or furnish any information. This penalty shall be in addition to all other applicable penalties in this section.

(2) If any taxpayer fails to make and file a return required by this chapter on or before the due date of the return or the due date as extended by the cabinet, then, unless it is shown to the satisfaction of the cabinet that the failure is due to reasonable cause, five percent of the tax found to be due by the cabinet shall be added to the tax for each thirty days or fraction thereof that filing the return is beyond the time prescribed or extended, but the total penalty shall not exceed twenty-five percent (25%) of the tax.

(3) If any taxpayer fails to pay the tax imposed by this chapter on or before the due date of the return or the due date as extended by the cabinet, unless it is shown to the satisfaction of the cabinet that the failure is due to reasonable cause, there shall be added to the tax found to be due by the cabinet one-half percent (0.5%) of the amount of the tax if the failure is for not more than one (1) month, with an additional one-half percent (0.5%) for each additional month or fraction thereof that payment of the tax is made beyond the time prescribed or extended, but the total penalty shall not exceed twenty-five percent (25%) of the tax.

(4) If any corporation granted an extension of time to file its income return under the provisions of KRS 141.170(2) fails to pay any remaining balance shown on the return by the extended due date of the return, or fails to pay, prior to the granting of the extension, an amount equal to either:

141.985 Interest on tax not paid by date due

If the tax imposed by this chapter, whether assessed by the cabinet, or the taxpayer, or any instalment or portion of the tax is not paid on or before the date prescribed for its payment, there shall be collected, as a part of the tax, interest upon the unpaid amount at the tax interest rate as defined in KRS 131.010(6) from the date prescribed for its payment until payment is actually made to the department. Interest shall be assessed, collected, and paid in the same manner as if it were a deficiency.

(a) The tax shown on the return of the corporation for the preceding taxable year, if a return showing a liability for tax was filed by the corporation for the preceding taxable year and the preceding year was a taxable year of twelve (12) months; or

(b) Ninety percent (90%) of its liability for the taxable year after the liability is reduced by any estimated tax payments, overpayments from prior years or other prepayments which may be properly claimed as a credit, then, unless it is shown to the satisfaction of the cabinet that the failure is due to reasonable cause, the penalty provided for in subsection (3) of this section shall be imposed from the original due date of the return.

(5) If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, five percent (5%) of the total amount of the deficiency, in addition to the deficiency and other penalties provided in this section, shall apply.

(6) If any part of any deficiency is due to fraud with intent to evade tax, fifty percent (50%) of the total amount of the deficiency, in addition to the deficiency and other penalties provided in this section, shall apply.

(7) Any person required under the provisions of KRS 141.150 or 141.335 to furnish a statement required under that section who willfully furnishes a false or fraudulent statement, or who willfully fails to furnish a statement in the manner at the time and showing the information required under KRS 141.150 and 141.335, may for each such failure be subject to a civil penalty of ten dollars (\$10). Such penalty may be assessed and collected by the cabinet, and the assessment of such penalty may be reviewed only in the manner provided in KRS 131.110.

(8) (a) Any employer required under the provisions of KRS 141.310, 141.315 or 141.330 to withhold taxes on wages, file returns, and make payment of amounts withheld to the cabinet, who fails to withhold such taxes, or to file such returns when due, or who fails to remit amounts collected to the cabinet when due, or when filing the returns understates the amount due shall, unless such failure to comply is shown to the satisfaction of the cabinet to be due to reasonable cause, be subject to a civil penalty equal to five percent (5%) per month or fraction thereof not to exceed twenty-five percent, (25%) of the amount of taxes that should have been properly withheld and paid over to the cabinet, or ten dollars (\$10), whichever is greater, for each such failure. However, where such failure is shown to be due to reasonable cause the cabinet may reduce the penalty provided herein to an amount equal to five percent (5%) of the amount of taxes that should have been properly withheld and paid over to the cabinet but not to exceed one hundred dollars (\$100), or ten dollars (\$10), whichever is greater, for each such penalty. Each penalty shall be assessed and collected by the cabinet and the assessment of such penalty may be reviewed only in the manner provided in KRS 131.110. The penalty may be waived if the return and payment are received within thirty (30) days after the due date and the employer has no previous record of late filing or late payment within two (2) years next preceding such due date.

(b) Any employer required to file a return under the provisions of KRS 141.330(1) when no tax should have been properly withheld, and who fails to file the same when due, shall be subject to a civil penalty of ten dollars (\$10) for each violation. Such penalty shall be assessed and collected by the cabinet and the assessment of such penalty

may be reviewed only in the manner provided in KRS 131.110. The penalty may be waived if the return is received within thirty (30) days after the due date and the employer has no previous record of late filing within two (2) years next preceding such due date.

(9) Any individual required by KRS 141.300 to file a declaration of estimated tax and required by KRS 141.305 to pay such declaration of estimated tax may be subject to a penalty of ten percent (10%) of any underpayment or any late payment. Underpayment, for purposes of this subsection, is determined by subtracting applicable credits allowed by KRS 141.070, 141.300 and 141.310 from seventy percent (70%) of the tax liability as shown on the return for the taxable year. This subsection shall not apply to the taxable year in which the death of the taxpayer occurs nor in the case of a farmer exercising an election under subsection (5) of KRS 141.305.

(10) Any corporation required by KRS 141.042 to file a declaration of estimated tax and required to pay such declaration of estimated tax by the installment method prescribed by subsection (1) of KRS 141.044, may be subject to a penalty of ten percent (10%) of any installment underpayment or any installment not paid on time. Installment underpayment is the installment determined by subsection (1) of KRS 141.044, less the installment actually paid, based upon seventy percent (70%) of the income tax shown to be due on the final return for the year reduced by five thousand dollars (\$5,000).

(11) Any penalty imposed by subsections (1), (2), (3), (4), (5), (6), (7), or (8) of this section shall be assessed, collected, and paid in the same manner as if it were a deficiency.

(12) Every tax imposed by this chapter, and all increases, interest and penalties thereon, shall become, from the time it is due and payable, a personal debt to the state from the taxpayer or other person liable therefor.

(13) In addition to the penalties herein prescribed, any taxpayer or employer, who willfully fails to make a return or willfully makes a false return, or who willfully fails to pay taxes owing or collected, with intent to evade payment of the tax or amount collected, or any part thereof, shall upon conviction thereof be fined not less than five hundred dollars (\$500) nor more than five thousand dollars (\$5,000), or confined in the penitentiary for not less than twelve (12) months or more than five (5) years, or both.

(14) Any person who willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under KRS

Chapter 141 of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document, shall be guilty of a felony and, upon conviction thereof, shall be fined not more than five thousand dollars (\$5,000), or imprisoned not more than three (3) years, or both, together with the costs of prosecution.

(15) A return for the purpose of this section shall mean and include any return, declaration or form prescribed by the cabinet and required to be filed with the cabinet by the provisions of this chapter, or by the rules and regulations of the cabinet or by written request for information to the taxpayer by the cabinet.

APPENDIX 4-B

***Selected Tax Forms For Use In
Kentucky Corporate Income Taxation**

INDEX OF FORMS

<u>FORM</u>	<u>TITLE</u>
1) 720	Kentucky Corporation Income Tax Return
2) 720L	Kentucky Corporation License Tax Return
3) 720Q	Kentucky Corporation Questionnaire
4) 720	Instructions for Corporation Income Tax Return & Corporation License Tax Return
5) Schedule A (Form 720)	Apportionment and Allocation
6) Schedule D (Form 720)	Kentucky Capital Gains and Losses
7) Schedule Z (Form 720)	Internal Revenue Service Audit Adjustments
8) 720-ES	Corporation Estimated Tax Declaration-Voucher
9) 720-ES	Corporation Estimated Tax Worksheet
10) 720S	Kentucky S Corporation Income Tax Return and Instructions
11) Schedule D (Form 720S)	Kentucky Capital Gains and Losses
12) Schedule K-1 (Form 720S)	Kentucky Shareholder's Share of Income, Credits, Deductions, Etc. and Instructions
13) 720X	Amended Kentucky Corporation Income Tax and Corporation License Tax Return and Instructions
14) 732	Kentucky Depreciation Under CLADR System
15) 762	Kentucky Depreciation and Instructions
16) 4684-K	Kentucky Computation of Casualties & Thefts of Business Property
17) 4797-K	Kentucky Sales of Business Property and Instructions
18) 6252-K	Kentucky Installment Sale Income

720

KENTUCKY CORPORATION INCOME TAX RETURN

1993

41A720

(S Corporations Use Form 720S)

Commonwealth of Kentucky REVENUE CABINET

Taxable period beginning _____, 1993, and ending _____, 199__.

IMPORTANT: Failure to enter taxable period above may result in a request for a delinquent return.

Form with fields: Name of Corporation, Number and Street, City, State, ZIP Code, Telephone Number, Kentucky Account No., Federal Identification No., Federal Business Code No., State and Date of Incorporation, Principal Business Activity in Kentucky, Kentucky Business Code No.

All lines on this page must be completed. Federal schedules may be used.

Table with 34 rows and 3 columns. Rows include: 1. Gross receipts and/or sales, 2. Less: Cost of goods sold, 3. Gross profit, 4. Interest on loans, 5. Interest from obligations, 6. Gross rents, 7. Gross royalties, 8. Capital gain net income, 9. Net gain or (loss) from Form 4797-K, 10. Other income, 11. TOTAL income, 12. Compensation of officers, 13. Salaries and wages, 14. Repairs, 15. Bad debts, 16. Rents, 17. Taxes excluding federal and state taxes, 18. Interest, 19. Contributions, 20. Special deduction for property donated, 21. Depreciation from Form 762, 22. Less depreciation deducted elsewhere, 23. Depletion, 24. Advertising, 25. Pension, profit-sharing, etc., plans, 26. Employee benefit programs, 27. Other deductions, 28. TOTAL deductions, 29. Income (loss) before adjustment, 30. Add: Deductions directly or indirectly attributable to nontaxable income, 31. Net income (loss), 32. Kentucky taxable net income before NOL deduction, 33. Less: Kentucky net operating loss deduction, 34. Kentucky taxable net income after NOL deduction.

TAX PAYMENT SUMMARY: Income, License, Interest, Penalty, TOTAL

Make checks payable to Kentucky State Treasurer. Mail return with payment to Kentucky Revenue Cabinet, Frankfort, Kentucky 40620.

I, the undersigned, declare under the penalties of perjury, that I have examined these returns, including all accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete.

Signature of principal officer or chief accounting officer Date Name and Social Security or federal identification number of person or firm preparing return

IMPORTANT: If refund reflected on Form 720, page 2, Section II, Line 14(c) or 19(b), check block. 143

Form 720, page 2

SECTION I. RECONCILIATION OF KENTUCKY NET INCOME TO FEDERAL TAXABLE INCOME (Attach Federal Schedules M-1 and M-2)

Table with 19 rows for Section I. Rows 1-7 are ADDITIONS, rows 8-14 are DEDUCTIONS. Includes items like Net income, Dividend income, Depreciation, and State taxes.

SECTION II. TAX COMPUTATION

Table with 17 rows for Section II. Rows 1-7 are INCOME TAX, rows 8-14 are LICENSE TAX. Includes tax rate schedule, current year liability, and license tax calculations.

720L

KENTUCKY CORPORATION LICENSE TAX RETURN

1993

41A720L

Commonwealth of Kentucky
REVENUE CABINET

Taxable period beginning _____, 1993, and ending _____, 199_____.

Name of Corporation	Federal Identification Number	Kentucky Account Number
_____	_____	_____

▶ **IMPORTANT:** All applicable lines must be completed. Complete balance sheet or attach copy of financial balance sheet for book purposes.

1. Capital stock (less cost of treasury stock)	1	
2. Paid-in or capital surplus	2	
3. Retained earnings — appropriated (attach schedule)	3	
4. Retained earnings — unappropriated	4	
5. Mortgages, notes, bonds payable in less than 1 year	5	•
6. Loans from stockholders	6	
7. Mortgages, notes, bonds payable in 1 year or more	7	•
8. Other liabilities (attach schedule)	8	
9. Accounts/notes payable to affiliated companies	9	
10. Other capital accounts (attach schedule)	10	
11. Total capital (add lines 1 through 10)	11	
12. Apportionment factor from Schedule A, Section I, line 12 (wholly Kentucky corporations enter 100%)	12	x %
13. Capital employed subject to license tax (line 11 multiplied by line 12)	13	•
14. Total tax before credit (line 13 multiplied by .0021)	14	
15. Less credit, if applicable (see instructions)	15	•
16. Total tax (line 14 less line 15) or \$30, whichever is larger. Enter here	16	

(Also, enter on Form 720, page 2, Section II, line 15, or on Form 720S, page 1, Section I, line 8.)

BALANCE SHEET

	Beginning of Taxable Year		End of Taxable Year	
	(a) Amount	(b) Total	(c) Amount	(d) Total
ASSETS				
1. Cash				
2. Trade notes and accounts receivable			•	
(a) Less allowance for bad debts				
3. Inventories				•
4. Gov't. obligations: (a) U.S. and instrumentalities				
(b) State, subdivisions thereof, etc.				
5. Other current assets; (attach schedule)				•
6. Loans to stockholders				•
7. Mortgage and real estate loans				•
8. Other investments (attach schedule)				•
9. Buildings and other fixed depreciable assets	•		•	
(a) Less accumulated depreciation	•		•	
10. Depletable assets			•	
(a) Less accumulated depletion				
11. Land (net of any amortization)				
12. Intangible assets (amortizable only)				
(a) Less accumulated amortization				
13. Other assets (attach schedule)				•
14. Total assets				
LIABILITIES AND EQUITY				
15. Accounts payable				
16. Mtges., notes, bonds payable in less than 1 yr.				•
17. Other current liabilities (attach schedule)				
18. Loans from stockholders				
19. Mtges., notes, bonds payable in 1 yr. or more				•
20. Other liabilities (attach schedule)				
21. Capital stock (a) preferred stock				
(b) common stock				
22. Paid-in or capital surplus (attach reconciliation)				
23. Retained earnings-appropriated (attach schedule)				
24. Retained earnings-unappropriated				
25. Less cost of treasury stock		()		()
26. Total liabilities and equity				

KENTUCKY CORPORATION QUESTIONNAIRE

1993

41A720Q

Note: Do not enter name and account numbers if entered on Form 720L on reverse.

Name of Corporation _____	Federal Identification No. _____	Kentucky Account No. _____
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IMPORTANT: If this is the corporation's first return or if the corporation did not file a return under the same name for the preceding year, questions 1 and 2 *must* be answered. Failure to do so may result in a request for delinquent returns.

1. Indicate whether: (a) completely new business; (b) successor to previously existing business which was organized as:
 (1) corporation; (2) partnership; (3) sole proprietorship; or (4) other (indicate) _____
 If successor to previously existing business, give name and address and federal I.D. number of the previous business organization.

 Federal I.D. Number _____ - _____ - _____

2. List the following *Kentucky* account numbers. Enter N/A for any number not applicable.
 Employer Withholding Number _____
 Sales and Use Tax Permit Number(s) _____
 Consumer Use Tax Number(s) _____
 Unemployment Insurance Number _____
 Coal Severance and/or Processing Tax Registration Number _____

3. If foreign corporation enter date qualified to do business in Kentucky. ____ / ____ / ____
 4. The corporation's books are in care of: _____

 Address: _____

- 5. Was a consolidated U.S. Corporation Income Tax Return filed which included the period covered in this return? Yes No. If "Yes," give names and federal I.D. numbers of other corporations (attach schedule).
- 6. (a) Did the corporation at any time during the taxable year own 50 percent or more of the voting stock of another corporation, either domestic or foreign? Yes No; (b) Did any corporation,

- individual, partnership, trust or association at any time during the taxable year own 50 percent or more of the corporation's voting stock? Yes No. (If either answer is "Yes," attach separate schedule showing: (1) name, address and federal I.D. number; (2) percentage of stock owned; (3) date stock was acquired; and (4) corporations filing in Kentucky.)
- 7. Did the corporation operate as a DISC or a FSC or as the parent of a DISC or a FSC? Yes No.
- 8. Was this return prepared on: (a) cash or (b) accrual basis; (c) percentage of completion or (d) completed contract?
- 9. Did the corporation have payroll and/or property located both within and without Kentucky? Yes No. If "Yes," indicate what method was used to allocate and apportion net income: statutory formula; separate accounting; other. If other than statutory formula, attach a copy of letter granting permission to use other method.
- 10. Was this return prepared on a separate return, combined or consolidated return basis? If this is a consolidated or combined return, attach a copy of the Cabinet's letter requiring consolidation or combination.
- 11. Does the corporation own or lease property located within Kentucky which has been certified as a pollution control facility? Yes No. If "Yes," enter PCTEC Number. _____
- 12. Is the corporation a public service corporation subject to taxation under KRS 136.120? Yes No.
- 13. Has the corporation been declared a qualified business by the Enterprise Zone Authority of Kentucky? Yes No. If "Yes," enter Certificate Number. _____
- 14. (a) Did the corporation file a Kentucky intangible property tax return? Yes No. (b) Did the corporation file a Kentucky tangible personal property tax return? Yes No.

- 15. Is the corporation currently under audit by the Internal Revenue Service? Yes No. Has the Internal Revenue Service made any final changes in your taxable income which have not been reported to this Cabinet? Yes No. If "Yes," enter years audited, and complete and attach Internal Revenue Service Audit Adjustments, Schedule Z.

OFFICER INFORMATION

Last Name	First Name	M.I.	Title	Percent of Stock Owned	Residence Address	Social Security Number

INSTRUCTIONS

1993 KENTUCKY CORPORATION INCOME TAX RETURN
AND CORPORATION LICENSE TAX RETURN

ITEMS OF SPECIAL INTEREST

INTERNAL REVENUE CODE REFERENCE DATE—Unless specified otherwise, references to the "Internal Revenue Code" for Kentucky income tax purposes mean the Internal Revenue Code (IRC) in effect on December 31, 1991, exclusive of any amendments made subsequent to that date, other than amendments which (1) provide for changes in accounting methods or (2) extend provisions in effect on December 31, 1991, that would otherwise terminate. KRS 141.0101 (depreciation methods and transition rules) specifically refers to the IRC in effect on December 31, 1980, or 1989, depending on when property is placed in service.

NET OPERATING LOSS DEDUCTION—The Kentucky Supreme Court ruled in the *Southwire Co., et al.* case that the amount of net operating loss to be carried back or forward and deducted for Kentucky income tax purposes is the amount of loss determined on the Kentucky return, and in the case of multistate corporations it is the amount determined after apportionment and allocation. In the year of deduction the loss is to be deducted from Kentucky taxable net income. In accordance with the rules of IRC Section 172, unless the corporation elects to relinquish the carryback period, the loss must first be carried back to the earliest of the three preceding years and may be carried forward 15 years.

Important: If the corporation elects in accordance with IRC Section 172(B)(3)(c) to relinquish the carryback period and carry the entire loss forward, a statement making such election must be attached to the Kentucky return of the loss year when filed. Such an election is irrevocable, and an election for federal purposes does not constitute an election for Kentucky purposes.

CORPORATE DISTRIBUTIONS, LIQUIDATIONS AND REORGANIZATIONS—KRS 141.0101(10) was amended to restrict the use of the IRC in effect on December 31, 1980, for determining a Kentucky basis, to property placed in service before January 1, 1990. Based on this change, the provisions of Subchapter C of the IRC including Section 338 will apply for Kentucky purposes for distributions, liquidations and reorganizations taking place after December 31, 1989. Thus, the rules for determining income or loss and basis of property involved in such transactions will be the same for Kentucky purposes as for federal purposes. For further information see Revenue Policy 41P260.

S CORPORATIONS—Any corporation which qualifies and elects S corporation treatment for federal income tax purposes must file Form 720S for Kentucky income tax purposes. A packet containing the applicable forms will be mailed to S corporations which have previously filed with Kentucky. Others may obtain them from the Revenue Cabinet.

AMENDED RETURNS—Form 720X, Amended Kentucky Corporation Income Tax and Corporation License Tax Return, is available for filing amended returns. Use Form 720X to correct Form 720 and/or Form 720L as originally filed or as later adjusted by an amended return, claim for refund, etc. This form may be obtained from the Revenue Cabinet.

INCOME TAX CREDITS

HEALTH INSURANCE CREDIT—Corporations with 50 or fewer employees which pay health insurance premiums to a Health Care Trust, established in accordance with KRS 304.18-025, may be entitled to a credit against income tax for a portion of such premiums. Schedule HC, Health Insurance Credit, which may be obtained from the Revenue Cabinet, fully explains the qualifications that must be met to be entitled to the credit. To claim the credit, Schedule HC must be completed and attached to the return.

This credit may not exceed the income tax liability and unused portions of the credit may not be applied to any other tax year.

UNEMPLOYMENT TAX CREDIT—If the corporation has hired unemployed Kentucky residents and such person(s) remain in the employ of the taxpayer for 180 consecutive days during the tax year, it may be entitled to the unemployment tax credit provided by KRS 141.065. For each qualified person hired, a one-time credit of \$100 may be claimed, not to exceed the income tax liability less any health insurance credit claimed for the year. The period of unemployment must be certified by the Cabinet for Human Resources, Frankfort, KY, and a copy of the certification must be maintained by the corporation. To claim this credit Schedule UTC must be filed.

RECYCLING AND COMPOSTING EQUIPMENT TAX CREDIT—KRS 141.390 provides that taxpayers, who purchase recycling or composting equipment to be used exclusively in Kentucky for recycling or composting post-consumer waste materials, shall be entitled to a credit against the income tax imposed on the taxpayer by KRS Chapter 141 in an amount equal to 50 percent of the installed cost of the equipment. Application for this credit must be made on Schedule RC, which may be obtained from the Revenue Cabinet, and a copy of Schedule RC reflecting the amount of credit approved by the Revenue Cabinet must be attached to the taxpayer's return on which the credit is claimed. The amount of this credit claimed for the tax year may not exceed 25 percent of the income tax liability less any health insurance tax credit and unemployment tax credit claimed for the year.

COAL CONVERSION TAX CREDIT—KRS 141.041 provides a credit against corporation income tax equal to 4.5 percent of expenditures for Kentucky coal (less transportation costs) for corporations which convert boilers from other fuels to the use of Kentucky coal or which substitute Kentucky coal for other fuels in a boiler capable of burning coal and other fuels to produce energy for specific purposes. Unused portions of this credit cannot be carried forward or back. The credit is calculated on Schedule CC, which may be obtained from the Revenue Cabinet.

ENTERPRISE ZONE TAX CREDIT—Effective for employees hired on or after July 14, 1992, a corporation certified by the Kentucky Enterprise Zone Authority as a qualified business is allowed a credit against Kentucky corporation income tax equal to 10 percent of wages paid to each employee who has been certified by the Cabinet for Human Resources as having been unemployed for at least 90 days or having received public assistance benefits, based on need and intended to alleviate poverty, for at least 90 days prior to employment with the qualified business. The credit is limited to \$1,500 per employee, and any unused credit may be carried forward for up to five years. To claim the credit, Schedule EZC must be filed.

GENERAL INFORMATION

REQUIRED FORMS AND INFORMATION—Each taxpayer must enter all applicable information on Form 720 and must attach appropriate federal schedules. For Form 720L, a copy of the corporation's financial balance sheet for book purposes may be attached in lieu of completing the balance sheet section of the form. *Complete the questionnaire as required, and enter current officer information.*

Corporations claiming depreciation must complete and file Form 762, and attach a copy of federal Form 4562. Multistate corporations must complete Schedule A, Apportionment and Allocation, and attach it to Form 720. Corporations which have received final adjustments resulting from Internal Revenue Service audits must complete and attach Schedule Z, IRS Audit Adjustments.

KENTUCKY ACCOUNT NUMBER—Enter the six-digit Kentucky Account Number in the appropriate box at the top of each form and schedule and on checks and correspondence. This number is located in the upper right portion of the address label on the packet. If account number is not known, leave blank. Also enter the federal identification number where requested.

Prior to doing business in Kentucky, each corporation should obtain and complete a Kentucky Tax Registration Application, Revenue Form 10A100. Copies of the application are available at Kentucky Taxpayer Service Centers or from the Revenue Cabinet, Taxpayer Registration Section, Frankfort, KY 40620 (see Revenue Circular 10C030).

KENTUCKY BUSINESS CODE NUMBER—In the appropriate box at the top of Form 720, enter the four-digit principal business activity code number from the listing in federal Form 1120 instructions that best describes your principal business activity in Kentucky. **Note:** The Kentucky and federal business code numbers you enter on Form 720 may be different if your principal business in Kentucky varies from your principal business outside Kentucky.

SIGNATURE—Form 720 must be signed by an authorized corporate officer.

Failure to complete forms properly may result in denial of deductions and delays in the issuance of refunds.

SUBSTITUTE FORMS—Any form to be used in lieu of an official Kentucky Revenue Cabinet form must be submitted to the Cabinet for prior approval.

CONSOLIDATED RETURNS—Affiliated corporations cannot file consolidated or combined income tax returns unless they have been required to do so in writing by the Kentucky Revenue Cabinet (see Revenue Policy 41P225).

Each corporation that participates in filing a consolidated or combined Kentucky income tax return that is required to file a Kentucky license tax return, must file a separate entity basis Form 720L. The taxpayer identification, tax payment summary and signature portions on page 1 of Form 720 must also be completed for each corporation and submitted with Form 720L. Write "Consolidated or Combined Income Tax Return Filed" across the face of Form 720 and complete the Kentucky Corporation Questionnaire. **Failure to file separate entity Form 720L could result in a failure to file notice.**

SHORT-PERIOD RETURNS—Corporations filing short-period returns are required to annualize taxable net income. The income tax payable shall be such part of the tax computed on the annual basis as the number of days in the period is of the number of days in the year (see Revenue Policy 41P020).

DECLARATIONS OF ESTIMATED TAX FOR 1994—A declaration of estimated tax (Form 720ES) must be filed by every corporation whose income tax liability for the taxable year can reasonably be expected to exceed \$5,000. The prior year's income tax liability is not a factor in determining whether a declaration is required. In general, a declaration must be filed and the first payment made by the 15th day of the sixth month of the taxable year. To determine the amount of the first payment, subtract \$5,000 from the estimated full-year liability, and divide the result by two. The remaining one-half is due in equal installments on the 15th day of the ninth and 12th months, respectively.

Failure to pay declaration installments equal to the amount determined by subtracting \$5,000 from 70 percent of the total income tax liability shown on the return for the taxable year will result in the assessment of an underpayment penalty. The amount of the penalty is 10 percent of the amount of the underpayment, but not less than \$25.

Declaration forms will be mailed to taxpayers with a past income tax liability of at least \$5,000 or who have filed declarations for past years. Other corporations required to make declaration payments must obtain Form 720ES from the Revenue Cabinet.

RETURN DUE DATE—Corporation returns must be filed and payment must be made on or before the 15th day of the fourth month following the close of the taxable year. Mail return with payment to Kentucky Revenue Cabinet, Frankfort, KY 40620. Make check payable to Kentucky State Treasurer.

EXTENSION OF TIME TO FILE RETURN—An extension of time (maximum of six months) to file corporation income and license tax returns may be obtained by either making a specific request to the Revenue Cabinet or attaching a copy of the federal extension to the return when filed. Submission of a copy of the federal extension after the return is filed does not constitute a valid extension. For further information, see instructions for Form 720SL.

INTEREST—Interest is applied to all corporation income and license tax liabilities not paid by the original due date of the return(s). This includes tax due as a result of IRS audits, amended returns and additional tax paid with the return on an extended filing date. The computation period is from the due date of the return to the date of payment. For years ending prior to July 1, 1982, the rate is 8 percent per annum until paid. For tax years ending after June 30, 1982, variable rates apply to the periods during which the tax was unpaid as follows: July through December 1982, 16 percent; calendar 1983, 13 percent; calendar 1984, 11 percent; calendar 1985, 13 percent; calendar 1986, 10 percent; calendar 1987, 8 percent; calendar 1988, 9 percent; calendar 1989, 10 percent; calendar 1990, 11 percent; calendar 1991, 10 percent; calendar 1992, 8 percent; and calendar 1993, 7 percent.

PENALTIES—Penalties are:

Failure to file a declaration or underpayment of the declaration—10 percent of the underpayment. The minimum penalty is \$25. (KRS 131.180(3))

Failure to file an income or license tax return by the due date or the extended due date—2 percent of the tax due for each 30 days or fraction thereof that the return is late (maximum 20 percent). The minimum penalty is \$10. (KRS 131.180(1))

Failure to pay income or license tax by the due date or the extended due date—2 percent of the tax due for each 30 days or fraction thereof that the payment is overdue (maximum 20 percent). The minimum penalty is \$10. (KRS 131.180(2))

Failure or refusal to file income or license tax return or furnish information requested in writing—5 percent of the tax assessed for each 30 days or fraction thereof that the return is not filed or the information is not submitted (maximum 50 percent). The minimum penalty is \$25. (KRS 131.180(4))

Fraud—50 percent of the tax assessed. (KRS 131.180(8))

Negligence—10 percent of the tax assessed. (KRS 131.180(7))

POST-AMNESTY COST OF COLLECTION FEES

- 20 percent on all taxes assessed and collected by the Cabinet for taxable periods ending before December 1, 1987, or
- 50 percent on all taxes assessed and collected by the Cabinet relating to the nonfiling of a tax return for taxable periods ending before December 1, 1987, and
- 20 percent on all taxes, which are or become final, due and owing for any reporting period, regardless of when due.

These collection fees are in addition to all other penalties provided by law.

FORM 720—INSTRUCTIONS

WHO MUST FILE—A Kentucky Corporation Income Tax Return, Form 720, must be filed by every corporation (a) organized under the laws of Kentucky, (b) having its commercial domicile in Kentucky, (c) owning or leasing property in Kentucky, (d) having one or more individuals employed or subject to unemployment insurance tax in Kentucky or (e) which is a partner in a partnership doing business in Kentucky.

Corporations which are exempt by law from Kentucky income tax include banks and trust companies except bankers banks organized under KRS 287.135, insurance companies, savings and loan associations, corporations exempted by IRC Section 501 and religious, educational, charitable and like corporations not conducted for profit.

ACCOUNTING PROCEDURES—Kentucky income tax law requires taxpayers to report income on the same calendar or fiscal year and to use the same methods of accounting required for federal income tax purposes. Any federally approved change in accounting periods or methods must be reported to the Revenue Cabinet. Attach a copy of the federal approval to the return when filed.

DEFINITION OF INCOME

Kentucky income tax statutes referencing the IRC mean the IRC in effect December 31, 1991. Except for the specific statutory differences, Kentucky's definition of net income for income tax purposes is based on the federal definition of gross income in Section 61 of the 1991 IRC less the deductions allowed in Chapter 1 of the 1991 IRC. Consequently, the amount of items of gross income and deductions should generally be the same for Kentucky income tax purposes as for federal income tax purposes except for the statutory differences listed below (see Revenue Policy 41P070).

GROSS INCOME DIFFERENCES

Include:

- A. Interest income from obligations of states other than Kentucky and the political subdivisions of states other than Kentucky.
- B. Net income from transactions described in KRS 141.205. Corporations that carried on transactions with stockholders or affiliated corporations directly or indirectly shall increase the net income of such corporation to an amount that would result if such transactions were carried on at arm's length.

Exclude:

- A. Dividends received.
- B. Interest income from U.S. government bonds or from securities issued by a federal agency or other income exempt from state taxation by the Kentucky Constitution, the United States Constitution or the United States Code (see Revenue Circular 40C003).
- C. Fifty percent of the gross royalty income derived from any disposal of coal with a retained economic interest defined by IRC Section 631(c) and all IRC Section 272 expenses if the corporation elects not to use percentage depletion. A deduction is allowed for cost depletion and other expenses not classified as IRC Section 272 expenses for federal income tax purposes (see Revenue Policy 41P080).
- D. Safe harbor lease income (see Revenue Circular 41C020).

DEDUCTION DIFFERENCES

- A. **Depreciation**—Effective for property placed in service after December 31, 1989, Kentucky adopted the depreciation and expense deductions allowed by 1989 IRC Sections 168 and 179. However, for property placed in service prior to January 1, 1990, the Kentucky depreciation system based on 1980 IRC Sections 167 and 179 remains in effect.

The provisions of IRC Section 280F(a) imposing a limitation on the amount of depreciation deduction allowed under IRC Section 168 for luxury automobiles does apply for Kentucky purposes for such automobiles placed in service after December 31, 1989. Likewise, the expense deduction allowed by IRC Section 280F(a)(2)(b) for the unrecovered basis of luxury automobiles in the years following the recovery period is allowable for Kentucky purposes for such automobiles placed in service after December 31, 1989. However, for luxury automobiles placed

in service prior to January 1, 1990, the depreciation allowable for Kentucky purposes continues to be the full amount of depreciation determined under IRC Section 167 in effect December 31, 1980, without limitation and, likewise, the expense deduction allowed by IRC Section 280F(a)(2)(b) for luxury automobiles placed in service prior to January 1, 1990, continues to be unallowable for Kentucky purposes.

- B. **Dividends**—Because dividends are not included in income for Kentucky, the deductions in IRC Sections 243, 244, 245 and 247 do not apply for Kentucky.
- C. **State Taxes**—No deduction is allowed for "state" taxes measured in whole or in part by gross or net income. "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States or any foreign country or political subdivision thereof (see Revenue Policies 41P100, 41P110, 41P120 and 41P121 for discussion of some of these state taxes).
- D. **Salaries and Wages**—Do not reduce salaries and wages by the federal jobs credit. You may deduct the total amount of salaries and wages paid or incurred for the taxable year (see Revenue Policy 41P090).
- E. **Expenses Related to Nonbusiness and Nontaxable Income/Asset**—Do not deduct any expenses related directly or indirectly to the acquisition, management or disposition of assets, the income from which is not taxable. The related expense adjustment is required regardless of whether or not any income was actually received or accrued during the taxable year (see Revenue Policy 41P150).
- F. **Safe Harbor Lease Expenses**—See Revenue Circular 41C020.
- G. **Net Operating Loss Deduction**—The same carryback-carryforward provisions allowed by IRC Section 172 are applicable for Kentucky purposes for losses incurred in taxable years beginning after December 31, 1979, except that no loss may be carried to a taxable year beginning before January 1, 1980. The amount to be carried back or forward is the amount of loss determined on the Kentucky return and, in the case of multistate corporations, it is the amount determined after apportionment and allocation. The loss is to be deducted from Kentucky taxable net income.
- H. **Charitable Contribution Deduction and Deduction for Housing for a Homeless Family**—KRS 141.0202 allows a deduction for the value of leasehold interest of property donated to a charitable organization which is to be used to provide living quarters for a homeless family. This deduction is a special deduction allowed for Kentucky in addition to the ordinary charitable contribution deduction allowed by Chapter 1 of the IRC. However, in accordance with KRS 141.010(13)(d) the same item may not be deducted more than once. Therefore, the ordinary charitable contribution deduction must be reduced by any amount attributable to property on which the deduction allowed by KRS 141.0202 is taken. Also, to determine the maximum amount of the charitable contribution deduction for Kentucky purposes the percentage limitation provided by the IRC must be applied to Kentucky net income rather than federal net income. Therefore, the actual allowable amount of the charitable contribution deduction and the carryover amount may be different for Kentucky purposes than for federal purposes.
- I. **Depletion**—To determine the maximum depletion deduction allowable for Kentucky purposes, the percentage limitation provided by the IRC must be applied to Kentucky net income rather than federal net income.

OTHER DIFFERENCES

- A. The provisions of IRC Section 281, Terminal Railroad Corporations and Their Shareholders, are not recognized for Kentucky purposes.
- B. Foreign Sales Corporations (FSCs) and interest-deferred or interest-charged Domestic International Sales Corporations (DISCs) are subject to Kentucky income tax to the same extent as other corporations (see Revenue Policy 41P250).

- C. Corporations having property and/or payroll both within and without Kentucky must allocate and apportion income to Kentucky on Schedule A (Form 720), Apportionment and Allocation.
- D. Upon the sale, exchange or disposition of depreciable property placed in service after December 31, 1980, the amount of capital gains or losses and ordinary income determined under the provisions of the IRC shall be computed for Kentucky income tax purposes by using the Kentucky adjusted basis in such property rather than federal adjusted basis. However, for property placed in service after December 31, 1989, the Kentucky adjusted basis shall be the federal adjusted basis. Report such gains and losses on Schedule D (Form 720) or Form 4797-K (see Revenue Circular 40C005).
- E. The passive activity loss limitation rules of IRC Section 469 as they apply to personal service corporations and closely held C corporations are applicable for Kentucky income tax purposes. However, because of the differences listed above, the amounts of income and deductions used to determine passive activity losses for Kentucky may differ from the amounts used for federal income tax purposes. Therefore, corporations subject to the passive activity loss limitations must file federal Form 8810, Corporate Passive Activity Loss and Credit Limitations, using Part I and appropriate worksheets, reflecting the allowable passive activity loss(es) for Kentucky purposes. See instructions for federal Form 8810.

SCHEDULE A—INSTRUCTIONS

SECTION I—COMPUTATION OF APPORTIONMENT FACTOR—

A multistate corporation shall determine income taxable to Kentucky by completing Sections I through IV. The allocation and apportionment of net income for corporations with multistate operations under KRS Chapter 141 is substantially the same as the Uniform Division of Income for Tax Purposes Act written by the National Conference of Commissioners on Uniform State Laws, except that for Kentucky purposes the receipts factor is double weighted. Public service companies (defined in KRS 136.120), financial organizations and service organizations shall determine income taxable to Kentucky in accordance with KRS 141.120(10) and Regulations 103 KAR 16:100 through 103 KAR 16:150.

Multistate corporations shall compute the business apportionment factors as follows:

RECEIPTS—Sales are all gross receipts other than nonbusiness receipts. Sales of tangible personal property are assigned to Kentucky if the property is shipped or delivered to a purchaser in Kentucky. Sales are assigned to Kentucky if the property is shipped or delivered from Kentucky to the U.S. government. Sales of property other than tangible personal property are assigned to Kentucky according to the provisions of KRS 141.120.

PROPERTY—Total property includes all real and tangible personal property owned, or rented, and used during the taxable year. Property owned is valued at original cost. Leased and rented property is valued at eight times the annual rental rate less any nonbusiness subrentals. Real and tangible personal properties are assigned to Kentucky if owned, or rented, and used in Kentucky. Exclude (a) construction in progress and (b) property which has been certified by Kentucky as a pollution control facility, and is owned or leased by the corporation. Safe harbor lease property must be included in the factor of the seller/lessee at cost and excluded from the property factor of the purchaser/lessor.

PAYROLL—Total payroll is payroll reported on federal Form 940 before adjustments or exclusions. Kentucky payroll is total payroll subject to Kentucky unemployment insurance tax (before adjustments or exclusions to determine payroll actually taxed for unemployment insurance). A fiscal year taxpayer must adjust the unemployment insurance payroll from a calendar year basis to a fiscal year basis.

WEIGHTED APPORTIONMENT FACTOR—This factor is based on the ratio of a corporation's Kentucky sales (receipts), property and payroll to total sales (receipts), property and payroll. To determine the weighted apportionment factor, the total of these three factors must be divided by four. To arrive at the total of factors used, the sales factor must be multiplied by two and the property and payroll factors must each be multiplied by one. Thus, the sales factor reflects a weight of 50 percent and the property and payroll factors carry a weight of 25 percent each. A corporation, whose business activity does not reflect total sales, total property or total payroll, in the computation of the weighted apportionment factor, must average the factors which are used in determining the percentage of business apportioned to Kentucky. A corporation must use the above formula unless the corporation has approval from the Cabinet to use an alternate formula or the corporation qualifies for and elects to use one of the alternative apportionment methods provided by KRS 141.120(9)(b)(1) and (2).

SECTION II—ALLOCATION OF INCOME—Business income arises from transactions and activities in the regular course of the corporation's trade or business, and includes income from tangible and intangible property if the acquisition, management or disposition of the property constitutes integral parts of the corporation's trade or business.

Classifying income by categories (such as interest, rents, royalties and capital gains) does not determine whether income is business or nonbusiness. For example, gain or loss recognized on the sale of property may be business income or nonbusiness income depending upon the relation to the corporation's trade or business.

Nonbusiness income includes all income not properly classified as business income less all direct or indirect expenses attributable to the production of this income. See Revenue Policy 41P150 for a detailed explanation of indirect expenses. Nonbusiness income is allocated to Kentucky if (a) the corporation's commercial domicile, the principal place from which the trade or business is managed, is located in Kentucky, or (b) property creating the non-business income is utilized in Kentucky. Generally, tangible personal property is utilized in Kentucky if it is physically located in Kentucky; intangible property, such as patents and copyrights, is utilized in Kentucky if it is actually used in Kentucky.

FORM 720L—INSTRUCTIONS

WHO MUST FILE—A Kentucky Corporation License Tax Return, Form 720L, must be filed by every corporation (a) organized under the laws of Kentucky, (b) having its commercial domicile in Kentucky, (c) owning or leasing property in Kentucky, or (d) having one or more individuals employed or subject to unemployment insurance tax in Kentucky. This includes electing small business corporations (S corporations).

Each corporation that participates in filing a consolidated or combined Kentucky income tax return that is required to file a Kentucky license tax return, must file a separate entity basis Form 720L. The taxpayer identification, tax payment summary and signature portions on page 1 of Form 720 must also be completed for each corporation and submitted with Form 720L. Write "Consolidated or Combined Income Tax Return Filed" across the face of Form 720 and complete the Kentucky Corporation Questionnaire. Failure to file separate entity Form 720L could result in a failure to file notice.

EXEMPTIONS—Kentucky law exempts the following from corporation license tax: banks and trust companies; insurance companies; savings and loan associations; corporations exempted by IRC Section 501; religious, educational, charitable and like corporations not conducted for profit; public service companies subject to ad valorem tax under KRS 136.120; certified alcohol production facilities; and certified fluidized bed energy production facilities.

CAPITAL DEFINED—The definition of "capital" is established by law and is not dependent upon the various technical definitions of capital prescribed for accounting, economics or other governmental purposes. The term "capital" includes, but is not

limited to, the various capital stock accounts, various surplus (retained earnings) accounts, various intercompany accounts including advances, all accounts representing borrowed monies (see exceptions in the following paragraph) and all other accounts which represent capital used directly or indirectly in the business, such as deferred income or taxes, customer advances and customer deposits. Equity capital required under A.P.B. Bulletin 18 shall be included in capital if the corporation elected to record such equity on its books or general ledger.

Do not include those liabilities representing customer trade accounts and trade notes payable, taxes payable, salaries payable and accounts payable representing various types of liabilities incurred for supplies. In the case of borrowed monies, the corporation may exclude amounts directly borrowed to purchase inventory, provided the corporation can prove that the amounts excluded were specifically used to purchase inventory.

The accounts comprising capital shall be reported in amounts shown on the balance sheet used for "book" purposes and not at those amounts shown on various special purpose balance sheets such as "equity," "businessman's," "tax," etc.

MULTISTATE APPORTIONMENT—Corporations which have all their property and payroll within Kentucky are subject to license tax on 100 percent of their capital. Corporations which have property and payroll both within and without Kentucky must apportion capital to Kentucky. They may use the weighted income tax apportionment factor, Line 12, Section I, Schedule A, Form 720, or the method provided in KRS 136.070. The two methods are essentially the same.

SHORT-PERIOD RETURNS—Corporations filing short-period returns resulting from a change in accounting period are required to annualize license tax and determine the computation of the capital in the usual manner. To compute the correct license tax due, multiply capital times the tax rate times the number of months in the short period and divide by 12.

CONSOLIDATED RETURNS—The statutes do not permit corporations to file a consolidated license tax return except as provided in KRS 136.071 and KRS 136.100(3).

FINAL RETURN—No license tax is due on the corporation's final return. Corporation license tax is a privilege tax paid for the right to do business in Kentucky for the following period. If a corporation dissolves, withdraws its qualification to do business in Kentucky, or ceases to do business in Kentucky for any reason, there is no liability for license tax on the final return (see Revenue Policy 41P510). If a corporation ceases operations or business in Kentucky in 1994, the license tax payment with the 1993 return must be paid in full, not annualized or prorated.

TAX RATE—Corporations subject to license tax shall pay an annual license tax at the rate of \$2.10 on each \$1,000 of capital employed in the business in Kentucky or a minimum of \$30.

TAX CREDIT—A corporation with gross income of \$500,000 or less is allowed a credit against the license tax of \$1.40 per \$1,000 of the first \$350,000 of capital employed (maximum credit \$490). For the purpose of this credit, gross income means total taxable and nontaxable receipts and shall not be reduced by cost of goods sold, cost of assets sold or any other deduction. This credit is deducted on Line 15 of Form 720L (see Regulation 103 KAR 20:010).

TAXPAYER ASSISTANCE

Forms:

Property and Mail Services Section
859 East Main Street
Revenue Cabinet
Frankfort, KY 40620
(502) 564-3658 (toll)

Information:

Corporation Income Tax Section
Revenue Cabinet
P.O. Box 1302
Frankfort, KY 40602-1302
Revenue Cabinet
Capitol Annex Building
Frankfort, KY 40620
(502) 564-4580 (toll)
(502) 564-3058 (Telecommunication Device for the Deaf)

KENTUCKY TAXPAYER SERVICE CENTERS

Information and forms are available from Kentucky Taxpayer Service Centers in the following cities.

Ashland, 134 Sixteenth Street, 41101-7670
(606) 329-9982

Bowling Green, 1502 Westen Avenue, 42104-3356
(502) 843-5470

Corbin, 1707 18th Street, Suite 5, 40701-8676
(606) 528-3322

Hazard, 233 Birch Street, 41701-2179
(606) 439-2388

Hopkinsville, 105 Hammond Plaza
4011 Ft. Campbell Blvd., 42240-4929
(502) 887-2521

Lexington, 301 East Main Street, Suite 500, 40507-1556
(606) 233-3837

Louisville, 620 South Third Street, Suite 102, 40202-2446
(502) 595-4512

Northern Kentucky, Kentucky Executive Building
2055 Dixie Highway, Ft. Mitchell, 41011-2648
(606) 292-6603

Owensboro, 311 West Second Street, 42302-0734
(502) 686-3301

Paducah, Paducah Bank Building, Suite 306
555 Jefferson Street, 42001-1001
(502) 444-8148

Pikeville, 1279 North Mayo Trail, 41501-8230
(606) 437-4075

INTANGIBLE PROPERTY TAXES—The listing period for intangible property is January 1 through April 15 of each year. Each taxpayer is responsible for reporting intangible property subject to ad valorem taxation. The Intangible Property Tax Return, Revenue Form 62A376, and instructions can be obtained from the Department of Property Taxation or your local county Property Valuation Administrator's office.

TANGIBLE PERSONAL PROPERTY TAXES—The listing period for tangible personal property is January 1 through April 15 of each year. Each taxpayer is responsible for reporting his tangible personal property subject to ad valorem taxation. The Tangible Personal Property Tax Return, Revenue Form 62A500, and instructions can be obtained from the Department of Property Taxation or your local county Property Valuation Administrator's office. A separate form must be filed for each location in Kentucky where you have tangible personal property.

The Kentucky Revenue Cabinet does not discriminate on the basis of race, color, national origin, sex, religion, age or disability in employment or the provision of services.

 Printed on recycled paper.

SCHEDULE A APPORTIONMENT AND ALLOCATION

Form 720

41A720A

(For corporations taxable both within and without Kentucky.)

For taxable year ended

___ / ___
Mo. Yr.

Commonwealth of Kentucky
REVENUE CABINET

Name of Corporation	Federal Identification Number	Kentucky Account Number

SECTION I. COMPUTATION OF APPORTIONMENT FACTOR			SECTION II. ALLOCATION OF INCOME		
1. Kentucky sales		•	1. Net income (from Form 720, page 1, line 31)		•
2. Total sales		•	2. Deduct nonbusiness income:		
		•	(a) Interest		
3. Line 1 divided by line 2	%		(b) Rents		
4. Receipts factor (line 3 multiplied by 2)		•	(c) Royalties		
		%	(d) Net gain or loss on sale or exchange of capital assets		
5. Average value of Kentucky real/tangible property (Section III)		•	(e) Total (lines (a) through (d))		•
6. Average value of total real/tangible property (Section IV)		•	(f) Less related expenses (attach schedule)		•
7. Property factor (line 5 divided by line 6)		•	3. Net nonbusiness income		
		%	4. Business income (line 1 less line 3)		•
8. Kentucky payrolls		•	5. Business income apportioned to Kentucky (line 4 multiplied by line 12, Section I)		•
9. Total payrolls (include officers' salaries)		•	6. Add Kentucky nonbusiness income:		
10. Payroll factor (line 8 divided by line 9)		•	(a) Interest		
		%	(b) Rents		
11. Total (lines 4, 7 and 10)		•	(c) Royalties		
		%	(d) Net gain or loss on sale or exchange of capital assets		
12. Apportionment factor—line 11 divided by 4 or number of factors present (sales representing 2 factors)		•	(e) Total (lines (a) through (d))		•
		%	(f) Less Kentucky related expenses (attach schedule)		•
			7. Kentucky net nonbusiness income		
			8. Kentucky taxable net income (line 5 plus line 7) (enter here and on Form 720, page 1, line 32)		•

See Instructions

See Instructions

SECTION III. KENTUCKY REAL/TANGIBLE PROPERTY			SECTION IV. TOTAL REAL/TANGIBLE PROPERTY		
PROPERTY	A. Beginning of Year	B. End of Year	PROPERTY	A. Beginning of Year	B. End of Year
1. Inventories		•	1. Inventories		
2. Buildings			2. Buildings		
3. Machinery and equipment	•	•	3. Machinery and equipment		
4. Land			4. Land		
5. Other tangible assets			5. Other tangible assets		
6. Total (lines 1 through 5)			6. Total (lines 1 through 5)		
7. Average value of real/ tangible property owned in Kentucky, total of line 6, columns A and B divided by 2			7. Average value of real/ tangible property owned everywhere, total of line 6, columns A and B divided by 2		
8. Leased property (Eight times the annual rental rate less subrentals)			8. Leased property (Eight times the annual rental rate less subrentals)		
9. Total (lines 7 and 8) (enter on line 5, Section I)			9. Total (lines 7 and 8) (enter on line 6, Section I)		

See Property Factor Instructions

See Property Factor Instructions

SCHEDULE D

(Form 720)

Commonwealth of Kentucky
REVENUE CABINET

**KENTUCKY
CAPITAL GAINS AND LOSSES**

FORM 720

1993

▶ Attach to your Kentucky Corporation Income Tax Return.

Name of corporation	Federal ID number -----	Kentucky account number -----
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IMPORTANT: Federal rules and instructions apply for computation of gains and losses. However, Kentucky Schedule D (Form 720) and related forms must be completed due to federal/Kentucky differences in adjusted basis of property placed in service between December 31, 1980, and January 1, 1990. File federal Form 8824 reflecting Kentucky amounts for each "like-kind" exchange.

PART I—SHORT-TERM CAPITAL GAINS AND LOSSES (Assets Held One Year or Less)

a. Kind of property and description <i>(Example, 100 shares of "Z" Co.)</i>	b. Date acquired <i>(mo., day, yr.)</i>	c. Date sold <i>(mo., day, yr.)</i>	d. Gross sales price	e. Cost or other basis, plus expense of sale	f. Gain or (loss) <i>(d less e)</i>
1.					
2. Short-term capital gain from installment sales from Form 6252-K					2
3. Short-term capital gain or (loss) from like-kind exchanges (attach federal Form 8824 reflecting Kentucky amounts)					3
4. Unused capital loss carryover (attach computation)					4 ()
5. Net short-term capital gain or (loss) (combine lines 1 through 4)					5

PART II—LONG-TERM CAPITAL GAINS AND LOSSES (Assets Held More Than One Year)

6.					
7. Enter gain from Form 4797-K					7
8. Long-term capital gain from installment sales from Form 6252-K					8
9. Long-term capital gain or (loss) from like-kind exchanges (attach federal Form 8824 reflecting Kentucky amounts)					9
10. Net long-term capital gain or (loss) (combine lines 6 through 9)					10

PART III—SUMMARY OF PARTS I AND II

11. Enter excess of net short-term capital gain (line 5) over net long-term capital loss (line 10)					11
12. Net capital gain. Enter excess of net long-term capital gain (line 10) over net short-term capital loss (line 5)					12
13. Total of lines 11 and 12. Enter here and on Form 720, page 1, line 8					13

Note: If losses exceed gains, see instructions on capital losses for explanation of capital loss carrybacks.

SCHEDULE Z

Form 720

41A720Z

Commonwealth of Kentucky
REVENUE CABINET

**INTERNAL REVENUE SERVICE
AUDIT ADJUSTMENTS**

Name of Corporation	Federal Identification Number	Kentucky Account Number

NOTE: A copy of the completed Revenue Agent's Report including any further proceedings from protests or the appellate court must be attached. Before any refund will be authorized for any year for which the four-year period for claiming refunds has expired (KRS 141.235), a valid federal or Kentucky waiver must be submitted.

Schedule of Adjustments and Computation of Income Tax

Taxable year(s) ended (Enter month and year.)	___ / ___	___ / ___	___ / ___
1. Net increase (decrease) from federal adjustments			
2. Itemize decreases included in line 1 not applicable to Kentucky:			
(a) _____			
(b) _____			
(c) _____			
(d) _____			
(e) _____			
(f) _____			
3. Subtotal (line 1 plus lines 2(a) through 2(f))			
4. Itemize increases included in line 1 not applicable to Kentucky:			
(a) _____			
(b) _____			
(c) _____			
(d) _____			
(e) _____			
(f) _____			
5. Net adjustment applicable to Kentucky (line 3 less lines 4(a) through 4(f))			
6. Net income (loss) before NOLD per Kentucky return filed			
7. Net income (loss) after federal adjustments (line 5 plus line 6)			
8. Net nonbusiness income (attach schedule)			
9. Business income to be apportioned (line 7 less line 8)			
10. Apportionment factor per Kentucky return filed or as amended			
11. Business income apportioned to Kentucky (line 9 multiplied by line 10)			
12. Kentucky net nonbusiness income (attach schedule)			
13. Kentucky taxable net income before NOLD (line 11 plus line 12)			
14. Kentucky net operating loss deduction (attach schedule)			
15. Kentucky taxable net income (line 13 less line 14)			
16. Total income tax*			
17. Credits (attach schedule)			
18. Overpayment (if line 17 is larger than line 16)			
19. Additional income tax due (if line 16 is larger than line 17)			
20. Enter interest due**			
21. Total Due. Add lines 19 and 20. Enter here and on Form 720, page 2, Section II, line 9***			

*Tax rates prior to January 1, 1980: 4 percent of first \$25,000 plus 5.8 percent of amount over \$25,000. Rates after December 31, 1979: 3 percent of first \$25,000, 4 percent of next \$25,000, 5 percent of next \$50,000 and 6 percent of amount over \$100,000. Rates after July 31, 1985: 3 percent of first \$25,000, 4 percent of next \$25,000, 5 percent of next \$50,000, 6 percent of next \$150,000 and 7.25 percent of amount over \$250,000. Rates after December 31, 1989: increased by one percentage point. Computation must be attached.

**Interest rate: For years ending prior to July 1, 1982, 8 percent per annum until paid. For tax years ending after June 30, 1982, variable rates apply to the periods during which the tax was unpaid as follows: July through December 1982, 16 percent; calendar 1983, 13 percent; calendar 1984, 11 percent; calendar 1985, 13 percent; calendar 1986, 10 percent; calendar 1987, 8 percent; calendar 1988, 9 percent; calendar 1989, 10 percent; calendar 1990, 11 percent; calendar 1991, 10 percent; calendar 1992, 8 percent; and calendar 1993, 7 percent.

***If not filing Schedule Z with Form 720, attach payment. Make check payable to Kentucky State Treasurer, and mail to Kentucky Revenue Cabinet, Frankfort, Kentucky 40620.

**CORPORATION ESTIMATED TAX
DECLARATION—VOUCHER**

INSTALLMENT 1 C

41A720ES (8-91)
COMMONWEALTH
OF KENTUCKY

Form 720ES

Date _____

	Kentucky Account No.	Tax Year Ending	Due Date
Name and Address			

1. Total Estimated Tax
for year.

\$	
----	--

2. Amount of this payment.
(From worksheet)

\$	
----	--

Make check payable to:
Kentucky State Treasurer

Mail to:
Kentucky Revenue Cabinet
Frankfort, KY 40619

No reminder will be sent prior to next installment due date.

TEAR HERE

**CORPORATION ESTIMATED TAX
DECLARATION—VOUCHER**

INSTALLMENT 2 C

41A720ES (8-91)
COMMONWEALTH
OF KENTUCKY

Form 720ES

Date _____

	Kentucky Account No.	Tax Year Ending	Due Date
Name and Address			

Amount of this payment.
(From worksheet)

\$	
----	--

Make check payable to:
Kentucky State Treasurer

Mail to:
Kentucky Revenue Cabinet
Frankfort, KY 40619

No reminder will be sent prior to next installment due date.

TEAR HERE

**CORPORATION ESTIMATED TAX
DECLARATION—VOUCHER**

INSTALLMENT 3 C

41A720ES (8-91)
COMMONWEALTH
OF KENTUCKY

Form 720ES

Date _____

	Kentucky Account No.	Tax Year Ending	Due Date
Name and Address			

Amount of this payment.
(From worksheet)

\$	
----	--

Make check payable to:
Kentucky State Treasurer

Mail to:
Kentucky Revenue Cabinet
Frankfort, KY 40619

No reminder will be sent prior to next installment due date. 155

CORPORATION ESTIMATED TAX WORKSHEET

(Keep For Your Records)

TAX YEAR 19__

1. Estimated Kentucky corporation income tax (enter on line 1 of Installment 1) . . . \$ _____
2. Statutory exemption \$ 5,000
3. Subtract line 2 from line 1. This is the amount of estimated Kentucky corporation income tax to be paid in installments \$ _____

RECORD OF ESTIMATED TAX PAYMENTS SCHEDULE					
Voucher Number	Col. A	Col. B	Col. C	Col. D	Col. E
	Due Date	One-half of amount from line 3 above.	One-fourth of amount from line 3 above.	Overpayment credit from previous return and/or unemployment tax credit. Subtract.	Amount to be paid with voucher. Enter here and on voucher. *
1					
2					
3					
Total					

*If amount credited exceeds amount of installment, enter excess in Column D of next line.

AMENDED COMPUTATION SCHEDULE		
<i>Use if your estimated tax changes after you make your first payment.</i>		
1. Enter amended estimated tax	1	
2. Less:		
(a) Amount of any overpayment credited and/or unemployment tax credit	2(a)	
(b) Payments made on estimated tax for current year	2(b)	
(c) Total of lines 2(a) and 2(b)	2(c)	
3. Unpaid balance (line 1 less line 2(c)) (see instructions)	3	

720S
41A720S

KENTUCKY S CORPORATION INCOME TAX RETURN

1993

Commonwealth of Kentucky
REVENUE CABINET

Taxable period beginning _____, 1993, and ending _____, 199__.

IMPORTANT: Failure to enter taxable period above may result in a request for a delinquent return.

Form with fields for Name of Corporation, Number and Street, City, State, ZIP Code, Telephone Number, Kentucky Account No., Federal Identification No., Federal Business Code No., etc.

Federal Form 1120S and applicable federal schedules must be attached.

IMPORTANT: Include only trade or business income and expenses on lines 1 through 21. See instructions for more information.

Table with 2 columns: Description (Income and Deductions) and Line Number. Includes items like Gross receipts, Compensation of officers, Depreciation, etc.

SECTION I. TAX COMPUTATION

INCOME TAX

Table for Income Tax computation with rows for taxable income, tax rates (4%, 5%, 6%, 7%, 8.25%), total liability, and credits.

LICENSE TAX

Table for License Tax with rows for license tax from Form 720L, payments, and differences.

TAX PAYMENT

Summary table for Tax Payment with fields for Income, License, Interest, Penalty, and TOTAL.

Make checks payable to Kentucky State Treasurer. Mail return with payment to Kentucky Revenue Cabinet, Frankfort, Kentucky 40620.

SECTION II. RECONCILIATION OF KENTUCKY TO FEDERAL ORDINARY INCOME (LOSS) FROM TRADE OR BUSINESS ACTIVITIES

Table with 10 rows for reconciliation of Kentucky to federal ordinary income. Rows include: 1. Ordinary income (loss) (page 1, line 21); 2. Federal net gain or (loss) from federal Form 1120S; 3. Federal jobs credit from federal Form 1120S; 4. Kentucky depreciation on ordinary income (loss); 5. Total. Add lines 1 through 4; 6. Kentucky net gain or (loss) (page 1, line 4); 7. State taxes measured by net/gross income; 8. Federal depreciation on ordinary income (loss); 9. Total. Add lines 6 through 8; 10. Subtract line 9 from line 5. (This amount must equal ordinary income (loss) per federal Form 1120S.)

SCHEDULE K—SHAREHOLDERS' SHARES OF INCOME, CREDITS, DEDUCTIONS, ETC. (See Specific Instructions for Each Line Item)

(a) Pro Rata Share Items

(b) Total Amount

Income (Losses) and Deductions

Table with 10 rows for Income (Losses) and Deductions. Rows include: 1. Ordinary income (loss) from trade or business activities (page 1, line 21); 2. Net income (loss) from rental real estate activities (attach federal Form 8825); 3. (a) Gross income from other rental activities; (b) Less expenses (attach schedule); (c) Net income (loss) from other rental activities; 4. Portfolio income (loss): (a) Interest income; (b) Dividend income; (c) Royalty income; (d) Net short-term capital gain (loss) (attach Schedule D (Form 720S)); (e) Net long-term capital gain (loss) (attach Schedule D (Form 720S)); (f) Other portfolio income (loss) (attach schedule); 5. Net gain (loss) under section 1231 (other than due to casualty or theft) (attach Form 4797-K); 6. Other income (loss) (attach schedule); 7. Charitable contributions (attach schedule) and housing for homeless deduction (attach Schedule HH); 8. Section 179 expense deduction (attach Form 762); 9. Deductions related to portfolio income (loss) (attach schedule); 10. Other deductions (attach schedule).

Investment Interest

Table with 2 rows for Investment Interest. Rows include: 11. (a) Interest expense on investment debts; (b) (1) Investment income included on lines 4(a) through 4(f) above; (2) Investment expenses included on line 9 above.

Credits

Table with 3 rows for Credits. Rows include: 12. Kentucky Unemployment Tax Credit (attach Schedule UTC); 13. Health Insurance Credit (attach Schedule HC); 14. Recycling and Composting Equipment Tax Credit (attach approved Schedule RC).

Other Items

Table with 5 rows for Other Items. Rows include: 15. (a) Total expenditures to which a section 59(e) election may apply; (b) Type of expenditures; 16. Tax-exempt interest income; 17. Other tax-exempt income; 18. Nondeductible expenses; 19. Total property distributions (including cash) other than dividends reported on line 21 below; 20. Other items and amounts required to be reported separately to shareholders (attach schedule); 21. Total dividend distributions paid from accumulated earnings and profits.

I, the undersigned, declare under the penalties of perjury, that I have examined these returns, including all accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct and complete.

Signature of principal officer or chief accounting officer

Date

Name and Social Security or federal identification number of person or firm preparing return

**INSTRUCTIONS FOR 1993 KENTUCKY S CORPORATION
INCOME TAX RETURN AND CORPORATION LICENSE TAX RETURN**

720S**TAX TREATMENT OF S CORPORATION AND SHAREHOLDER(S)**

Any corporation which elects S corporation treatment for federal income tax purposes in accordance with Sections 1361(a) and 1362(a) of the Internal Revenue Code must file as an S corporation for Kentucky income tax purposes. Generally, income earned by an S corporation is taxed at the shareholder level rather than at the corporate level although S corporations are taxed on certain capital gains. Each shareholder includes on his return, on a pro rata basis, each item of income, loss, deduction or credit of the S corporation that can affect the computation of his tax liability. Pursuant to Section 1366 of the Internal Revenue Code, each such item is treated as if it were realized directly from the source from which it was realized by the S corporation or incurred in the same manner as incurred by the S corporation.

S corporations having 15 or more full-year nonresident individual shareholders with no other Kentucky income may receive special permission from the Revenue Cabinet to file a combined return in lieu of separate returns for the qualifying shareholders (see Revenue Circular 40C010). For further information, contact the Division of Compliance and Taxpayer Assistance, Revenue Cabinet, Frankfort, Kentucky 40620.

ITEMS OF SPECIAL INTEREST

INTERNAL REVENUE CODE REFERENCE DATE—Unless specified otherwise, references to the "Internal Revenue Code" for Kentucky income tax purposes mean the Internal Revenue Code (IRC) in effect on December 31, 1991, exclusive of any amendments made subsequent to that date, other than amendments which (1) provide for changes in accounting methods or (2) extend provisions in effect on December 31, 1991, that would otherwise terminate. KRS 141.0101 (depreciation methods and transition rules) specifically refers to the IRC in effect on December 31, 1980, or 1989, depending on when property is placed in service.

UNEMPLOYMENT TAX CREDIT—If the S corporation has hired unemployed Kentucky residents and such person(s) remain in the employ of the taxpayer for 180 consecutive days during the tax year, it may be entitled to the unemployment tax credit provided by KRS 141.065. For each qualified person hired, a one-time credit of \$100 may be claimed, not to exceed the tax liability. The period of unemployment must be certified by the Cabinet for Human Resources, Frankfort, KY, and a copy of the certification must be maintained by the S corporation.

The unemployment tax credit is determined by the S corporation and then passed through pro rata to its shareholders. The credit is computed on Schedule UTC which contains detailed instructions and may be obtained from the Revenue Cabinet. To claim the credit, Schedule UTC must be filed.

HEALTH INSURANCE CREDIT—Employers with 50 or fewer employees who pay health insurance premiums to a Health Care Trust, established in accordance with KRS 304.18-025, are entitled to a credit against Kentucky income tax for a portion of such premiums. Schedule HC, Health Insurance Credit, which may be obtained from the Revenue Cabinet, fully explains the qualifications that must be met for the employer to be entitled to the credit.

The employer portion of the health insurance credit is determined by the S corporation and passed through pro rata to its shareholders. Schedule HC must be completed and attached to the S corporation's return reflecting computation of the credit. The total amount of the credit should be entered on Schedule K, and each shareholder's pro rata share should be reflected on their Schedule K-1.

RECYCLING AND COMPOSTING EQUIPMENT TAX CREDIT—KRS 141.390 provides that taxpayers, who purchase recycling

or composting equipment to be used exclusively in Kentucky for recycling or composting post-consumer waste materials, shall be entitled to a credit against the income tax imposed by KRS Chapter 141 in an amount equal to 50 percent of the installed cost of the equipment. Application for this credit must be made by the S corporation on Schedule RC, which may be obtained from the Revenue Cabinet.

The approved credit is passed through pro rata to the shareholders of the S corporation. A copy of Schedule RC reflecting the amount of credit approved by the Revenue Cabinet must be attached to the S corporation's return for the year during which the equipment was purchased. The total amount of the approved credit should be entered on Schedule K. The S corporation must compute each shareholder's pro rata share by completing Parts I and II of Schedule RC (K-1), Pro Rata/Distributive Share of Approved Recycling and/or Composting Equipment Tax Credit. A copy of the completed Schedule RC (K-1) should be provided to each shareholder with their Schedule K-1 (Form 720S).

TAX CREDIT APPLICABLE TO S CORPORATIONS

ENTERPRISE ZONE TAX CREDIT—Effective for employees hired on or after July 14, 1992, an S corporation certified by the Kentucky Enterprise Zone Authority as a qualified business is allowed a credit against Kentucky income tax imposed on the S corporation equal to 10 percent of wages paid to each employee who has been certified by the Cabinet for Human Resources as having been unemployed for at least 90 days or having received public assistance benefits, based on need and intended to alleviate poverty, for at least 90 days prior to employment with the qualified business. The credit is limited to \$1,500 per employee, and any unused credit may be carried forward for up to five years. To claim the credit, Schedule EZC must be filed.

GENERAL INFORMATION

REQUIRED FORMS AND INFORMATION—Each taxpayer must enter all applicable information on Form 720S with federal Form 1120S attached and Form 720L and appropriate supporting schedules. For Form 720L, a copy of the S corporation's financial balance sheet for book purposes may be attached in lieu of completing the balance sheet section of the form. *Complete the questionnaire as required, and enter current officer information.*

S corporations claiming depreciation must complete and file Form 762 and attach a copy of federal Form 4562. Multistate S corporations must complete Schedule A, Apportionment and Allocation, and attach it to Form 720S. S corporations which have received final adjustments resulting from Internal Revenue Service audits must complete and attach Schedule Z, IRS Audit Adjustments.

KENTUCKY ACCOUNT NUMBER—Enter the six-digit Kentucky Account Number in the appropriate box at the top of each form and schedule and on checks and correspondence. This number is located in the upper right portion of the address label on the packet. If account number is not known, leave blank. Also enter the federal identification number where requested.

Prior to doing business in Kentucky, each S corporation should obtain and complete a Kentucky Tax Registration Application, Revenue Form 10A100. Copies of the application are available at Kentucky Taxpayer Service Centers or from the Revenue Cabinet, Taxpayer Registration Section, Frankfort, KY 40620 (see Revenue Circular 10C030).

KENTUCKY BUSINESS CODE NUMBER—In the appropriate box at the top of Form 720S, enter the four-digit principal business activity code number from the listing in federal Form 1120S instructions that best describes your principal business activity in Kentucky. **Note:** The Kentucky and federal business code numbers you enter on Form 720S may be different if your principal business in Kentucky varies from your principal business outside Kentucky.

SIGNATURE—Form 720S must be signed by an authorized corporate officer.

Failure to complete forms properly may result in denial of deductions and delays in the issuance of refunds.

SUBSTITUTE FORMS—Any form to be used in lieu of an official Kentucky Revenue Cabinet form must be submitted to the Cabinet for prior approval.

SHORT-PERIOD RETURNS—S corporations filing short-period returns are required to annualize taxable net income. The income tax payable shall be such part of the tax computed on the annual basis as the number of days in the period is of the number of days in the year (see Revenue Policy 41P020).

DECLARATIONS OF ESTIMATED TAX FOR 1994—A declaration of estimated tax (Form 720ES) must be filed by every S corporation whose income tax liability for the taxable year can reasonably be expected to exceed \$5,000. The prior year's income tax liability is not a factor in determining whether a declaration is required. In general, a declaration must be filed and the first payment made by the 15th day of the sixth month of the taxable year. To determine the amount of the first payment, subtract \$5,000 from the estimated full-year liability, and divide the result by two. The remaining one-half is due in equal installments on the 15th day of the ninth and 12th months, respectively.

Failure to pay declaration installments equal to the amount determined by subtracting \$5,000 from 70 percent of the total income tax liability shown on the return for the taxable year will result in the assessment of an underpayment penalty. The amount of the penalty is 10 percent of the amount of the underpayment but not less than \$25.

Declaration forms will be mailed to taxpayers with a past income tax liability of at least \$5,000 or who have filed declarations for past years. Other S corporations required to make declaration payments must obtain Form 720ES from the Revenue Cabinet.

RETURN DUE DATE—S corporation returns must be filed and payment must be made on or before the 15th day of the fourth month following the close of the taxable year. Mail return with payment to Kentucky Revenue Cabinet, Frankfort, KY 40620. Make check payable to **Kentucky State Treasurer**.

EXTENSION OF TIME TO FILE RETURN—An extension of time (maximum of six months) to file corporation income and license tax returns may be obtained by either making a specific request to the Revenue Cabinet or **attaching a copy of the federal extension to the return when filed**. Submission of a copy of the federal extension after the return is filed does not constitute a valid extension. For further information, see instructions for Form 720SL.

INTEREST—Interest is applied to all corporation income and license tax liabilities not paid by the original due date of the return(s). This includes tax due as a result of IRS audits, amended returns and additional tax paid with the return on an extended filing date. The computation period is from the due date of the return to the date of payment. For years ending prior to July 1, 1982, the rate is 8 percent per annum until paid. For tax years ending after June 30, 1982, variable rates apply to the periods during which the tax was unpaid as follows: July through December 1982, 16 percent; calendar 1983, 13 percent; calendar 1984, 11 percent; calendar 1985, 13 percent; calendar 1986, 10 percent; calendar 1987, 8 percent; calendar 1988, 9 percent; calendar 1989, 10 percent; calendar 1990, 11 percent; calendar 1991, 10 percent; calendar 1992, 8 percent; and calendar 1993, 7 percent.

PENALTIES—Penalties are:

Failure to file a declaration or underpayment of the declaration—10 percent of the underpayment. The minimum penalty is \$25. (KRS 131.180(3))

Failure to file an income or license tax return by the due date or the extended due date—2 percent of the tax due for each 30 days or fraction thereof that the return is late (maximum 20 percent). The minimum penalty is \$10. (KRS 131.180(1))

Failure to pay income or license tax by the due date or the extended due date—2 percent of the tax due for each 30 days or fraction thereof that the payment is overdue (maximum 20 percent). The minimum penalty is \$10. (KRS 131.180(2))

Failure or refusal to file income or license tax return or furnish information requested in writing—5 percent of the tax assessed for each 30 days or fraction thereof that the return is not filed or the information is not submitted (maximum 50 percent). The minimum penalty is \$25. (KRS 131.180(4))

Fraud—50 percent of the tax assessed. (KRS 131.180(8))

Negligence—10 percent of the tax assessed. (KRS 131.180(7))

POST-AMNESTY COST OF COLLECTION FEES

- 20 percent on all taxes assessed and collected by the Cabinet for taxable periods ending before December 1, 1987, or
- 50 percent on all taxes assessed and collected by the Cabinet relating to the nonfiling of a tax return for taxable periods ending before December 1, 1987, and
- 20 percent on all taxes which are or become final, due and owing for any reporting period, regardless of when due.

These collection fees are in addition to all other penalties provided by law.

FORM 720S—INSTRUCTIONS

WHO MUST FILE—Every S corporation (a) organized under the laws of Kentucky, (b) having its commercial domicile in Kentucky, (c) owning or leasing property in Kentucky, (d) having one or more individuals employed or subject to unemployment insurance tax in Kentucky, or (e) which is a partner in a partnership doing business in Kentucky must file a Kentucky S Corporation Income Tax Return, Form 720S (federal Form 1120S must be attached).

ACCOUNTING PROCEDURES—Kentucky income tax law requires taxpayers to report income on the same calendar or fiscal year and to use the same methods of accounting required for federal income tax purposes. Any federally approved change in accounting periods or methods must be reported to the Revenue Cabinet. Attach a copy of the federal approval to the return when filed.

TAXABLE INCOME OF S CORPORATION

The taxable income of an S corporation, like that of a partnership, is defined in KRS 141.206 and is computed in the same manner as in the case of an individual under KRS 141.010(9) through (11) and the adjustments required under IRC Sections 703(a) and 1363(b). Computations of taxable income and each shareholder's pro rata share of net income, gains, losses, deductions or credits shall be as nearly as practicable identical with those required for federal income tax purposes except to the extent required by differences between Kentucky income tax law and the federal income tax law and regulations.

INCOME AND EXPENSES OF AN S CORPORATION

Because the shareholders of an S corporation, rather than the S corporation, are taxed on its income and because some income and expense items are subject to special rules, it is necessary to divide the S corporation's items of income, loss, expense and credit into two categories: (1) separately stated items and (2) items used to figure nonseparately computed income or loss. Nonseparately computed income or loss is the net income or loss (gross income less allowable deductions) of the S corporation computed after

excluding all the items that must be separately stated. The separately stated items and the nonseparately computed income or loss are collectively known as pass through items because they are passed through to the shareholders on a pro rata basis.

DEFINITION OF INCOME

Kentucky income tax statutes referencing the IRC mean the IRC in effect December 31, 1991. Except for the specific statutory differences, Kentucky's definition of net income for S corporation income tax purposes is based on the federal definition of gross income in 1991 IRC Section 61 less the deductions allowed in 1991 IRC Chapter 1. Consequently, the amount of items of gross income and deductions should generally be the same for Kentucky income tax purposes as for federal income tax purposes except for the statutory differences listed below.

GROSS INCOME DIFFERENCES

- A. Include interest income from obligations of states other than Kentucky and the political subdivisions of states other than Kentucky.
- B. Exclude interest income from U.S. government bonds or from securities issued by a federal agency or other income exempt from state taxation by the Kentucky Constitution, the United States Constitution or the United States Code (see Revenue Circular 40C003).
- C. Upon the sale, exchange or disposition of depreciable property placed in service after December 31, 1980, the amount of capital gains or losses and ordinary income determined under the provisions of the IRC shall be computed for Kentucky income tax purposes by using the Kentucky adjusted basis in such property rather than federal basis. However, for property placed in service after December 31, 1989, the Kentucky adjusted basis shall be the federal adjusted basis. Report such gains and losses on Schedule D (Form 720S) or Form 4797-K (see Revenue Circular 40C005).

DEDUCTION DIFFERENCES

- A. **Depreciation**—Effective for property placed in service after December 31, 1989, Kentucky adopted the depreciation and expense deductions allowed by 1989 IRC Sections 168 and 179. However, for property placed in service prior to January 1, 1990, the Kentucky depreciation system based on 1980 IRC Sections 167 and 179 remain in effect.

The provisions of IRC Section 280F(a) imposing a limitation on the amount of depreciation deduction allowed under IRC Section 168 for luxury automobiles does apply for Kentucky purposes for such automobiles placed in service after December 31, 1989. Likewise, the expense deduction allowed by IRC Section 280F(a)(2)(b) for the unrecovered basis of luxury automobiles in the years following the recovery period is allowable for Kentucky purposes for such automobiles placed in service after December 31, 1989. However, for luxury automobiles placed in service prior to January 1, 1990, the depreciation allowable for Kentucky purposes continues to be the full amount of depreciation determined under IRC Section 167 in effect December 31, 1980, without limitation and, likewise, the expense deduction allowed by IRC Section 280F(a)(2)(b) for luxury automobiles placed in service prior to January 1, 1990, continues to be unallowable for Kentucky purposes.

- B. **State Taxes**—No deduction is allowed for "state" taxes measured in whole or in part by gross or net income. "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any foreign country or political subdivision thereof (see Revenue Policy 41P100; 41P110; 41P120 and 41P121 for discussion of state taxes).

- C. **Salaries and Wages**—Do not reduce salaries and wages by the federal jobs credit. You may deduct the total amount of salaries and wages paid or incurred for the taxable year (see Revenue Policy 41P090).

- D. **Expenses Related to Nontaxable Income**—No deduction is allowed for expenses or amounts allocable to income which is not subject to Kentucky income tax.

- E. **Depletion**—To determine the maximum depletion deduction allowable for Kentucky purposes, the percentage limitation provided by the IRC must be applied to Kentucky net income rather than federal net income.

COMPUTATION OF KENTUCKY ORDINARY INCOME (LOSS) FROM TRADE OR BUSINESS ACTIVITIES

Kentucky ordinary income (loss) from trade or business activities is nonseparately computed income (loss) of the S corporation passed through to the shareholders on a pro rata basis. It includes only trade or business income and expenses and generally does not include income and expenses attributable to rental real estate activities or other rental activities, and investment or portfolio income and related expenses. Complete all applicable lines on Form 720S, and attach copy of federal Form 1120S and applicable schedules.

SCHEDULE K—SHAREHOLDERS' SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.

GENERAL INSTRUCTIONS—Schedule K, Form 720S, is a summary schedule of all the shareholders' shares of the S corporation's income, deductions, credits, etc. Shareholders are liable for income tax on their share of the corporation's income (reduced by any federal tax paid by the S corporation on the income). Complete all applicable lines entering the total pro rata share amount for each item listed. Federal instructions for Form 1120S and federal Schedule K provide additional information which will assist the S corporation in completing Schedule K, Form 720S.

Passive Activity Limitations—IRC Section 469 provides for limitations on losses and deductions that shareholders may claim from "passive activities." The limitations apply to the shareholders of the S corporation and not the S corporation itself. Generally, a passive activity is any activity of the S corporation which involves the conduct of any trade or business in which a shareholder does not materially participate and any rental activity even if the shareholder materially participates. The passive activity rules provide that losses from passive activities can generally be applied only against income from passive activities. Thus, passive losses cannot be applied against income from salaries, wages, professional fees, or a business in which the shareholder materially participates; or against portfolio income. Generally, portfolio income includes all gross income, other than income derived in the ordinary and regular course of a trade or business, that is attributable to interest; dividends; royalties; income from a real estate investment trust, a regulated investment company, a real estate mortgage investment conduit, a common trust fund, a controlled foreign corporation, a qualified electing fund, or a cooperative; income from the disposition of property that produces income of a type defined as portfolio income; and income from the disposition of property held for investment.

SPECIFIC INSTRUCTIONS

Line 1—Enter ordinary income (loss) from trade or business activities reported on Line 21, Form 720S.

Line 2—Enter net income (loss) from rental real estate activities reported on federal Schedule K, Form 1120S, adjusted to reflect any differences in Kentucky and federal depreciation and any other differences in Kentucky and federal income tax laws.

Line 3(a)—Enter the gross income from other rental activities reported on federal Schedule K, Form 1120S.

Line 3(b)—Enter the rental expenses reported on federal Schedule K, Form 1120S, adjusted to reflect Kentucky depreciation rather than federal depreciation and any other differences in Kentucky and federal income tax laws.

Line 4(a)—Enter interest income from federal Schedule K, Form 1120S, adjusted to exclude tax-exempt U.S. government interest, if any, and to include interest income from obligations of states other than Kentucky and their political subdivisions.

Lines 4(b) and (c)—Enter the amount of dividend and royalty income reported on federal Schedule K, Form 1120S.

Line 4(d)—Enter net short-term capital gain (loss) from Schedule D (Form 720S), Part I, Line 6, that is portfolio income. Report any gain or loss that is not portfolio income on Line 6, Schedule K, Form 720S.

Line 4(e)—Enter net long-term capital gain (loss) from Schedule D (Form 720S), Part II, Line 12, that is portfolio income. Report any gain or loss that is not portfolio income on Line 6, Schedule K, Form 720S.

Line 4(f)—Enter any other portfolio income not reported on Schedule K, Form 720S, Lines 4(a) through 4(e).

Line 5—Enter net gain (loss) under Section 1231 from Form 4797-K. Do not include net gains (losses) from involuntary conversions due to casualties or thefts on this line. Instead, report them on Line 6.

Line 6—Enter all other items of income (loss) of the S corporation not included on Lines 1 through 5. See federal instructions for Schedule K, Form 1120S.

Line 7—Enter total contributions paid by the S corporation during its taxable year and attach a schedule showing separately the contributions subject to the 50 percent, 30 percent and 20 percent limitations. These percentage limitations must be applied to the Kentucky amounts rather than the federal amounts. ss) under Section 1231 from Form 4797-K. Do not include net gains (losses) from involuntary conversions due to casualties or thefts on this line. Instead, report them on Line 6.

Also, enter amount of deduction allowable from Schedule HH for the value of leasehold interest of property donated for living quarters for a homeless family. The ordinary charitable contribution deduction must be reduced by any amount attributable to property on which this deduction is taken.

Line 8—Enter IRC Section 179 expense deduction from Form 762, Line 1(c).

Line 9—Enter the expenses related to portfolio income reported on federal Schedule K, Form 1120S, adjusted to exclude expenses related to tax-exempt interest income and other exempt income.

Line 10—Enter any other deductions of the S corporation not included on Lines 7, 8 and 9. See federal instructions for Schedule K, Form 1120S.

Line 11(a)—Enter the S corporation's deductible interest expense allocable to debt on property held for investment purposes. Property held for investment purposes includes property that produces investment income (interest, dividends, annuities, royalties, etc.). The total amount you enter should equal the amount of interest expense reported on federal Schedule K, Form 1120S, adjusted to exclude any interest expense on debts incurred to purchase or carry investment property producing, or held for the production of, U.S. government interest income.

Lines 11(b)(1) and (b)(2)—Enter only the investment income included on Schedule K, Form 720S, Lines 4(a) through 4(f), and only the investment expenses related thereto included on Schedule K, Form 720S, Line 9.

Investment income includes gross income from property held for investment, gain attributable to the disposition of property held for investment, and other amounts that are gross portfolio income. Generally, investment income and investment expenses do not include any income or expense from a passive activity.

Line 12—Enter amount from Schedule UTC, Unemployment Tax Credit, Line 38.

Line 13—Enter amount from Schedule HC, Health Insurance Credit, Line 9.

Line 14—Enter amount from Schedule RC, Application for Income Tax Credit for Recycling and/or Composting Equipment, Part II, Line 2.

Line 15(a)—Enter amount reported on federal Schedule K, Form 1120S, Line 16(a).

Line 15(b)—Enter the information provided on federal Schedule K, Form 1120S, Line 16(b).

Line 16—Enter the total amount of interest income of the S corporation from U.S. government bonds and securities and obligations of Kentucky and its political subdivisions.

Line 17—Enter the total amount of any other type of income of the S corporation on which the shareholder is exempt from Kentucky income tax.

Line 18—Enter the total amount of nondeductible expenses paid or incurred by the S corporation including, but not limited to, state taxes measured by gross/net income, expenses related to tax-exempt income, etc.

Line 19—Enter amount reported on federal Schedule K, Form 1120S, Line 20.

Line 20—Attach schedules to report the S corporation's total income, expenses and other information applicable to items not included on Lines 1 through 19 including, but not limited to, any recapture of Section 179 deduction from the disposition of property acquired by the S corporation in tax years beginning after December 31, 1985, gross income and other information relating to oil and gas well properties enabling the shareholder to figure the allowable depletion deduction, and any other information the shareholders need to prepare their Kentucky income tax returns. See federal instructions for Schedule K, Form 1120S, Line 21.

Line 21—Enter amount reported on federal Schedule K, Form 1120S, Line 22.

SCHEDULE K-1 (FORM 720S)—KENTUCKY SHAREHOLDER'S SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.

GENERAL INSTRUCTIONS—Schedule K-1 (Form 720S) shows each shareholder's pro rata share of the S corporation's income, deductions, credits, etc. On each Schedule K-1 (Form 720S) enter the names, addresses and identifying numbers of the shareholder and S corporation, complete items A, B, C and D. Please make sure the shareholder's name, Social Security or identifying number and other shareholder information are complete and legible. Schedule K-1 (Form 720S) must be completed and given to each shareholder on or before the day on which Form 720S is filed with the Revenue Cabinet.

A copy of each shareholder's K-1 (Form 720S) must be attached to Form 720S filed with the Revenue Cabinet. A copy is kept as part of the S corporation's records and each shareholder receives his or her own separate copy with instructions. The shareholder's instructions are included on the reverse side of Schedule K-1 (Form 720S). Additional copies of Schedule K-1 (Form 720S) are available from the Revenue Cabinet.

Photocopies of Schedule K-1 (Form 720S) may be used in lieu of the official schedule printed by the Revenue Cabinet, provided the photocopies are on bond paper of at least 16 pounds and are of good quality. You may find it more convenient to make photocopies of the schedule than to order the schedule from the Cabinet. If photocopies are made, be sure to give each shareholder a copy of the shareholder's instructions for Schedule K-1 (Form 720S) included on the reverse side of the official schedule. Prior approval from the Cabinet to use photocopies of Schedule K-1 (Form 720S) is not required.

SPECIFIC INSTRUCTIONS

Federal instructions for Schedule K-1 (Form 1120S) explain the rules to follow for allocating items of income (loss), deductions, credits, etc., to each shareholder. The total pro rata share items (Column (b)) of all Schedules K-1 should equal the amounts reported on the same lines of Schedule K, Lines 1 through 19. The other lines do not correspond, but the instructions will explain the differences.

Multiple Activities—If items of income, loss or deduction from more than one activity are reported on Lines 1, 2 or 3 of Schedule K-1 (Form 720S), the S corporation must provide information for each activity to its shareholders. See **Passive Activity Reporting Requirements** in the instructions for Schedule K-1 (Form 1120S) for details on the information to be provided on an attachment to Schedule K-1 (Form 720S) for each activity.

At-Risk Activities—If the S corporation is involved in one or more at-risk activities for which a loss is reported on Schedule K-1 (Form 720S), the S corporation must report information separately for each at-risk activity. See **Special Reporting Requirements for At-Risk Activities** in the federal instructions for Schedule K-1 (Form 1120S) for details on the information to be provided on an attachment to Schedule K-1 (Form 720S) for each at-risk activity.

Item D(2)—An S corporation which has all of its property and payroll within Kentucky must enter 100 percent. An S corporation which has property and/or payroll both within and without Kentucky must enter the percentage or ratio of its gross receipts from sales to purchasers or customers in Kentucky or services performed in Kentucky to its gross receipts from sales or services everywhere during the tax year.

The terms "sales" or "services" mean all gross receipts derived from transactions or activities in the ordinary and regular course of the S corporation's trade or business and which are includible in its gross income including gross receipts from farming and rental activities if these activities are in the ordinary or regular course of the S corporation's business.

Interest, dividends, royalties and gains or losses on the disposition of property acquired, held, owned or used in the **ordinary or regular course of the S corporation's business** are gross receipts used to determine the business ratio. Gross receipts of this kind are included in the Kentucky receipts portion (numerator) of the business ratio if the S corporation is managed, directed or controlled in Kentucky (domiciled) or the source of such income is in Kentucky. If the S corporation is managed, directed or controlled outside of Kentucky (domiciled) but the source of such income is in Kentucky, the gross receipts are in the numerator of the business ratio. The denominator of the business ratio is the total gross receipts in the ordinary or regular course of the S corporation's trade or business.

Gross receipts, for determining the business ratio, do not include in either the numerator or the denominator interest, dividends, royalties and gains or losses on the disposition of property held for **other than trade or business purposes**.

The S corporation must attach a copy of this computation to Form 720S.

Lines 1 through 20—Enter the shareholder's total pro rata share of each item listed on Schedule K, Form 720S. **Do not multiply these amounts by the percentage entered on Item D(2).** Attach schedules showing separately the required information for each IRC Section 469 passive activity and each Section 465 at-risk activity. Other schedules are to be attached for line items where requested on Schedule K-1 (Form 720S).

Line 21—Enter on attached schedules the supplemental information required to be reported separately to each shareholder for Lines 1 through 20 and any other information or items and amounts not included on Schedule K-1 (Form 720S) that the shareholder needs to prepare a Kentucky income tax return including, but not limited to, any recapture of Section 179 deduction from the disposition of property acquired by the S corporation in tax years beginning after December 31, 1985, gross income and other information relating to oil and gas well properties enabling the shareholder to figure the allowable depletion deduction, etc. See instructions for federal Schedule K-1 (Form 1120S), Line 23.

Lines 22 through 24—The amounts in Column (b) are to be entered by the shareholder, not the S corporation.

INCOME TAX ON S CORPORATION

KRS 141.040(5) imposes an income tax on certain capital gains of an S corporation. If the S corporation's Kentucky taxable income is more than \$25,000, and Kentucky net capital gain is more than \$25,000 and more than 50 percent of taxable income, and such capital gains are not exempt from federal income tax under IRC Section 1374, the S corporation is liable for income tax. (See instructions for Schedule D (Form 720S) below.)

SCHEDULE D INSTRUCTIONS

Line 16—If the S corporation's net capital gain exceeds \$25,000 and IRC Section 1374 does not exempt such capital gains from federal income tax, the S corporation must figure its taxable income to determine if it is liable for income tax. Taxable income is computed in the same manner as in the case of an individual under KRS 141.010(9) through (11) and the adjustments required under IRC Sections 703(a) and 1363(b) which include all items of income, loss and expense separately stated and all items used to figure nonseparately computed income or loss reported on Form 720S.

If taxable income exceeds \$25,000 and the net capital gain exceeds \$25,000 and is more than 50 percent of taxable income and such capital gains are not exempt from federal income tax, the S corporation is liable for income tax and required to complete Lines 17 through 22. Attach schedule used in figuring taxable income to Schedule D (Form 720S).

If the capital gain results in the S corporation being subject to the tax determined in either Part III or Part IV of the federal Schedule D (Form 1120S), such gain is deemed not to be exempt from tax under IRC Section 1374, and, therefore, the S corporation is subject to the tax imposed by KRS 141.040(5) if the tests in the above paragraphs are met.

MULTISTATE APPORTIONMENT

In computing the income tax for a multistate S corporation such corporation shall determine income taxable to Kentucky by completing Sections I, III and IV of Schedule A, Apportionment and

Allocation. The apportionment of net income for S corporations with multistate operations under KRS Chapter 141 is substantially the same as the Uniform Division of Income for Tax Purposes Act written by the National Conference of Commissioners on Uniform State Laws, except that for Kentucky purposes the receipts factor is double weighted. Public service companies (defined in KRS 136.120), financial organizations and service organizations shall determine income taxable to Kentucky in accordance with KRS 141.120(10) and Regulations 103 KAR 16:100 through 103 KAR 16:150.

Multistate S corporations shall compute the business apportionment factors as follows:

RECEIPTS—Sales are all gross receipts other than nonbusiness receipts. Sales of tangible personal property are assigned to Kentucky if the property is shipped or delivered to a purchaser in Kentucky. Sales are assigned to Kentucky if the property is shipped or delivered from Kentucky to the U. S. government. Sales of property other than tangible personal property are assigned to Kentucky according to the provisions of KRS 141.120.

PROPERTY—Total property includes all real and tangible personal property owned, or rented, and used during the taxable year. Property owned is valued at original cost.

Leased and rented property is valued at eight times the annual rental rate less any nonbusiness subrentals. Real and tangible personal properties are assigned to Kentucky if owned, or rented, and used in Kentucky. Exclude (a) construction in progress and (b) property which has been certified by Kentucky as a pollution control facility, and is owned or leased by the S corporation. Safe harbor lease property must be included in the factor of the seller/lessee at cost and excluded from the property factor of the purchaser/lessor.

PAYROLL—Total payroll is payroll reported on federal Form 940 before adjustments or exclusions. Kentucky payroll is total payroll subject to Kentucky unemployment insurance tax (before adjustments or exclusions to determine payroll actually taxed for unemployment insurance). A fiscal year taxpayer must adjust the unemployment insurance payroll from a calendar year basis to a fiscal year basis.

WEIGHTED APPORTIONMENT FACTOR—This factor is based on the ratio of the S corporation's Kentucky sales (receipts), property and payroll to total sales (receipts), property and payroll. To determine the weighted apportionment factor, the total of these three factors must be divided by four. To arrive at the total of factors used, the sales factor must be multiplied by two and the property and payroll factors must each be multiplied by one. Thus, the sales factor reflects a weight of 50 percent and the property and payroll factors carry a weight of 25 percent each. An S corporation, whose business activity does not reflect total sales, total property or total payroll, in the computation of the weighted apportionment factor, must average the factors which are used in determining the percentage of business apportioned to Kentucky. An S corporation must use the above formula unless the corporation has approval from the Cabinet to use an alternate formula or the S corporation qualifies for and elects to use one of the alternative apportionment methods provided by KRS 141.120(9)(b)(1) and (2).

FORM 720L—INSTRUCTIONS

WHO MUST FILE—Except as indicated below, every S corporation (a) organized under the laws of Kentucky, (b) having its commercial domicile in Kentucky, (c) owning or leasing property in Kentucky, or (d) having one or more individuals employed or subject to unemployment insurance tax in Kentucky must file a Corporation License Tax Return (Form 720L) and pay corporation license tax.

EXEMPTIONS—Kentucky law exempts the following from corporation license tax: banks and trust companies; insurance companies; savings and loan associations; corporations exempted by IRC Section 501; religious, educational, charitable and like corporations not conducted for profit; public service companies subject to ad valorem tax under KRS 136.120; certified alcohol production facilities; and certified fluidized bed energy production facilities.

CAPITAL DEFINED—The definition of "capital" is established by law and is not dependent upon the various technical definitions of capital prescribed for accounting, economics or other governmental purposes. The term "capital" includes, but is not limited to, the various capital stock accounts, various surplus (retained earnings) accounts, various intercompany accounts including advances, all accounts representing borrowed monies (see exceptions in the following paragraph) and all other accounts which represent capital used directly or indirectly in the business, such as deferred income or taxes, customer advances and customer deposits. Equity capital required under A.P.B. Bulletin 18 shall be included in capital if the S corporation elected to record such equity on its books or general ledger.

Do not include those liabilities representing customer trade accounts and trade notes payable, taxes payable, salaries payable and accounts payable representing various types of liabilities incurred for supplies. In the case of borrowed monies, the S corporation may exclude amounts directly borrowed to purchase inventory, provided the S corporation can prove that the amounts excluded were specifically used to purchase inventory.

The accounts comprising capital shall be reported in amounts shown on the balance sheet used for "book" purposes and not at those amounts shown on various special purpose balance sheets such as "equity," "businessman's," "tax," etc.

MULTISTATE APPORTIONMENT—S corporations which have all their property and payroll within Kentucky are subject to license tax on 100 percent of their capital. S corporations which have property and payroll both within and without Kentucky must apportion capital to Kentucky. They may use the weighted income tax apportionment factor, Line 12, Section I, Schedule A, Form 720, or the method provided in KRS 136.070. The two methods are essentially the same.

SHORT-PERIOD RETURNS—S corporations filing short-period returns resulting from a change in accounting period are required to annualize license tax and determine the computation of the capital in the usual manner. To compute the correct license tax due, multiply capital times the tax rate times the number of months in the short period and divide by 12.

FINAL RETURN—No license tax is due on the S corporation's final return. Corporation license tax is a privilege tax paid for the right to do business in Kentucky for the following period. If an S corporation dissolves, withdraws its qualification to do business in Kentucky or ceases to do business in Kentucky for any reason, there is no liability for license tax on the final return (see Revenue Policy 41P510). If an S corporation ceases operations or business in Kentucky in 1994, the license tax payment with the 1993 return must be paid in full, not annualized or prorated.

TAX RATE—S corporations subject to license tax shall pay an annual license tax at the rate of \$2.10 on each \$1,000 of capital employed in the business in Kentucky or a minimum of \$30.

TAX CREDIT—An S corporation with gross income of \$500,000 or less is allowed a credit against the license tax of \$1.40 per \$1,000 of the first \$350,000 of capital employed (maximum credit \$490). For the purpose of this credit, gross income means total taxable and nontaxable receipts and shall not be reduced by cost of goods sold, cost of assets sold or any other deduction. This credit is deducted on Line 15 of Form 720L (see Regulation 103 KAR 20:010).

TAXPAYER ASSISTANCE*Forms:*

Property and Mail Services Section
859 East Main Street
Frankfort, KY 40620
(502) 564-3658 (toll)

Information:

Corporation Income Tax Section
P.O. Box 1302
Frankfort, KY 40602-1302

Revenue Cabinet
Capitol Annex Building
Frankfort, KY 40620
(502) 564-4580 (toll)
(502) 564-3058 (Telecommunication Device for the Deaf)

Information and forms are available from Kentucky Taxpayer Service Centers in the following cities:

Ashland, 134 Sixteenth Street, 41101-7670
(606) 329-9982

Bowling Green, 1502 Westen Avenue, 42104-3356
(502) 843-5470

Corbin, 1707 18th Street, Suite 5, 40701-8676
(606) 528-3322

Hazard, 233 Birch Street, 41701-2179
(606) 439-2388

Hopkinsville, 105 Hammond Plaza
4011 Ft. Campbell Blvd., 42240-4929
(502) 887-2521

Lexington, 301 East Main Street, Suite 500, 40507-1556
(606) 233-3837

Louisville, 620 South Third Street, Suite 102, 40202-2446
(502) 595-4512

Northern Kentucky, Kentucky Executive Building
2055 Dixie Highway, Ft. Mitchell, 41011-2648
(606) 292-6603

Owensboro, 311 West Second Street, 42302-0734
(502) 686-3301

Paducah, Paducah Bank Building, Suite 306
555 Jefferson Street, 42001-1001
(502) 444-8148

Pikeville, 1279 North Mayo Trail, 41501-8230
(606) 437-4075

INTANGIBLE PROPERTY TAXES—The listing period for intangible property is January 1 through April 15 of each year. Each taxpayer is responsible for reporting intangible property subject to ad valorem taxation. The Intangible Property Tax Return, Revenue Form 62A376, and instructions can be obtained from the Department of Property Taxation or your local county Property Valuation Administrator's office.

TANGIBLE PERSONAL PROPERTY TAXES—The listing period for tangible personal property is January 1 through April 15 of each year. Each taxpayer is responsible for reporting his tangible personalty subject to ad valorem taxation. The Tangible Personal Property Tax Return, Revenue Form 62A500, and instructions can be obtained from the Department of Property Taxation or your local county Property Valuation Administrator's office. A separate form must be filed for each location in Kentucky where you have tangible personal property.

The Kentucky Revenue Cabinet does not discriminate on the basis of race, color, national origin, sex, religion, age or disability in employment or the provision of services.

SCHEDULE D
(Form 720S)

Commonwealth of Kentucky
REVENUE CABINET

**KENTUCKY
CAPITAL GAINS AND LOSSES
FORM 720S**

1993

▶ Attach to your Kentucky S Corporation Income Tax Return.

Name of corporation	Federal ID number	Kentucky account number
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IMPORTANT: Federal rules and instructions apply for computation of gains and losses. However, Kentucky Schedule D (Form 720S) and related forms must be completed due to federal/Kentucky differences in adjusted basis of property placed in service between December 31, 1980, and January 1, 1990. File federal Form 8824 reflecting Kentucky amounts for each "like-kind" exchange.

PART I—SHORT-TERM CAPITAL GAINS AND LOSSES (Assets Held One Year or Less)

a. Kind of property and description <i>(Example, 100 shares of "Z" Co.)</i>	b. Date acquired <i>(mo., day, yr.)</i>	c. Date sold <i>(mo., day, yr.)</i>	d. Gross sales price	e. Cost or other basis, plus expense of sale	f. Gain or (loss) <i>(d less e)</i>
1.					
2. Short-term capital gain from installment sales from Form 6252-K					2
3. Short-term capital gain or (loss) from like-kind exchanges (attach Form 8824 reflecting Kentucky amounts)					3
4. Combine lines 1 through 3					4
5. Tax on short-term gain included on line 31 of Schedule D (Form 1120S) <i>adjusted to exclude the 1 percent rate increase enacted by the Revenue Reconciliation Act of 1993</i>					5
6. Net short-term capital gain or (loss). Subtract line 5 from line 4. Enter here and on Form 720S, Schedule K, line 4(d) or 6					6

PART II—LONG-TERM CAPITAL GAINS AND LOSSES (Assets Held More Than One Year)

7.					
8. Long-term capital gain from installment sales from Form 6252-K					8
9. Long-term capital gain or (loss) from like-kind exchanges (attach Form 8824 reflecting Kentucky amounts)					9
10. Combine lines 7 through 9					10
11. Tax on long-term gain included on lines 23 and 31 of Schedule D (Form 1120S) <i>adjusted to exclude the 1 percent rate increase enacted by the Revenue Reconciliation Act of 1993</i>					11
12. Net long-term capital gain or (loss). Subtract line 11 from line 10. Enter here and on Form 720S, Schedule K, line 4(e) or 6					12
13. Enter section 1231 gain from Form 4797-K					13
14. Net long-term gain or (loss) (combine lines 10 and 13)					14

PART III—SUMMARY OF SCHEDULE D GAINS FOR TAX COMPUTATION PURPOSES

15. Net capital gain. Enter excess of net long-term capital gain (line 14) over net short-term capital loss (line 4). (If line 15 is more than \$25,000, see instructions for Schedule D under "Income Tax on S Corporation." If line 15 is \$25,000 or less, do not complete Part IV.)	15
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PART IV—COMPUTATION OF KENTUCKY TAXABLE INCOME

16. Enter taxable income (see instructions and attach computation schedule)	16		
17. Subtract statutory exemption		(\$25,000)	17
18. Enter net capital gain from line 15	18		
19. Subtract statutory exemption		(\$25,000)	19
20. Enter the lesser of line 17 or line 19			20
21. Enter apportionment factor from Schedule A, Section I, or 100%			21
22. Kentucky taxable income. Multiply line 20 by line 21. Enter here and on Form 720S, page 1			22

SCHEDULE K-1
(Form 720S)

KENTUCKY SHAREHOLDER'S SHARE
OF INCOME, CREDITS, DEDUCTIONS, ETC.

1993

Commonwealth of Kentucky
REVENUE CABINET

Taxable period beginning _____, 1993, ending _____, 199__

Shareholder's identifying number ► Shareholder's name, address and ZIP Code	Corporation's identifying number ► Corporation's name, address and ZIP Code
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A. Shareholder's percentage of stock ownership for tax year	%
B. Shareholder's percentage of time devoted to business during tax year	%
C. Shareholder's compensation for tax year	%
D. Shareholder's taxable percentage of S corporation's pro rata share items below (see instructions):	
(1) Resident shareholder	100%
(2) Nonresident shareholder (see Form 720S instructions for Item D(2))	%

IMPORTANT: Refer to Shareholder's Instructions for Schedule K-1 before entering information from Schedule K-1 on your tax return.

	(a) Pro Rata Share Items	(b) Amount
Income (Losses)	1. Ordinary income (loss) from trade or business activities	1
	2. Net income (loss) from rental real estate activities	2
	3. Net income (loss) from other rental activities	3
	4. Portfolio income (loss):	
	(a) Interest	4(a)
	(b) Dividends	(b)
	(c) Royalties	(c)
	(d) Net short-term capital gain (loss)	(d)
	(e) Net long-term capital gain (loss)	(e)
	(f) Other portfolio income (loss) (attach schedule)	(f)
Deductions	5. Net gain (loss) under section 1231 (other than due to casualty or theft)	5
	6. Other income (loss) (attach schedule)	6
	7. Charitable contributions (attach schedule) and housing for homeless deduction (attach Schedule HH).	7
	8. Section 179 expense deduction	8
Investment Interest	9. Deductions related to portfolio income (loss) (attach schedule)	9
	10. Other deductions (attach schedule)	10
	11. (a) Interest expense on investment debts	11(a)
Credits	(b) (1) Investment income included on lines 4(a) through 4(f) above	(b)(1)
	(2) Investment expenses included on line 9 above	(2)
	12. Kentucky Unemployment Tax Credit	12
Other Items	13. Health Insurance Credit	13
	14. Recycling and Composting Equipment Tax Credit (attach Schedule RC (K-1))	14
	15. (a) Total expenditures to which a section 59(e) election may apply	15(a)
	(b) Type of expenditures ► _____	(b)
	16. Tax-exempt interest income	16
	17. Other tax-exempt income	17
	18. Nondeductible expenses	18
	19. Property distributions (including cash) other than dividend distributions reported to you on Form 1099-DIV	19
	20. Amount of loan repayments for "Loans from Shareholders"	20
21. Supplemental information required to be reported to each shareholder (attach schedules)	21	
Resident Shareholder Adjustment	22. Combination of Kentucky Schedule K-1, lines 1 through 5, 8 and portions of lines 6 and 10. Add income amounts and subtract (loss) and deduction amounts (see instructions)	22
	23. Combination of federal Schedule K-1, lines 1 through 5, 8 and portions of lines 6 and 10. Add income amounts and subtract (loss) and deduction amounts (see instructions)	23
	24. Enter difference of lines 22 and 23 here and on appropriate line on Form 740, page 2 (see instructions)	24

SEE INSTRUCTIONS ON REVERSE.

SCHEDULE K-1
(Form 720S)

KENTUCKY SHAREHOLDER'S SHARE
OF INCOME, CREDITS, DEDUCTIONS, ETC.

1993

Commonwealth of Kentucky
REVENUE CABINET

Taxable period beginning _____, 1993, ending _____, 199_____

Shareholder's identifying number ▶	Corporation's identifying number ▶
Shareholder's name, address and ZIP Code	Corporation's name, address and ZIP Code

A. Shareholder's percentage of stock ownership for tax year ▶ _____ %

B. Shareholder's percentage of time devoted to business during tax year ▶ _____ %

C. Shareholder's compensation for tax year ▶ _____ %

D. Shareholder's taxable percentage of S corporation's pro rata share items below (see instructions):

(1) Resident shareholder ▶ 100%

(2) Nonresident shareholder (see Form 720S instructions for Item D(2)) ▶ _____ %

IMPORTANT: Refer to Shareholder's Instructions for Schedule K-1 before entering information from Schedule K-1 on your tax return.

	(a) Pro Rata Share Items	(b) Amount
Income (Losses)	1. Ordinary income (loss) from trade or business activities 1	•
	2. Net income (loss) from rental real estate activities 2	
	3. Net income (loss) from other rental activities 3	
	4. Portfolio income (loss):	
	(a) Interest 4(a)	
	(b) Dividends (b)	
	(c) Royalties (c)	
	(d) Net short-term capital gain (loss) (d)	
	(e) Net long-term capital gain (loss) (e)	
	(f) Other portfolio income (loss) (attach schedule) (f)	
	5. Net gain (loss) under section 1231 (other than due to casualty or theft) 5	
	6. Other income (loss) (attach schedule) 6	
Deductions	7. Charitable contributions (attach schedule) and housing for homeless deduction (attach Schedule HH) 7	
	8. Section 179 expense deduction 8	
	9. Deductions related to portfolio income (loss) (attach schedule) 9	
	10. Other deductions (attach schedule) 10	
Investment Interest	11. (a) Interest expense on investment debts 11(a)	
	(b) (1) Investment income included on lines 4(a) through 4(f) above (b)(1)	
	(2) Investment expenses included on line 9 above (2)	
Credits	12. Kentucky Unemployment Tax Credit 12	
	13. Health Insurance Credit 13	
	14. Recycling and Composting Equipment Tax Credit (attach Schedule RC (K-1)) 14	
Other Items	15. (a) Total expenditures to which a section 59(e) election may apply 15(a)	
	(b) Type of expenditures ▶ _____ (b)	
	16. Tax-exempt interest income 16	
	17. Other tax-exempt income 17	
	18. Nondeductible expenses 18	
	19. Property distributions (including cash) other than dividend distributions reported to you on Form 1099-DIV 19	
	20. Amount of loan repayments for "Loans from Shareholders" 20	
21. Supplemental information required to be reported to each shareholder (attach schedules) ... 21		
Resident Shareholder Adjustment	22. Combination of Kentucky Schedule K-1, lines 1 through 5, 8 and portions of lines 6 and 10. Add income amounts and subtract (loss) and deduction amounts (see instructions) 22	
	23. Combination of federal Schedule K-1, lines 1 through 5, 8 and portions of lines 6 and 10. Add income amounts and subtract (loss) and deduction amounts (see instructions) 23	
	24. Enter difference of lines 22 and 23 here and on appropriate line on Form 740, page 2 (see instructions) 24	

SEE INSTRUCTIONS ON REVERSE.

SHAREHOLDER'S INSTRUCTIONS FOR SCHEDULE K-1 (FORM 720S)

PURPOSE

Although the S corporation is subject to a Kentucky capital gains tax, you, the shareholder, are liable for Kentucky income tax on your pro rata share of the S corporation's income, whether or not distributed, and you must include your share on your Kentucky income tax return for the year in which the tax year of the S corporation ends. The S corporation uses Schedule K-1 (Form 720S) to report to you your share of the S corporation's income (reduced by any federal tax the S corporation paid on the income), loss, credits, deductions, etc. Please keep it for your records.

GENERAL INSTRUCTIONS

Schedule K-1 (Form 720S) will help when preparing your Kentucky income tax return. Where "(attach schedule)" appears next to a line on Schedule K-1, it means the S corporation will have attached a statement to Schedule K-1 to show information for the line item, if applicable. If you believe the S corporation has made an error on your Schedule K-1 (Form 720S), notify the S corporation and ask for a corrected schedule. Do not change any item on your copy.

Schedule K-1 (Form 720S) does not show the amount of actual dividend distributions the S corporation paid to you. The S corporation must report such amounts to you on Form 1099-DIV. You report actual dividend distributions on federal Schedule B (Form 1040). Refer to the shareholder instructions you received for federal Schedule K-1 (Form 1120S) for information concerning your basis in corporate stock, elections to be made by you separately on your income tax return and not by the S corporation, etc.

Every individual, including estates and trusts, who is a resident of Kentucky and is a shareholder in an S corporation is required to report 100 percent of his or her share of income (loss), credits, deductions, etc., for Kentucky individual income tax purposes. A nonresident shareholder must report the portion of his or her share of income attributable to the S corporation's business in Kentucky as reflected in Item D(2). A **resident** is an individual domiciled within Kentucky or an individual who is not domiciled in Kentucky but maintains a place of abode in Kentucky and spends in the aggregate more than 183 days of the taxable year in Kentucky. A **nonresident** is any individual not a resident of Kentucky.

At-Risk Limitations—Generally, if you have a loss from any activity carried on as a trade or business or for the production of income by the S corporation and you, the shareholder, have amounts invested in that activity for which you are not at risk, you will be required to complete federal Form 6198, At-Risk Limitations, to figure the allowable loss to report on your Kentucky income tax return. Your deductible loss from each activity for the tax year generally is limited to the amount you could actually lose in the activity. To help you complete Form 6198, if required, the S corporation has provided a schedule showing your share of income, expenses, etc., for each at-risk activity.

Passive Activity Limitations—The passive activity limitations in IRC Section 469 are figured at the shareholder level and may apply to any loss reported on lines 1, 2 or 3 and any other related items of income, loss and deductions reported on Schedule K-1 (Form 720S). Refer to the federal Shareholder's Instructions for Schedule K-1 (Form 1120S) to determine if the passive activity limitations apply to your share of loss(es) reported on Schedule K-1 (Form 720S), and if you must file Form 8582-K, Kentucky Passive Activity Loss Limitations. When applicable, the passive activity limitations on losses are applied after the limitations on losses for a shareholder's at-risk amount.

SPECIFIC INSTRUCTIONS

Kentucky Resident Shareholders (Form 740 Filers)—You, as the shareholder, will need to determine the net difference between your federal Schedule K-1 amounts and your Kentucky Schedule K-1 amounts. This will adjust the items of income, loss and deductions used to compute your federal adjusted gross income to the Kentucky amounts shown in Column (b), Schedule K-1. To determine this difference, complete Lines 22, 23 and 24.

Lines 22 and 23—Include on these lines, the Kentucky Schedule K-1 and federal Schedule K-1 amounts from Lines 1 through 5 and 8.

Also include the amounts from Lines 6 and 10 that do not pass through to Schedule A as itemized deductions (see Shareholder's Instructions for Schedule K-1 (Form 1120S)).

NOTE: If Form 8582-K is required, adjust the amounts entered on Lines 22 and 23 to exclude any income, loss, deduction or expense related to a passive activity. Complete the passive activities adjustment worksheet (Form 8582-K, page 2) to determine additions to or subtractions from federal adjusted gross income. See Form 740 instructions for Line 39 and/or Line 47.

If amounts on Lines 4(d) and 4(e) are subject to the capital loss limitations, do not include on Lines 22 and 23. Complete federal Schedule D using Kentucky amounts to determine additions to or subtractions from federal adjusted gross income.

Line 24—Enter difference of Lines 22 and 23. If Line 22 is greater than Line 23, enter the difference as an addition to federal adjusted gross income on Form 740, page 2, Line 38. If Line 23 is greater than Line 22, enter the difference as a subtraction on Form 740, page 2, Line 46.

Caution: If the amounts on both Lines 22 and 23 are (loss) amounts the smaller dollar amount of (loss) is the greater amount, and to determine the difference subtract the smaller dollar amount from the larger dollar amount. If the amount on either Line 22 or 23 is an income amount and the amount on the other line is a (loss) amount the income amount is the greater amount, and to determine the difference add the two amounts.

Nonresident Shareholders (Form 740-NP Filers)—If the percentage shown in Item D(2) is "100%," you must enter on the appropriate lines of Form 740-NP and related schedules the amounts shown on Lines 1 through 5 and 8, portions of Lines 6, 10 and 11(a) and the portion of Line 15(a) actually deducted for the current year.

If the percentage shown in Item D(2) is less than 100 percent, the amounts on Lines 1 through 5 and 8, the portions of Lines 6, 10 and 11(a) which do not pass through to Schedule A and the portion of Line 15(a) actually deducted for the current year must be multiplied by this percentage and entered on the appropriate lines of the Nonresident or Part-Year Resident Income Tax Return, Form 740-NP, and related schedules. Lines 7 and 9, and the portions of Lines 6, 10 and 11(a) which pass through to Schedule A should not be multiplied by the percentage in Item D(2) since they will be prorated by the percentage on Line 27 of Form 740-NP. Also the credits on Lines 12, 13 and 14 should not be multiplied by the percentage in Item D(2).

Refer to specific instructions below and federal Shareholder's Instructions for Schedule K-1 (Form 1120S).

Lines 1 through 3—Enter on federal Schedule E using Kentucky amounts or on Form 8582-K, if applicable.

Lines 4(a) and (b)—Enter on Line 10, Column B, Form 740-NP.

Line 4(c)—Enter on federal Schedule E using Kentucky amounts.

Lines 4(d) and (e)—Enter on federal Schedule D using Kentucky amounts or Form 8582-K, if applicable.

Line 4(f)—Enter on applicable lines of your return (see federal Shareholder's Instructions for Schedule K-1 (Form 1120S)).

Line 5—Enter on federal Form 4797 using Kentucky amounts.

Line 6—Enter on applicable lines of your return (see federal Shareholder's Instructions for Schedule K-1 (Form 1120S)).

Line 7—Enter on Schedule A, Form 740-NP.

Line 8—Enter on federal Schedule E using Kentucky amounts.

Line 9—Enter on Schedule A, Form 740-NP.

Line 10—Enter on applicable form or schedule (see federal Shareholder's Instructions for Schedule K-1 (Form 1120S)).

For All Shareholders

Line 11—See federal Shareholder's Instructions for Schedule K-1 (Form 1120S).

Line 12—Enter credit on Schedule UTC.

Line 13—Enter this amount on Schedule TC, Line 5(c) (Form 740-NP, Line 35) and attach a copy of Schedule K-1.

Line 14—See Schedule RC (K-1) instructions.

Lines 15(a) through 21—See federal Shareholder's Instructions for Lines 16(a) through 21 and 23, Schedule K-1 (Form 1120S).

Estates and Trusts (Form 741 Filers)—If you are an estate or trust, report the amounts shown in Column (b) on Form 741, Kentucky Fiduciary Income Tax Return, and related schedules. See federal Shareholder's Instructions for Schedule K-1 (Form 1120S).

720X

41A720X
(10-93)

Commonwealth of Kentucky
REVENUE CABINET

AMENDED
KENTUCKY CORPORATION INCOME TAX
AND CORPORATION LICENSE TAX RETURN

For taxable year ended

Mo. / Yr.

Foreign or Domestic

Please print or type	Name of Corporation				Kentucky Account No.
	Number and Street				Federal Identification No.
	City	State	ZIP Code	Telephone Number	Federal Business Code No.
	State and Date of Incorporation	Principal Business Activity in Kentucky		Kentucky Business Code No.	

► Fill in applicable items and use Part III to explain any changes. ◀

NOTE: Use Form 720X to correct Form 720 and/or Form 720L as originally filed or as later adjusted by an amended return, claim for refund, etc. A corporation taxable both within and without Kentucky must complete lines 1 through 9. A 100% Kentucky corporation must complete line 1 and enter the amount on line 1 on line 7, omitting lines 2 through 6.

PART I—INCOME TAX		A. As Originally Reported or as Adjusted (see specific instructions)	B. Net Change— Increase or (Decrease) (explain in Part III)	C. Correct Amount
1. Net income before NOL deduction (NOLD)	1			
2. Nonbusiness income (net)	2			
3. Total business income (line 1 less line 2)	3			
4. Apportionment factor	4			
5. Kentucky business income (line 3 multiplied by line 4)	5			
6. Kentucky nonbusiness income (net)	6			
7. Taxable net income before NOLD (line 5 plus line 6, or line 1)	7			
8. Kentucky NOLD (attach schedule)	8			
9. Taxable net income after NOLD (line 7 less line 8)	9			
10. Total income tax (see instructions)	10			
11. Enter credits (see instructions)	11			
12. Net income tax due. Subtract line 11 from line 10. (If line 11 exceeds line 10, enter 0.)	12			
13. Income tax previously paid	13			
14. Income tax due (If line 12, column C, exceeds line 13, enter difference as INCOME TAX DUE)	14			
15. Income tax refund (If line 13 exceeds line 12, column C, enter difference as INCOME TAX REFUND)	15			

PART II—LICENSE TAX		A. As Originally Reported or as Adjusted (see specific instructions)	B. Net Change— Increase or (Decrease) (explain in Part III)	C. Correct Amount
16. Total capital employed	16			
17. Apportionment factor (wholly KY corporations enter 100%)	17			
18. Capital subject to license tax (line 16 multiplied by line 17)	18			
19. Total license tax before credit	19			
20. Less credit, if applicable (see instructions)	20			
21. Net license tax (see instructions)	21			
22. License tax previously paid	22			
23. License tax due (If line 21 exceeds line 22, enter difference as LICENSE TAX DUE)	23			
24. License tax refund (If line 22 exceeds line 21, enter difference as LICENSE TAX REFUND)	24			

TAX PAYMENT SUMMARY			
Income Tax	License Tax	Interest	TOTAL

I, the undersigned, declare under the penalties of perjury, that I have examined this return, including all accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct and complete.

Signature of principal officer or chief accounting officer _____	Date _____	Name and Social Security or federal identification number of person or firm preparing return _____
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Make check payable to Kentucky State Treasurer. Mail return with payment to Kentucky Revenue Cabinet, Frankfort, Kentucky 40620.

PART III—Explanation of Changes to Net Income, Nonbusiness Income, Apportionment Factor, Capital Employed, Credits, etc.

Enter the line reference from page 1 for which a change is reported, and give the reason for each change. Show any computation in detail. Attach any schedules needed.

GENERAL INSTRUCTIONS

Purpose of Form—Use Form 720X to correct your Form 720, Kentucky Corporation Income Tax Return and/or Form 720L, Kentucky Corporation License Tax Return, as you originally filed or as later adjusted by amended returns, claim for refund or an examination.

Do not use this form to report federal audit changes. Form 720, Schedule Z should be used to report such changes.

When to File—File Form 720X only after you have filed your original return. Generally, you must file Form 720X within four years after the date the original return was due or four years after the date you filed it, whichever was later.

Information on Income, Deductions, Tax Computation, etc.—Refer to the instructions for Kentucky Corporation Income Tax Return, Form 720, and Kentucky Corporation License Tax Return, Form 720L, related schedules and forms, for the year you are amending concerning the taxability of certain types of income, the allowability of certain expenses as deductions from income, computation of tax, etc.

Where to File—Mail this form to Kentucky Revenue Cabinet, Frankfort, Kentucky 40620.

SPECIFIC INSTRUCTIONS

LINE 1, Column A—Enter the amount from original return, or as later adjusted.

Column B—Enter the increase or decrease you are making. Explain the increase or decrease in Part III. If the change involves an item of income or deduction that the corporation income tax return or its instructions requires you to support with a schedule, statement or form, attach the appropriate schedule, statement or form to Form 720X. Do not include changes to net operating loss deduction here (see line 8 instructions below).

Column C—Enter the result of adding the increase in column B to the amount in column A or subtracting the column B decrease from column A. If there is no change entered in column B enter the amount from column A.

LINES 2 THROUGH 6

Note: These lines are applicable only to corporations taxable both within and without Kentucky. Corporations taxable only in Kentucky omit these lines and enter amount from line 1 on line 7.

Column A—On each line, 2 through 6, enter amount from appropriate line of Schedule A, Form 720 as originally filed, or as later adjusted.

Column B—Enter on lines 2, 4 and 6 any increases or decreases you are making, and explain in Part III and attach a corrected Schedule A, Form 720.

Column C—On lines 2, 4 and 6 enter the result of adding the increase in column B to the amount in column A or subtracting the column B decrease from column A. If there is no change entered in column B enter the amount from column A.

LINE 8, Column C—The amount of NOL to be carried back or forward for Kentucky income tax purposes is the amount of loss determined on the Kentucky return, and in the case of multistate corporations it is the amount determined after apportionment and allocation (attach schedule showing computation of the amount claimed).

LINE 10, Column C—Determine corrected income tax by using tax rates reflected on Tax Computation Schedule of Form 720 used for filing original return for the year.

LINE 11, Column A—Enter total amount of credit from appropriate lines of Tax Computation Schedule of Form 720 as originally filed or later adjusted.

Column B—Enter any increase or decrease you are making. If an entry is made on this line, attach a schedule reflecting computations (see Tax Computation Schedule of Form 720 for year originally filed for limitations). Also attach corrected Schedule UTC, Schedule CC, Schedule HC, Schedule RC and/or Schedule EZC.

Column C—Enter the result of adding the increase in column B to the amount in column A or subtracting the column B decrease from column A. If there is no change entered in column B, enter amount from column A.

LINE 13—Enter total income tax previously paid for taxable year less any refund previously received for taxable year.

LICENSE TAX—A corporation may amend its license tax return to include or exclude accounts of capital and to reflect changes in the apportionment factor. In accordance with KRS 136.070(2) accounts properly includable in capital employed must be reported at the amounts reflected on the balance sheet prepared for book purposes as of the last day of the taxable year. Therefore, the license tax return may not be amended to change the amount of an account includable in capital employed from the amount originally reported except to correct an error in recording the amount of an item from the balance sheet to the license tax return as originally filed.

LINES 16 AND 17—Enter in column A the amount from appropriate line of Form 720L as originally filed or later adjusted. Enter in column B any increases or decreases you are making and explain in Part III, or attach corrected Form 720L or other schedules to explain changes. Enter in column C the result of adding the increases in column A or subtracting the column B decrease from column A.

LINE 19—Determine corrected tax due on amount reflected on line 18. For tax years ending prior to August 1, 1985, the tax rate is \$.70 on each \$1,000 of capital employed or a minimum of \$10. For tax years ended after July 31, 1985, the tax rate is \$2.10 on each \$1,000 of capital employed or a minimum of \$30.

LINE 20—For taxable years ending before August 1, 1985, leave this line blank and enter amount on line 19 on line 21. For taxable years ending after July 31, 1985, a corporation with gross income of \$500,000 or less is allowed a credit against the license tax of \$1.40 per thousand of the first \$350,000 of capital employed. For the purpose of this credit, gross income means total taxable and nontaxable receipts and shall not be reduced by cost of goods sold, cost of assets sold or any other deduction.

LINE 21—For taxable years ending before August 1, 1985, enter amount from line 19. For taxable years ending after July 31, 1985, subtract the amount on line 20, if applicable, from the amount on line 19, and enter the result or \$30 whichever is larger.

LINE 22—Enter total license tax previously paid for the taxable year less any refund previously received for the taxable year.

TAX PAYMENT SUMMARY—If amounts of additional tax due are reflected on either line 14 or line 23, enter amounts due in proper place in this section. Compute interest from the due date of the return to the date of payment. For years ending prior to July 1, 1982, the rate is 8 percent per annum until paid. For tax years ending after June 30, 1982, variable rates apply to the periods during which the tax was unpaid as follows: July through December 1982, 16 percent; calendar 1983, 13 percent; calendar 1984, 11 percent; calendar 1985, 13 percent; calendar 1986, 10 percent; calendar 1987, 8 percent; calendar 1988, 9 percent; calendar 1989, 10 percent; calendar 1990, 11 percent; calendar 1991, 10 percent; calendar 1992, 8 percent; and calendar 1993, 7 percent.

INSTRUCTIONS—KENTUCKY DEPRECIATION (FORM 762)

KENTUCKY DEPRECIATION RULES

Kentucky taxpayers will be required to use different depreciation systems and methods depending upon the date that property is first acquired and placed in service (see Revenue Circular 40C005).

Property Placed in Service Before January 1, 1981

Property placed in service before January 1, 1981, will continue to be depreciated under the system used when the property was placed in service. Such systems and methods must conform to the provisions of Sections 167 and 179 of the IRC and related federal income tax regulations in effect at the time the property was first placed in service. Enter the amount of allowable depreciation on this property on Form 762, line 2(a).

Property Placed in Service January 1, 1981, through July 31, 1985

Conversion property, property placed in service January 1, 1981, through July 31, 1985, which the taxpayer was required to convert to the straight-line method of the 1980 IRC, will continue to be depreciated under the straight-line method over its remaining useful life using the Kentucky adjusted basis. Enter the amount of allowable depreciation on this property on Form 762, line 3.

Corporate taxpayers who made the election to depreciate property placed in service after 1980 and before August 1, 1985, under IRC Section 167 in lieu of the Accelerated Cost Recovery System (ACRS) provided under IRC Section 168 must continue to depreciate this property under the specific provisions of Sections 167 and 179 of the 1980 IRC. Enter the amount of allowable depreciation on this property on Form 762, line 2(c).

Property Placed in Service August 1, 1985, through December 31, 1989

All property placed in service after July 31, 1985, and before January 1, 1990, must be depreciated under Sections 167 and 179 of the 1980 IRC and related federal income tax regulations, rulings and procedures. You may elect to use either the useful life or CLADR system of depreciation. Enter the amount of allowable depreciation on this property on Form 762, line 2(b) and/or line 2(d) if the CLADR system is elected. If the CLADR system is used, you must complete Form 732 and attach it to your return. Form 732 may be obtained from the Revenue Cabinet.

Property Placed in Service After December 31, 1989

For property placed in service after December 31, 1989, the basis and the amount of depreciation for Kentucky income tax purposes generally must be the same as for federal income tax purposes. **Exception (1)—Like-kind Exchanges**—Since no gain or loss is recognized for tax purposes on like-kind exchanges the basis in the new property is determined by adding to the adjusted basis of the old property the cash difference paid for the new property. Therefore, where the adjusted basis for old property is different for Kentucky and federal purposes because of the differences in Kentucky and federal depreciation for property placed in service after December 31, 1980, and before January 1, 1990, the basis in the new property, acquired by like-kind exchanges after December 31, 1989, will be different for Kentucky and federal purposes. **Exception (2)—1989 IRC Sections 168 and 179—KRS 141.0101** specifically allows the deductions allowed under IRC Sections 168 and 179 in effect as of December 31, 1989. Thus, any changes made to these sections of the IRC by the Revenue Reconciliation Acts of 1990 and 1993, including the change in definition of "Section 179 property," the \$7,500 increase in limitation of Section 179 deduction and the lengthening of the depreciation period for nonresidential realty, have not been adopted for Kentucky purposes.

To determine the Kentucky depreciation deduction for assets placed in service after December 31, 1989, enter on line 4(a) of Form 762 the amounts from lines 14 and 15 of federal Form 4562 filed for the taxable year. Enter on line 4(b) of Form 762 the amounts from lines 16, 17, 18 and 19 of federal Form 4562. Individual and other noncorporate taxpayers (including S corporations) not required to file federal Form 4562 for federal tax purposes for the taxable year, write "Form 4562 Not Required" on line 4(a) and enter on line 4(b) the total depreciation deducted on the federal tax return. **Note:** Exclude from lines 4(a) and 4(b) any depreciation included on lines 14, 15, 16, 17, 18 and 19 of federal Form 4562 applicable to assets discussed in exception (1) above.

Also, before entering the amounts from lines 14, 15, 16, 17, 18 and 19 of federal Form 4562 on lines 4(a) and 4(b) they should be adjusted for any difference in Kentucky and federal depreciation resulting from exception (2) above.

On line 4(c) enter the amount of line 4(b) which is applicable to assets placed in service before January 1, 1990. Subtract line 4(c) from line 4(b), and enter any remainder on line 4(d). Enter on line 4(e) the depreciation determined under Section 168 using the Kentucky basis for property placed in service after December 31, 1989, which was acquired by like-kind exchanges as discussed above. A copy of federal Form 4562 must be attached.

First-Time Kentucky Filers

Taxpayers who are filing their initial Kentucky return and who are claiming a depreciation deduction for property placed in service before January 1, 1981, must determine such depreciation in the same manner as any other Kentucky taxpayer. (See instructions for Property Placed in Service Before January 1, 1981.)

Property placed in service after December 31, 1980, must be depreciated as follows:

(1) Property Placed in Service January 1, 1981, through July 31, 1985

This property must be converted to the straight-line method of the 1980 IRC and depreciated under this method for its remaining useful life using the federal adjusted basis as of the beginning of the first taxable year in Kentucky. Determine remaining useful life and the amount of depreciation allowable on conversion property as follows:

SECTION A. Determining Remaining Useful Life

- 1. Enter year property placed in service . . . _____
- 2. Enter number of years over which property can be depreciated, determined by useful life or class life guideline system _____
- 3. Enter number of years the property has been depreciated. This number must not be greater than 12 years _____
- 4. Enter remaining useful life. Subtract line 3 from line 2 _____

SECTION B. Determining Depreciation for This Year

- 1. Enter Kentucky (federal) adjusted basis . . . _____
- 2. Enter remaining useful life from Section A, line 4 _____
- 3. Depreciation for this year. Divide amount on line 1 by amount on line 2; enter the result here and on Form 762, line 3 _____

(2) Property Placed in Service August 1, 1985, through December 31, 1989

This property must be depreciated over its remaining useful life, under any of the methods allowed by Section 167 of the 1980 IRC using the federal adjusted basis as of the beginning of the first taxable year in Kentucky. (See instructions for Property Placed in Service August 1, 1985, through December 31, 1989.)

(3) Property Placed in Service After December 31, 1989

Depreciation for this property must be the same for Kentucky income tax purposes as the amount taken for federal income tax purposes under 1989 IRC Sections 168 and 179.

Election to Expense Depreciable Assets (1989 IRC Section 179)

Enter on line 1(a) of Form 762 the amount from line 12 of federal Form 4562 adjusted for any difference resulting from exception (2) above. On line 1(b) enter the amount of carryover expense included on line 1(a) applicable to assets placed in service before January 1, 1990. Subtract line 1(b) from line 1(a), and enter the remaining expense on line 1(c). A copy of federal Form 4562 must be attached.

For more information with regard to assets placed in service before January 1, 1990, see Publication 534, Depreciation (1980). A copy of the publication can be obtained from the Revenue Cabinet.

4797-K

41A720-S13

Commonwealth of Kentucky
REVENUE CABINET

KENTUCKY
SALES OF BUSINESS PROPERTY

1993

▶ Attach to Form 720, 720S, 741 or 765. ▶ See instructions.

IMPORTANT: Not for use by individual taxpayers. Individuals must attach a copy of federal Form 4797 to the Kentucky Individual Income Tax Return.

Enter name as shown on tax return.	Federal Identification Number
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PART I—Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty and Theft—Property Held More Than One Year

NOTE: • Use Form 4684-K to report involuntary conversions from casualty and theft. • File federal Form 6198 if you are reporting a loss and have amounts invested in the activity for which you are not at risk (see federal instructions). • File federal Form 8824 reflecting Kentucky amounts for each "like-kind" exchange.

a. Description of property	b. Date acquired (Mo., day, yr.)	c. Date sold (Mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, plus improvements and expense of sale	g. LOSS (f minus the sum of d and e)	h. GAIN (d plus e minus f)
1.							
2. Gain, if any, from Form 4684-K, Part II, line 21							2
3. Section 1231 gain from installment sales from Form 6252-K, line 24 or 35							3
4. Section 1231 gain or (loss) from like-kind exchanges (attach federal Form 8824 reflecting Kentucky amounts)							4
5. Gain, if any, from line 33, Part III, from other than casualty and theft							5
6. Add lines 1 through 5 in column g and column h						()	6
7. Combine columns g and h of line 6. Enter gain or (loss) here and on the appropriate line as follows							7
Partnerships —Enter the gain or (loss) on Form 765, Schedule K. Skip lines 8, 9, 10 and 11 below.							
S corporations —Report the gain or (loss) following the instructions for Form 720S, Schedule K. Skip lines 8, 9, 10 and 11 below, unless line 7 is a gain and the S corporation is subject to the capital gains tax.							
All others —If line 7 is zero or a loss, enter the amount on line 10 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain as a long-term capital gain on Schedule D and skip lines 8, 9 and 11 below.							
8. Nonrecaptured net section 1231 losses from prior years (see Form 4797-K instructions)							8
9. Subtract line 8 from line 7. If zero or less, enter zero. Also enter on appropriate line as follows							9
S corporations —Enter this amount (if greater than zero) on Form 720S, Schedule D, line 13, and skip lines 10 and 11 below.							
All others —If line 9 is zero, enter the amount from line 7 on line 11 below. If line 9 is more than zero, enter the amount from line 8 on line 11 below, and enter the amount from line 9 as a long-term capital gain on appropriate Kentucky Schedule D.							

PART II—Ordinary Gains and Losses

10. Loss, if any, from line 7							10
11. Gain, if any, from line 7 or amount from line 8 if applicable							11
12. Gain, if any, from line 32, Part III							12
13. Net gain or (loss) from Form 4684-K, Part II, lines 13 and 20a							13
14. Ordinary gain from installment sales from Form 6252-K, line 23 or 34							14
15. Ordinary gain or (loss) from like-kind exchanges (attach federal Form 8824 reflecting Kentucky amounts)							15
16. Recapture of section 179 deduction for partners from property dispositions by partnerships (see instructions)							16
17. Other ordinary gains and losses (include property held one year or less):							
18. Add lines 10 through 17 in column g and column h						()	18
19. Combine columns g and h of line 18. Enter gain or (loss) here, and on the appropriate return							19

PART III—Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, 1255

20. Description of sections 1245, 1250, 1252, 1254 and 1255 property:	Date acquired (Mo., day, yr.)	Date sold (Mo., day, yr.)		
(A)				
(B)				
(C)				
(D)				
Relate lines 20(A) through 20(D) to these columns ▶			Property (A)	Property (B)
21. Gross sales price				
22. Cost or other basis plus expense of sale				
23. Depreciation (or depletion) allowed (or allowable) (see instructions)				
24. Adjusted basis, subtract line 23 from line 22				
25. Total gain, subtract line 24 from line 21				
26. If section 1245 property:				
(a) Depreciation allowed (or allowable) (see instructions)				
(b) Enter smaller of line 25 or 26(a)				
27. If section 1250 property: (If straight-line depreciation used, enter zero on line 27(g) unless you are a corporation subject to section 291.)				
(a) Additional depreciation after 12/31/75				
(b) Applicable percentage times the smaller of line 25 or line 27(a) (see federal instructions for Part III)				
(c) Subtract line 27(a) from line 25. If line 25 is not more than line 27(a), skip lines 27(d) and 27(e)				
(d) Additional depreciation after 12/31/69 and before 1/1/76				
(e) Applicable percentage times the smaller of line 27(c) or 27(d) (see federal instructions for Part III)				
(f) Section 291 amount (for corporations only)				
(g) Add lines 27(b), 27(e) and 27(f)				
28. If section 1252 property: (Skip this section if you did not dispose of farmland or if you are a partnership.)				
(a) Soil, water and land clearing expenses				
(b) Line 28(a) times applicable percentage (see federal instructions for Part III)				
(c) Enter smaller of line 25 or 28(b)				
29. If section 1254 property:				
(a) Intangible drilling and development costs (see federal instructions for Part III)				
(b) Enter smaller of line 25 or line 29(a)				
30. If section 1255 property:				
(a) Applicable percentage of payments excluded from income under section 126 (see federal instructions for Part III)				
(b) Enter the smaller of line 25 or 30(a)				

Summary of Part III Gains (Complete property columns (A) through (D) through line 30(b) before going to line 31.)

31. Total gains for all properties (add columns (A) through (D), line 25)	31
32. Add columns (A) through (D), lines 26(b), 27(g), 28(c), 29(b), and 30(b). Enter here and on Part II, line 12	32
33. Subtract line 32 from line 31. Enter the portion from casualty and theft on Form 4684-K, Part II, line 15; enter the portion from other than casualty and theft on Form 4797-K, Part I, line 5	33

41A720-S13(I)
9-93

INSTRUCTIONS—FORM 4797-K

PURPOSE OF FORM

Form 4797-K is used to report the following:

- The sale or exchange of trade or business property, depreciable and amortizable property, oil, gas and geothermal property and section 126 property.
- The involuntary conversion (other than casualty or theft) of trade or business property and capital assets held in connection with a trade or business or a transaction entered into for profit.
- Disposition of other noncapital assets.
- Recapture of section 179 deductions. This is either additional first-year 20% bonus depreciation or special expensing of recovery property.

In general, federal rules and instructions for computing gains and losses will apply although amounts reported will be different due to federal/Kentucky differences in adjusted basis of property placed in service between December 31, 1980, and January 1, 1990. Special applications are discussed below.

NONRECAPTURED NET SECTION 1231 LOSSES

For tax years beginning on or after January 1, 1986, Kentucky adopted the federal rules for nonrecaptured net section 1231 losses.

Net section 1231 gains are treated as ordinary income to the extent that net section 1231 losses were deducted in 1988–1992.

In some cases losses previously recaptured only for federal income tax purposes may be recaptured for Kentucky purposes in 1993. Consequently, even though the rules are the same for Kentucky and federal purposes in 1993, the portion of gains reported as ordinary income may be different.

RECAPTURE OF SECTION 179 DEDUCTIONS

Partners (Line 16)—Enter any recapture of section 179 expense deduction included on Schedule K-1 (Form 765), Line 17, but only if it is due to a disposition. Report these amounts only to the extent a deduction was taken in prior years. Amounts subject to recapture for Kentucky may not be the same as those for federal purposes because the maximum amounts allowed for section 179 deductions were different after 1983.

Listed Property and Luxury Cars—Recapture rules under sections 280F and 179 for recovery property (listed property and luxury cars) when business usage drops to less than 50 percent are not applicable to Kentucky for such property placed in service before January 1, 1990. However, for such property placed in service after December 31, 1989, the same recapture rules apply for Kentucky as for federal purposes.

LINE 23 AND LINE 26(a)

Line 23—When federal instructions refer to depreciation, section 179 deduction, and 48(q) basis adjustment, include the amounts actually used for Kentucky.

S Corporations: The section 179 deduction was not a "pass through" item for Kentucky until tax years beginning after December 31, 1985. If you are disposing of property acquired during a taxable year beginning after December 31, 1985, report the section 179 deduction on Schedule K-1 (Form 720S).

Corporations: For property acquired after December 31, 1980, and before August 1, 1985, use federal depreciation allowed or allowable before conversion added to Kentucky depreciation allowed or allowable after conversion. This amount is then reduced by the ACRS depreciation not allowed for Kentucky purposes for tax years beginning after June 30, 1984. The section 179 deduction and section 48(q) investment tax credit basis adjustments must be included on this line.

SECTION 1245 AND 1250 PROPERTY

After December 31, 1985, and prior to January 1, 1990, Kentucky did not recognize recovery property. Consequently, for property placed in service before January 1, 1990, Kentucky allows section 1250 treatment for some real property classified as section 1245 for federal purposes. Use the instructions below to properly categorize gains and losses for Kentucky purposes for property placed in service before January 1, 1990.

Section 1245 property is property that is depreciable (or amortizable under section 185 of the 1985 IRC) and is one of the following:

Personal property.

Livestock held for draft, breeding, dairy or sport purposes.

Elevators and escalators.

Real property (other than property described under tangible real property below) subject to amortization or deductions under sections 169, 179, 185, 188, 190, 193 or 194 of the 1985 IRC.

Tangible real property (except buildings and their structural components) if it is used in any of the following ways:

- (1) As an integral part of certain business activities.
- (2) As a research facility.
- (3) For the bulk storage of fungible commodities (including commodities in a liquid or gaseous state) in connection with manufacturing, production, extraction or furnishing transportation, communications or certain other public utility services.

A single purpose agricultural or horticultural structure under section 48(q).

A storage facility (not including a building or its structural components) used in connection with the distribution of petroleum or any primary product of petroleum.

Section 1250 property is depreciable real property (other than section 1245 property).

LINE 27(a)

Enter the excess depreciation over straight-line depreciation based on the number of years the asset was originally depreciated, not the life in use after the property was converted. For example, if property was placed in service under ACRS with a 15-year life compute the depreciation on 15 years.

6252-K

KENTUCKY INSTALLMENT SALE INCOME

41A720-S14

See federal instructions. However, amounts and gross profit percentages may be different due to federal/Kentucky differences.

1993

Commonwealth of Kentucky REVENUE CABINET

Attach to Form 720, 720S, 741 or 765.

Use a separate form for each sale or other disposition of property on the installment method.

IMPORTANT: Not for use by individual taxpayers. Copy of federal Form 6252 must be attached to Form 740.

Enter name as shown on tax return. Federal Identification Number

- 1. Description of property
2. (a) Date acquired (month, day, and year) (b) Date sold (month, day and year)
3. Was property sold to a related party after May 14, 1980?
4. If the answer to 3 is "Yes," was the property a marketable security?

PART I—Computation of Gross Profit and Contract Price (For year of sale only.)

Table with 16 rows for Part I: 5. Selling price including mortgages and other indebtedness, 6. Mortgages and other indebtedness buyer assumes or takes property, 7. Subtract line 6 from line 5, 8. Cost or other basis of property sold, 9. Depreciation allowed or allowable, 10. Adjusted basis (subtract line 9 from line 8), 11. Commissions and other expenses of sale, 12. Income recapture from line 32, Form 4797-K, 13. Add lines 10, 11 and 12, 14. Gross profit (subtract line 13 from line 5), 15. Subtract line 13 from line 6, 16. Contract price (add lines 7 and 15).

PART II—Computation of Taxable Part of Installment Sale (For year of sale and any year you receive a payment.)

Table with 8 rows for Part II: 17. Gross profit percentage (divide line 14 by line 16), 18. For year of sale only—enter amount from line 15 above; otherwise enter zero, 19. Payments received during year, 20. Add lines 18 and 19, 21. Payments received in prior years, 22. Taxable part of installment sale (multiply line 20 by line 17), 23. Part of line 22 that is ordinary income under recapture rules, 24. Subtract line 23 from line 22.

PART III—Information and Computation for Related Party Installment Sale

(Do not complete this part if you received the final installment payment this tax year.)

- 25. Name and taxpayer identification number of related party
26. Did the related party, during this tax year, resell or dispose of the property?
27. If the answer to question 26 is "Yes," complete lines 28 through 35 below unless one of the following conditions is met (check only the box that applies):
(a) The second disposition was more than two years after the first disposition (other than dispositions of marketable securities).
(b) The first disposition was a sale or exchange of stock to the issuing corporation.
(c) The second disposition was an involuntary conversion where the threat of conversion occurred after the first disposition.
(d) The second disposition occurred after the death of the original seller or purchaser.
(e) It can be established that tax avoidance was not a principal purpose for either of the dispositions.

Table with 7 rows for Part III: 28. Selling price of property sold by related party, 29. Enter contract price from line 16 for year of first sale, 30. Enter the smaller of line 28 or line 29, 31. Total payments received by the end of your 1993 tax year, 32. Subtract line 31 from line 30, 33. Multiply line 32 by the gross profit percentage on line 17, 34. Part of line 33 that is ordinary income under recapture rules, 35. Subtract line 34 from line 33.

CHAPTER V.

PROCEDURES BEFORE THE KENTUCKY BOARD OF TAX APPEALS

Timothy C. Kimmel
Sites & Harbison
Frankfort, Kentucky

PROCEDURES BEFORE THE KENTUCKY BOARD OF TAX APPEALS

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**[5.1] PROCEDURES BEFORE THE
KENTUCKY BOARD OF TAX APPEALS**

By
Timothy C. Kimmel

I. [5.2] INTRODUCTION

Taxpayers find themselves before the Kentucky Board of Tax Appeals (the "Board") in generally one of two situations: (1) The taxpayer has been denied a refund request; or (2) The taxpayer has received a tax assessment for additional taxes. The process for challenging either of these two situations in Kentucky is both technical and complex, and can be influenced by such matters as (1) the agency assessing the tax (or denying the refund), (2) the method of assessment and (3) the type of tax involved. An understanding of these elements, and their importance, is essential to an understanding of the procedures before the Board. Thus, this chapter will examine these salient elements as well as the procedural requirements of practice before the Board.

II. [5.3] JURISDICTION OF THE BOARD

The Board is vested with exclusive jurisdiction to hear and determine appeals from final rulings, orders and determinations of any agency of state government affecting revenue and taxation. [KRS 131.340]. Such final rulings, orders and determinations are issued by the state agency in either (1) denying a refund request or (2) issuing a tax assessment.

III. [5.4] REFUND REQUEST

Kentucky has two refund statutes, KRS 134.580 and KRS 134.590 which have different rules and requirements, and, more importantly, different statutes of limitations.

A. [5.5] REFUND OF ALL TAXES, EXCEPT AD VALOREM TAXES AND TAXES PAID UNDER UNCONSTITUTIONAL STATUTES - FOUR YEAR STATUTE OF LIMITATION

A taxpayer may request a refund of money paid into the State Treasury in payment of any state tax (except ad valorem taxes and taxes paid under an unconstitutional statute), whether payment was made voluntarily or involuntarily, from the agency of state government which administers the tax within four years of the due date of the return or the date the money was paid into the State Treasury, whichever is the later, when a tax was overpaid or no tax was due. [KRS 134.580].

A refund request is made by filing a written request for a refund with the state agency that administers the tax either on a form proscribed by the agency or by a letter to the agency setting forth such information as (1) the name and address of the taxpayer, (2) the taxpayer identification or social security number, (3) the amount of the refund request, (4) the reason for the refund request and (5) any other information required by the agency. In addition, a refund request can be made by filing an amended tax return within the time proscribed for amending a return. [For example, see form 41A720X, Amended Kentucky Corporation Income Tax and Corporate License Tax Return.]

B. [5.6] REFUND OF AD VALOREM TAXES AND TAXES PAID UNDER UNCONSTITUTIONAL STATUTES - TWO YEAR STATUTE OF LIMITATION

Within two years from the date payment is made a taxpayer may request a refund of money paid into the State Treasury in payment of ad valorem taxes and taxes of any kind paid under an unconstitutional statute from the agency of state government which administers the tax. However, no refund for ad valorem taxes, except those held unconstitutional, can be made unless the taxpayer follows the administrative remedy procedures established through the protest provisions of KRS 131.110, the appeal provisions of KRS 133.120, the correction provisions of KRS 133.110 and 133.130, or other administrative remedy procedures. [KRS 134.590]. Thus, a taxpayer may not pay an ad valorem property tax assessment and later file a refund request solely under KRS 134.590, unless the constitutionality of the tax is in question.

KRS 134.590 is a trap for the unwary because of its shorter statute of limitations for ad valorem taxes and unconstitutional taxes. The constitutionality of the shorter two year refund statute was challenged as violating equal protection provisions of the Kentucky and U.S. Constitutions in Commonwealth v. Gossum, 92-SC-1041-TG and 94-SC-216-TX (1994) (NOTE: As of the date of publication, this opinion was not final and may not be cited as authority in any courts of the Commonwealth of Kentucky.) In that case, the Supreme Court of Kentucky ruled "that a reasonable basis does exist for a distinction sufficient to create a justification for the separate classification of a four or two year statute of limitation," and thus, equal protection provisions are not violated by the shorter two year refund statute. Therefore, taxpayers must be careful to file claims for refunds within two years of the payment date for taxes paid under unconstitutional taxes.

Finally, with respect solely to ad valorem taxes, if the question of the amount of taxes due is in litigation, the application for refund is due within two years from the date the amount due is finally determined. [KRS 134.590(6)]. Ad valorem taxpayers who rely on the "litigation" extension for filing a refund request under paragraph 6 of KRS 134.590 must be careful to name all agencies as parties to the litigation who are responsible for administering and collecting the tax. See Griggs v. Dolan, Ky., 759 S.W.2d 593 (1988), holding that the right to file a refund under KRS 134.590 against the board of education of Fayette County expired two years after the taxes in question were paid because the board of education was not a party to the lawsuit challenging the constitutionality of the tax. However, those taxpayers (members of the class involved in the constitutionality litigation) had two years from the finality date in their successful constitutional challenge of the ad valorem tax scheme to apply for a refund of the tax with the other agencies named in the lawsuit.

C. [5.7] APPEAL TO BOARD FROM FINAL RULING ON REFUND REQUEST

The agency receiving the refund request will either approve or deny the refund. A taxpayer receiving a "final" determination or ruling denying a refund request has thirty days from the date of the mailing of the agency's ruling, order or determination to prosecute an appeal to the Board, or forego the refund request. [KRS 131.340]. See Revenue Cabinet v. Castleton, Inc., Ky. App., 826 S.W.2d 334 (1992), holding that (1) the Board is vested with exclusive jurisdiction to hear and determine appeals only from final determinations or rulings on matters affecting revenue and taxation, and (2) an advisory letter denying a refund request is not a final determination or ruling which would require the taxpayer to file an appeal. [Note: Although the decision in Castleton was favorable to the taxpayer, because of the potential loss of the refund for not protesting a final ruling of an agency within thirty days, all written correspondence from an agency denying a refund request should be considered a "final ruling" and protested to the Board unless written assurance is received from the Cabinet that such correspondence is not a final ruling.]

IV. [5.8] TAX ASSESSMENTS

The Kentucky Revenue Cabinet (the "Cabinet") has authority over state income, license, sales and use and a host of other state taxes. The Cabinet also supervises the implementation and enforcement of property taxes. [KRS 131.030].

A. [5.9] FREQUENCY OF ASSESSMENTS

The Cabinet is entitled to audit the returns and records of taxpayers at any time consistent with the various statutes of limitations. For example, the statute for income tax is four (4) years [KRS 141.210]; sales and use tax is four (4) years [KRS 139.620]; and tangible and intangible property is five (5) years. [KRS 132.360]. In the case of fraud, or the failure to file a return, assessment can be made at any time. A taxpayer may formally execute in writing a waiver of the statute of limitations for a specified period. Such a waiver by the taxpayer will automatically extend accordingly the time available for filing a refund request under KRS 134.580. [KRS 134.580(4)].

B. [5.10] BOOKS AND RECORDS

The Cabinet may examine the records, documents and files of any taxpayer if the records will furnish knowledge of a possible tax liability. However, the Cabinet does not have the independent power to either summons or subpoena taxpayer records. While they may request certain information, the Cabinet may enforce the request only by application to the circuit court. [KRS 131.130(2)]. Furthermore, a taxpayer suing to compel the Cabinet to use the judicial process does not violate a statute prohibiting suits "to restrain or delay the collection or payment of any taxes." [KRS 139.760(3)]. See Revenue Cabinet, Comm. of Ky. v. Cherry, Ky., 803 S.W.2d 570 (1990).

C. [5.11] ASSESSMENT AND NOTICE OF TAX DUE

Once the Cabinet auditor completes the audit, the taxpayer will be provided with a letter from the Cabinet advising him of the amount of the tax assessment and notifying the taxpayer that Notices of Tax Due will be sent by the Cabinet setting forth the tax deficiencies and interest, plus any penalty which might be imposed. The tax, interest and penalty will be due forty-five (45) days after the date of the Notice unless the assessment is protested to the Cabinet. [KRS 131.110(1)].

D. [5.12] FORMAT OF PROTEST

To protest a tax assessment, the taxpayer must file a written protest with the Cabinet within forty-five (45) days of the date of the Notice of Tax Due. The taxpayer is entitled to a formal conference, if requested in writing, to present his case in person. A protest must be accompanied by a supporting statement setting forth the grounds upon which the protest is made. This statement should include sufficient facts for the Cabinet to understand and appreciate the circumstances of the taxpayer as well as the legal authority relied upon by the taxpayer for relief. An extension of time to file the supporting statement may be granted by the Cabinet. [KRS 131.110]. [Note: If a taxpayer fails to file a protest within the forty-five (45) day period, the tax becomes "due and payable." [KRS 131.110(1)]. Although the taxpayer must pay the tax, the taxpayer may file a claim for refund of the tax within four (4) years of the payment under KRS 134.580. See Revenue Cabinet v. Castleton, Inc., Ky. App., 826 S.W.2d 334 (1992), holding that KRS 134.580 (statute applicable to requesting a tax refund) and KRS 131.110 (statute applicable to

protesting a tax assessment) are separate and distinct procedures and have "no specific connection to each other."]

E. [5.13] PROCEDURE WITHIN THE REVENUE CABINET

The Cabinet shall consider the written protest and may also conduct an informal conference to clarify any questions that the respective parties might have. At the informal conference, the assessment can be reviewed on an item-by-item basis with discussion and, perhaps, concessions being made by either party. Penalties imposed by the Cabinet may be waived for just cause shown; interest on tax assessments is not waiveable by the state.

F. [5.14] FINAL RULING LETTER

If settlement of any tax assessment cannot be reached through the protest and conference, the Cabinet must issue a "final ruling" to the taxpayer. This ruling is required to state generally the issues in controversy, the Cabinet's position on those issues, and the procedure for prosecuting an appeal to the Kentucky Board of Tax Appeals. [KRS 131.110(3)]. The ruling must be mailed by certified mail within three (3) working days from the date of the decision. [KRS 131.340(2)].

G. [5.15] OTHER DETERMINATIONS

In addition to issuing a final ruling on any protested assessment, the Cabinet may make other decisions which might trigger appeal rights. Under KRS 131.130(4) the Cabinet is empowered to "advise on all questions respecting the construction of state revenue laws and the application thereof to various classes of taxpayers and property." Under this provision, a taxpayer could request a determination that he was entitled to a certain exempt classification, for example, the denial of which might require an appeal to be filed (if such letter constitutes a "final" ruling or decision).

Similarly, the Cabinet has duties to review certain aspects of intangible and tangible personal property tax assessments. Under KRS 132.486, the Cabinet has been given the responsibility to develop and administer a centralized ad valorem assessment system for such property with on-line computer terminals in each property valuation administrator's office. If the PVA increases the market value of such property which is listed, or lists previously unlisted property, the affected taxpayer may pursue administrative relief from the Kentucky Revenue Cabinet just as if the assessment had been made by the Cabinet itself. The Cabinet would then rule on the issues raised by the change in assessment.

V. [5.16] METHODS EMPLOYED IN ASSESSMENTS

The Cabinet utilizes several tools in the performance of audits. Of course, the Cabinet reviews invoices, financial statements, and other documents to determine if they disagree with any substantive position taken by the taxpayer. They also use other approaches. These approaches are discussed below.

A. [5.17] SAMPLING TECHNIQUES

In implementing the sales and use tax laws, for taxpayers who purchase or sell numerous small items in very large quantities, the Cabinet will often employ a sampling technique to determine the amount of sales and use tax deficiency attributable to transactions in these types of goods. To employ the technique, the Cabinet will take three (3) or four (4) months out of the audit period (frequently three (3) or four (4) years)

and determine the percentage of error attributable to that three (3) or four (4) month period. That percentage calculation is then applied to the total gross receipts involved during the entire audit period to determine the total tax owed.

In 1986, in the Board of Tax Appeals, a taxpayer challenged the right of the Cabinet to use a sampling technique when all of the taxpayer's books and records were available for a complete audit. The appeal was resolved by an Agreed Order between the taxpayer and the Cabinet, with no apparent resolution of the issue. See Leland Hall Electric and Quick Stop Food Mart v. Revenue Cabinet, Commonwealth of Kentucky, KBTA File No. K86-R-28.

Assuming a sampling technique is valid, to be properly applied the sample and error rate produced must bear a reasonable and rational statistical relationship to the entirety of the audit period.

B. [5.18] JEOPARDY ASSESSMENTS

The Cabinet is empowered to make "jeopardy" assessments against taxpayers in certain specified circumstances:

- (1) If the taxpayer has withdrawn from the state or concealed his assets to hinder or evade taxation.
- (2) If the taxpayer has desisted from any taxable activity in the state, or has become domiciled elsewhere, or has left the state with fraudulent intent to hinder or evade taxation.
- (3) If the taxpayer has done any act tending to render partly or wholly ineffective proceedings to assess or collect tax.
- (4) If any tax claim for any other reason is being endangered.

When one or more of these circumstances are present, "such tax liability shall become due and payable immediately upon assessment or the determination of the amount of taxes due." [KRS 131.150(1)]. If a jeopardy assessment is made, the Cabinet, without posting bond, may proceed immediately to bring garnishment, attachment or other legal proceedings to collect the tax. The taxpayer may stay such proceedings by posting a bond. [KRS 131.150(2)].

If a jeopardy assessment is made, the Cabinet has the statutory authority to require the taxpayer to file reports or other information necessary to determine the amount of tax due. [KRS 131.140(3)]. Apparently, the Cabinet will have to utilize the court process called for in the Cherry opinion to obtain such reports and information.

C. [5.19] ESTIMATED ASSESSMENTS

Under the sales tax law, the Cabinet is empowered to make an "estimated" assessment if the taxpayer "fails or refuses to file a return or furnish any information requested in writing by the cabinet." The estimate is to be made from records the Cabinet does have, and the Cabinet may assess tax which must not exceed twice the amount estimated to be due plus a ten (10) percent penalty.

VI. [5.20] TAXPAYERS BILL OF RIGHTS

The provisions of KRS 131.040 to 131.081 are known as the "Kentucky Taxpayers Bill of Rights." The following provisions are included within these provisions:

- KRS 131.071 creates and establishes the Office of Taxpayer Ombudsman within the Cabinet to:
 - (1) Coordinate the resolution of taxpayer complaints;
 - (2) Provide recommendations for new or revised informational publications as well as taxpayer and Cabinet educational programs to reduce or eliminate errors and improve voluntary taxpayer compliance;
 - (3) Provide recommendations for simplification or improvement of tax laws, regulations, forms, systems and procedures to promote better understanding and voluntary compliance by taxpayers.
- KRS 131.081(1) requires the Cabinet to develop and implement a Kentucky tax education and information program for taxpayers and Cabinet personnel.
- KRS 131.081(2) requires the Cabinet to publish and distribute information, in simple and nontechnical language, to explain procedures, remedies and the rights and obligations of taxpayers and the Cabinet. This information is required to be provided to taxpayers before the beginning of any audit, whenever a billing is issued or refund or credit is denied, and whenever the Cabinet denies, cancels or revokes a tax license, permit, etc.
- KRS 131.081(3) authorizes taxpayers to be represented by an attorney, accountant or other person in any conference, hearing or other matter before the Cabinet. The Cabinet is required to notify the taxpayer of this right prior to any such conference or hearing.
- KRS 131.081(4) requires the Cabinet to conduct audits and conduct conferences and hearings only at reasonable times and places.
- KRS 131.081(5) allows taxpayers to make audio recordings of any conference or hearing by the Cabinet, but allows the Cabinet to make such recordings only if prior written notice is given to the taxpayer. Taxpayers are specifically authorized to obtain a copy or transcript of such Cabinet recordings pursuant to the open records law.
- KRS 131.081(6) relieves taxpayers of any penalty or interest on liabilities resulting from incorrect written advice from the Cabinet.
- KRS 131.081(7) grants taxpayers the right to a copy of any audit of the Cabinet by the auditor of Public Accounts relating to the Cabinet's compliance with the Taxpayer Bill of Rights.
- KRS 131.081(8) requires the Cabinet to clearly and concisely explain each billing of tax, penalty or interest. A similar explanation must be included with each denial or reduction of any refund or credit claimed.
- KRS 131.081(9) grants taxpayers the right to an installment payment plan for delinquent taxes under certain circumstances.

- KRS 131.081(10) prohibits the Cabinet from conducting any investigation or surveillance of any person except for tax administration related purposes.
- KRS 131.081(11) guarantees taxpayers an equal extension of the due date of any report or return of any comparable Kentucky tax for which the IRS has granted an extension.
- KRS 131.081(12) requires the Cabinet to pay recording costs or bank charges for erroneous liens or levies if the taxpayer was not at fault. In such cases, the Cabinet must also notify the major credit reporting agencies of its error.
- KRS 131.081(13) prohibits the Cabinet from evaluating its employees based on the amount of taxes assessed or collected and prohibits the Cabinet from imposing or suggesting tax assessment or collection quotas or goals.
- KRS 131.081(14) provides taxpayers the right to bring suit and receive damage awards if they suffer monetary damages resulting from willful, reckless and intentional disregard by Cabinet employees of the Taxpayer Bill of Rights or other tax laws administered by the Cabinet.
- KRS 131.081(15) assures taxpayers of privacy with regard to the information provided on their Kentucky tax returns and reports.

VII. [5.21] APPEAL PROCEDURES TO THE KENTUCKY BOARD OF TAX APPEALS

Any party aggrieved by any final order of the Cabinet may appeal to the Kentucky Board of Tax Appeals within thirty (30) days from the date of mailing of the Cabinet's final ruling, order or determination. The Board also has exclusive jurisdiction to hear appeals of real property assessments issued by the various county boards of assessment appeals. [KRS 131.340].

A. [5.22] BOARD OF TAX APPEALS

The Board of Tax Appeals is a three-person administrative agency appointed by the Governor to review appeals from final rulings, orders and determinations of any agency of state or county government affecting revenue and taxation. The Board is not vested with jurisdiction over taxes levied by various school districts in the state. See Board of Educ. v. Logan Aluminum, Inc., Ky., 764 S.W.2d 75 (1989). The appointments to the Board are for a four (4) year term. [KRS 131.315]. A clerk of the Board of Tax Appeals is authorized by statute, but such clerk must be a college graduate. [KRS 131.330].

B. [5.23] FORMAT OF APPEAL

An appeal filed with the Kentucky Board of Tax Appeals may be in the format of a complaint or petition of appeal. Said appeal:

- (1) Must be in quintuplicate (appeals from county board of assessment appeals are to be filed in triplicate);
- (2) Must contain a brief statement of the law and facts in issue;
- (3) Must state the taxpayer's position regarding the law, facts or both;

- (4) Must contain a copy of the final ruling of the Cabinet.

C. [5.24] TIMING OF APPEAL

An appeal must be filed within thirty (30) days from the date of the mailing of the agency's final order or determination. "Mailing" of appeal to the Board does not constitute "filing." Revenue Cabinet v. JRS Data Systems, Inc., Ky. App., 738 S.W.2d 828 (1987).

D. [5.25] PARTIES

Disgruntled third-party protestors have no standing to challenge someone else's property tax assessment before the Board. Kentucky Board of Tax Appeals v. Simpson, Ky. App., 691 S.W.2d 221 (1985).

E. [5.26] DISCOVERY DURING APPEAL TO THE BOARD

Discovery is permissible as in civil litigation (depositions, interrogatories, etc.) but must be completed fifteen (15) days prior to hearing. Any member of the Board may issue subpoenas on the request in writing of any party. [KRS 131.350].

F. [5.27] PREHEARING STATEMENT

The Board of Tax Appeals has a standard Pre-Hearing Order that is issued to all parties at the time the hearing is set. It provides.

"IT IS ORDERED AND DIRECTED that each of the parties shall furnish the Board and opposing counsel the following information no later than thirty-five (35) days prior to the date set for this hearing;

1. All stipulations which can be entered into by the parties,
2. A list of all witnesses which each party expects to call at the hearing and the general nature of the testimony of each,
3. A brief summary of the position of each party on the issues of the law involved.

IT IS FURTHER ORDERED that the parties file with opposing counsel exhibits which they wish to introduce at the hearing of the within cause no later than thirty-five (35) days prior to the date set for hearing. A list of exhibits served on opposing counsel, not the actual exhibits, shall be filed with the Board no later than thirty-five (35) days prior to the date set for hearing.

IT IS FURTHER ORDERED that all motions shall be filed no later than forty-five (45) days prior to the date set for hearing. Notwithstanding the foregoing, the parties are allowed to make motions relating to discovery requests and to supplement their pre-hearing order compliance with

information learned through these discovery requests within ten (10) days of the service of the responses to these requests.

802 KAR 1:010 Section 3(6) which provides that "Discovery by parties shall be concluded fifteen (15) days prior to the time assigned for hearing by the board" shall be strictly enforced.

Each of said instruments shall be filed in quadruplicate."

G. [5.28] HEARING

The Board of Tax Appeals will conduct a hearing at its offices in Frankfort except when deemed necessary or convenient for the taxpayer or other interested party. All hearings before the Board are de novo. Findings by the Board are restricted to those issues raised by the parties to the appeal. In the event the Board finds that other issues are necessary to a full determination of the controversy, it may remand the whole proceeding to the agency from which the appeal was prosecuted for further determination. The parties may stipulate to the determination of such other issues without remand. [KRS 131.345]. At the hearing, a party may represent himself, or have an attorney (not a CPA or other non-attorney) represent him. Out-of-state counsel must obtain local counsel under Rule 3.030(2) of the Kentucky Supreme Court. Evidence may be presented and exhibits can be introduced at the hearing (in accordance with the Civil Rules) in support of the position of the taxpayer and the Cabinet. Testimony may be in the form of depositions, and stipulations are encouraged. After the hearing, attorneys for the parties normally prepare and submit briefs to the Board of Tax Appeals arguing their respective positions, and after consideration of the facts adduced at the hearing and the briefs submitted by the parties, the Board of Tax Appeals will enter its Findings of Fact, Conclusions of Law and Order adjudging the merits of the taxpayer's appeal.

VIII. [5.29] JUDICIAL REVIEW

Within thirty (30) days of the order of the Board, an aggrieved party may appeal the decision to the Franklin Circuit Court (located in Frankfort, Kentucky) or to the circuit court of the county in which the taxpayer resides or conducts his place of business. All appeals from the county board of assessment appeals must be filed in circuit court in the county where the aggrieved taxpayer resides. The appeal is taken by filing a notice of appeal with the Board of Tax Appeals and a statement of appeal with the appropriate circuit court. [KRS 131.370].

A. [5.30] STAY

Collection of the tax pending appeal may be stayed by the filing of a supersedeas bond [KRS 131.370] or the taxpayer may pay the tax and later file for refund under KRS 134.580.

B. [5.31] EVIDENCE

- (1) No new evidence may be introduced in the circuit court except as to the fraud or misconduct of some person engaged in the administration of the revenue laws and affecting the order.

- (2) The circuit court shall review the appeal based on the record made in the Board of Tax Appeals and shall dispose of the cause in a summary matter, its review being limited to determining whether: (a) the Board acted in excess of its powers; (b) the order by the Board of Tax Appeals was procured by fraud; (c) the order of the Board of Tax Appeals is not in conformity with the law; and, (d) if findings of fact are in issue, whether such findings of fact made by the Board support the order. [KRS 131.370(4)].

IX. [5.32] FURTHER APPEAL

Any aggrieved party may appeal from an adverse ruling of the circuit court to the Kentucky Court of Appeals pursuant to the Kentucky Rules of Civil Procedure. [KRS 131.370(6)].

APPENDIX 5

*** Selected Kentucky Revised Statutes**

131.030. Functions of cabinet — Settlement of tax cases.

- (1) The Revenue Cabinet shall exercise all administrative functions of the state in relation to the state revenue and tax laws, the licensing and registering of motor vehicles, the equalization of tax assessments, the assessment of public utilities and public service corporations for taxes, the assessment of franchises, the supervision of tax collections, and the enforcement of revenue and tax laws, either directly or through supervision of tax administration activity in other departments to which the Revenue Cabinet may commit administration of certain taxes.
 - (2) The Revenue Cabinet shall have all the powers and duties with reference to assessment or equalization of the assessment of property heretofore exercised or performed by any state board or commission.
 - (3) The Revenue Cabinet shall have all the powers and duties necessary to consider and settle tax cases under KRS 131.110 and refund claims made under KRS 134.580. The Revenue Cabinet is encouraged to settle controversies on a fair and equitable basis and shall be authorized to settle tax controversies based on the hazards of litigation applicable to them.
- (4114h-2, 4149b-12, 4202a-31, 4223b-10, 4224a-5, 4224c-3, 4257b-1, 4281a-33, 4281a-40, 4281b-23, 4281c-20, 4281e-9, 4281f-5, 4281f-27, 4281g-13, 4281h-12, 4281i-6, 4281j-4, 4618-30, 4618-91: amend. Acts 1992, ch. 361, § 2, effective July 14, 1992.)

KENTUCKY TAXPAYERS' BILL OF RIGHTS

131.041. Short title. — The provisions of KRS 131.041 to 131.081 shall be known and may be cited as the "Kentucky Taxpayers' Bill of Rights." (Enact. Acts 1990, ch. 423, § 8, effective July 13, 1990.)

131.051. Definitions for KRS 131.041 to 131.081. — As used in KRS 131.041 to 131.081, unless the context requires otherwise:

(1) "Taxpayer ombudsman" means the person appointed by the secretary of revenue to carry out the administrative functions and responsibilities relating to the Office of Taxpayer Ombudsman created pursuant to KRS 131.071.

(2) "Taxpayer representative" means any attorney, tax practitioner, or other person designated by a taxpayer to represent him before the cabinet in any matter relating to taxes administered by the cabinet. (Enact. Acts 1990, ch. 423, § 1, effective July 13, 1990.)

131.060. Division of motor vehicles. [Repealed.]

Compiler's Notes. This section (4816-95) was repealed by Acts 1960, ch. 68, Art. I, § 33, effective June 16, 1960.

131.061. KRS 131.041 to 131.081 to apply to all taxes administered by Revenue Cabinet. — In addition to all other rights or privileges afforded Kentucky taxpayers, and notwithstanding any provisions of the Kentucky Revised Statutes to the contrary, the provisions of KRS 131.041 to 131.081 shall apply with regard to all taxes administered by the Revenue Cabinet. (Enact. Acts 1990, ch. 423, § 2, effective July 13, 1990.)

131.070. Division of local finance. [Repealed.]

Compiler's Notes. This section (4618-96) was repealed by Acts 1960, ch. 68, Art. V, § 7 and Acts 1960, ch. 186, Art. I, § 33.

KENTUCKY TAXPAYERS' BILL OF RIGHTS

131.071. Office of Taxpayer Ombudsman — Qualifications and duties of ombudsman.

- (1) There is hereby created and established within the Revenue Cabinet an Office of Taxpayer Ombudsman to be staffed with a taxpayers' rights advocate and such other support personnel as may be deemed necessary to carry out the spirit and the specific purposes of KRS 131.041 to 131.081. For administrative and budgetary purposes, the Office of Taxpayer Ombudsman shall be attached to the Office of the Secretary of Revenue.
 - (2) The taxpayer ombudsman shall be a person with either no less than five (5) years of tax administration experience at a supervisory or management level or no less than ten (10) years of tax administration experience with at least five (5) years of experience working directly in the Office of Taxpayer Ombudsman. The taxpayer ombudsman shall possess a broad general knowledge of the tax laws, regulations, systems, and procedures administered or utilized by the cabinet.
 - (3) The taxpayer ombudsman shall:
 - (a) Coordinate the resolution of taxpayer complaints and problems if so requested by a taxpayer or his representative.
 - (b) Provide recommendations to the cabinet for new or revised informational publications and recommend taxpayer and cabinet employee education programs needed to reduce or eliminate errors or improve voluntary taxpayer compliance.
 - (c) Provide recommendations to the cabinet for simplification or other improvements needed in tax laws, regulations, forms, systems, and procedures to promote better understanding and voluntary compliance by taxpayers.
 - (d) At least annually, on or before October 1, prepare and submit a report to the secretary of the Revenue Cabinet summarizing the activities of the Office of Taxpayer Ombudsman during the immediately preceding fiscal year describing any recommendations made pursuant to paragraphs (b) and (c) of this subsection, including the progress in implementing such recommendations, and providing such other information as the taxpayer ombudsman deems appropriate relating to the rights of Kentucky taxpayers.
- (Enact. Acts 1990, ch. 423, § 3, effective July 13, 1990; 1994, ch. 10, § 1 effective July 15, 1994.)

- (10) The cabinet shall not knowingly authorize, require, or conduct any investigation or surveillance of any person for nontax administration related purposes, except internal security related investigations involving Revenue Cabinet personnel.
 - (11) In addition to the circumstances under which an extension of time for filing reports or returns may be granted pursuant to KRS 131.170, taxpayers shall be entitled to the same extension of the due date of any comparable Kentucky tax report or return for which the taxpayer has secured a written extension from the Internal Revenue Service provided the taxpayer notifies the cabinet thereof in writing and provides a copy of such extension at the time and in the manner which the cabinet may require.
 - (12) The cabinet shall bear the cost or, if paid by the taxpayer, reimburse the taxpayer for recording or bank charges as the direct result of any erroneous lien or levy by the cabinet, provided the erroneous lien or levy was caused by cabinet error and, prior to issuance of the erroneous lien or levy, the taxpayer timely responded to all contacts by the cabinet and provided information or documentation sufficient to establish his or her position. When the cabinet releases any such erroneous lien or levy, notice of the fact shall be mailed to the taxpayer and, if requested by the taxpayer, a copy of the release, together with an explanation thereof, shall be mailed to the major credit reporting companies located in the county where it was filed.
 - (13) The cabinet shall not evaluate individual officers or employees on the basis of taxes assessed or collected or impose or suggest tax assessment or collection quotas or goals.
 - (14) Taxpayers shall have the right to bring an action for damages against the Commonwealth to the Board of Claims for actual and direct monetary damages sustained by the taxpayer as a result of willful, reckless, and intentional disregard by cabinet employees of the rights of taxpayers as set out in KRS 131.041 to 131.081 or in the tax laws administered by the cabinet. In the awarding of damages pursuant to this subsection, the board shall take into consideration the negligence or omissions, if any, on the part of the taxpayer which contributed to the damages. If any such proceeding brought by a taxpayer is ruled frivolous by the board, the cabinet shall be reimbursed by the taxpayer for its costs in defending the action.
 - (15) Taxpayers shall have the right to privacy with regard to the information provided on their Kentucky tax returns and reports, including any information or documents attached thereto. Except as provided by KRS 131.190, no information pertaining to such returns, reports, or the affairs of a person's business shall be divulged by the cabinet or the Finance and Administration Cabinet's Office of Financial Management and Economic Analysis to any person.
- (Enact. Acts 1990, ch. 423, § 4, effective July 13, 1990; 1992, ch. 361, § 4, effective July 14, 1992; 1994, ch. 508, § 43, effective July 15, 1994.)

131.081. Rules applicable in the administration of all taxes under jurisdiction of Revenue Cabinet.

The following rules, principles, or requirements shall apply in the administration of all taxes subject to the jurisdiction of the Revenue Cabinet.

- (1) The cabinet shall develop and implement a Kentucky tax education and information program directed at new taxpayers, taxpayer and industry groups, and cabinet employees to enhance the understanding of and compliance with Kentucky tax laws, including the application of new tax legislation to taxpayer activities and areas of recurrent taxpayer noncompliance or inconsistency of administration.
- (2) The cabinet shall publish brief statements in simple and nontechnical language which explain procedures, remedies, and the rights and obligations of taxpayers and the cabinet. Such statements shall be provided to taxpayers with the initial notice of audit; each original notice of tax due; each denial or reduction of a refund or credit claimed by a taxpayer; each denial, cancellation, or revocation of any license, permit, or other required authorization applied for or held by a taxpayer; and, if practical and appropriate, in informational publications by the cabinet distributed to the public.
- (3) Taxpayers shall have the right to be assisted or represented by an attorney, accountant, or other person in any conference, hearing, or other matter before the cabinet. The taxpayer shall be informed of such right prior to conduct of any conference or hearing.
- (4) The cabinet shall perform audits and conduct conferences and hearings only at reasonable times and places.
- (5) Taxpayers shall have the right to make audio recordings of any conference with or hearing by the cabinet. The cabinet may make similar audio recordings only if prior written notice is given to the taxpayer. The taxpayer shall be entitled to a copy of such cabinet recording or a transcript thereof as provided in KRS 61.874.
- (6) If any taxpayer's failure to submit a timely return or payment to the cabinet is due to the taxpayer's reasonable reliance on written advice from the cabinet, the taxpayer shall be relieved of any penalty or interest with respect thereto provided the taxpayer requested such advice in writing from the cabinet and the specific facts and circumstances of the activity or transaction were fully described in the taxpayer's request, the cabinet did not subsequently rescind or modify the advice in writing and there were no subsequent changes in applicable laws or regulations or a final decision of a court which rendered the cabinet's earlier written advice no longer valid.
- (7) Taxpayers shall have the right to receive a copy of any audit of the cabinet by the Auditor of Public Accounts relating to the cabinet's compliance with the provisions of KRS 131.041 to 131.081.
- (8) The cabinet shall include with each notice of tax due a clear and concise description of the basis and amount of any tax, penalty, and interest assessed against the taxpayer, and copies of the agent's audit workpapers and the agent's written narrative setting forth the grounds upon which the assessment is made. Taxpayers shall be similarly notified regarding the denial or reduction of any refund or credit claim filed by a taxpayer.
- (9) Taxpayers shall have the right to an installment payment agreement for the payment of delinquent taxes, penalties, and interest owed provided the taxpayer requests the agreement in writing clearly demonstrating his inability to pay in full and that the agreement will facilitate collection by the cabinet of the amounts owed. The cabinet may modify or terminate an installment payment agreement if it determines the taxpayer has not complied with the terms of the agreement; the taxpayers' financial condition has sufficiently changed; the taxpayer fails to provide any requested financial condition update information; the taxpayer gave false or misleading information in securing the agreement; or the taxpayer fails to timely report and pay any other tax due the Commonwealth. The cabinet shall give written notice to the taxpayer at least thirty (30) days prior to modifying or terminating an installment payment agreement unless the cabinet has reason to believe that collection of the amounts owed will be jeopardized in whole or in part by delay.

131.110. Protest of assessment by Revenue Cabinet — Review — Appeal.

- (1) The Revenue Cabinet shall mail to the taxpayer a notice of any tax assessed by it. The assessment shall be due and payable if not protested in writing to the cabinet within forty-five (45) days from the date of notice. Claims for refund of paid assessments may be made under KRS 134.580 and denials appealed under KRS 131.340. The protest shall be accompanied by a supporting statement setting forth the grounds upon which the protest is made. Upon written request, the cabinet may extend the time for filing the supporting statement if it appears the delay is necessary and unavoidable. The refusal of the extension may be reviewed in the same manner as a protested assessment.
- (2) After a timely protest has been filed, the taxpayer may request a conference with the cabinet. The request shall be granted in writing stating the date and time set for the conference. The taxpayer may appear in person or by representative. Further conferences may be held by mutual agreement.
- (3) After considering the taxpayer's protest, including any matters presented at the final conference, the cabinet shall issue a final ruling on any matter still in controversy, which shall be mailed to the taxpayer. The ruling shall state that it is a final ruling of the cabinet, generally state the issues in controversy, the cabinet's position thereon and set forth the procedure for prosecuting an appeal to the Kentucky Board of Tax Appeals.
- (4) The taxpayer may request in writing a final ruling at any time after filing a timely protest and supporting statement. When a final ruling is requested, the cabinet shall issue such ruling within thirty (30) days from the date the request is received by the cabinet.
- (5) After a final ruling has been issued, the taxpayer may appeal to the Kentucky Board of Tax Appeals pursuant to the provisions of KRS 131.340.

(4114h-4, 4114h-5: amend. Acts 1946, ch. 233, § 1; 1958, ch. 69, § 1; 1964, ch. 141, § 13; 1978, ch. 233, § 32, effective June 17, 1978; 1990, ch. 120, § 1, effective July 13, 1990; 1990, ch. 423, § 9, effective July 13, 1990; 1992, ch. 361, § 4, effective July 14, 1992.)

Cited: Revenue Cabinet v. Plasma Alliance, Inc., 794 S.W.2d 639 (Ky. Ct. App. 1990).

131.130. General powers and duties of cabinet — Prosecution duties. — Without limitation of other duties assigned to it by law, the following powers and duties are vested in the revenue cabinet:

(1) The cabinet may make administrative regulations, and direct proceedings and actions, for the administration and enforcement of all tax laws of this state.

(2) The cabinet, by representatives appointed by it in writing, may take testimony or depositions, and may examine the records, documents, files and equipment of any taxpayer or of any person whose records, documents or equipment will furnish knowledge concerning the tax liability of any taxpayer, when it deems this reasonably necessary for purposes incident to the performance of its functions. The cabinet may enforce this right by application to the circuit court in the county wherein the person is domiciled or has his principal office, or by application to the Franklin Circuit Court, which courts may compel compliance with the orders of the cabinet.

(3) The cabinet shall prescribe the style, and determine and enforce the use or manner of keeping, of all assessment and tax forms and records employed by state and county officials, and may prescribe forms necessary for the administration of any revenue law.

(4) The cabinet shall advise on all questions respecting the construction of state revenue laws and the application thereof to various classes of taxpayers and property.

(5) Attorneys employed by the cabinet and approved by the attorney general as provided in KRS 15.020 may prosecute all violations of the criminal and penal laws relating to revenue and taxation. If a revenue cabinet attorney undertakes any of the actions prescribed in this subsection, he shall be authorized to exercise all powers and perform all duties in respect to the criminal actions or proceedings which the prosecuting attorney would otherwise perform or exercise, including, but not limited to, the authority to sign, file, and present any and all complaints, affidavits, information, presentments, accusations, indictments, subpoenas and processes of any kind, and to appear before all grand juries, courts, or tribunals.

(6) In the event of the incapacity of attorneys employed by the cabinet or at the request of the secretary of the revenue cabinet, the attorney general or his designee shall prosecute all violations of the criminal and penal laws relating to revenue and taxation. If the attorney general undertakes any of the actions prescribed in this subsection, he shall be authorized to exercise all powers and perform all duties in respect to the criminal actions or proceedings which the prosecuting attorney would otherwise perform or exercise, including, but not limited to, the authority to sign, file, and present any and all complaints, affidavits, information, presentments, accusations, indictments, subpoenas and processes of any kind, and to appear before all grand juries, courts, or tribunals.

(7) The cabinet may require the Commonwealth's attorneys and county attorneys to prosecute actions and proceedings and perform other services incident to the enforcement of laws assigned to the cabinet for administration.

(8) The cabinet may conduct research in the fields of taxation, finance and local government administration, and publish its findings, as the secretary may deem wise.

(9) The cabinet may make administrative regulations necessary to establish a system of taxpayer identifying numbers for the purpose of securing proper identification of taxpayers subject to any tax laws or other revenue measure of this state, and may require such taxpayer to place on any return, report, statement or other document required to be filed, any number assigned pursuant to such administrative regulations. (4019a-10c, 4114h-2, 4149b-12, 4202a-31, 4223b-10, 4224a-5, 4224c-3, 4224c-5, 4281a-33, 4281a-40, 4281b-23, 4281c-20, 4281e-9, 4281f-5, 4281f-27, 4281g-13, 4281h-12, 4281i-6, 4281j-4: amend. Acts 1962, ch. 56, § 2; 1988, ch. 322, § 12, effective July 15, 1988)

131.140. Powers and duties of cabinet concerning local finance — Supervision of local officials in revenue duties. — (1) The cabinet shall requisition the finance and administration cabinet to furnish to local officials an adequate supply of forms for listing property for taxation and other forms and blanks the state is required by law to provide. The books and records prescribed for use by property valuation administrators, county clerks, sheriffs and other county tax collectors shall be designed to promote economical operation, adequate control, availability of useful information, and safekeeping. The forms prescribed for listing intangible property shall be designed to secure a detailed list to provide convenient checking of valuations with available sources of information, and to safeguard the confidential character of the intangible property assessment.

(2) The cabinet may confer with, advise and direct local officials respecting their duties relating to taxation, and shall supervise the officials in the performance of those duties. The cabinet shall provide to the property valuation administrators up-to-date appraisal manuals outlining uniform procedures for appraising all types of real and personal property assessed by them. The property valuation administrators shall follow the uniform procedures for appraising property outlined in these manuals. The cabinet shall maintain and make accessible to all property valuation administrators a statewide commercial real property comparative sales file. The cabinet, by authorized agents, may visit local governmental units and officers for investigational purposes, when necessary.

(3) The revenue cabinet shall conduct a biennial performance audit of each property valuation administrator's office. This audit shall include, but shall not be limited to, an inspection of maps and records, an appraisal study of real property, and an evaluation of the overall effectiveness of the office. Each property valuation administrator's office shall provide the cabinet with access to its files, maps and records during the audit. The cabinet shall prepare a report on assessment equity and quality for each county based on the performance audit, and shall provide a copy to the legislative research commission.

(4) The cabinet shall arrange for an annual conference of the property valuation administrators, or the county officers whose duty it is to assess property for taxation, to give them systematic instruction in the fair and just valuation and assessment of property, and their duty in connection therewith. The conference shall continue not more than five (5) days. The officers shall attend and take part in the conference, unless prevented by illness or other reason satisfactory to the secretary. Any officer willfully failing to attend the conference may be removed from office by the circuit court of the county where he was elected. If the officer participates in all sessions of the conference, one-half (1/2) of his actual and necessary expenses in attending the conference shall be paid by the state, and the other half shall be paid by the county from which he attends. Each officer shall prepare an itemized statement showing his actual and necessary expenses, and if it is found regular and supported by proper receipts it shall be approved by the cabinet before payment. (4114h-2: amend. Acts 1960, ch. 68. Art. V, § 6; 1974, ch. 74, Art. II, § 9(1); 1978, ch. 384, § 256, effective June 17, 1978; 1988, ch. 418, § 1, effective July 15, 1988.)

131.150. Jeopardy assessments. — (1) When the revenue cabinet reasonably believes that any taxpayer has withdrawn from the state or concealed his assets or a material part thereof so as to hinder or evade the assessment or collection of taxes, or has desisted from any taxable activity in the state, or has become domiciled elsewhere, or has departed from this state with fraudulent intent to hinder or evade the assessment or collection of taxes, or has done any other act tending to render partly or wholly ineffective proceedings to assess or collect any such taxes, or contemplates doing any of these acts in the immediate future, or that any tax claim for any other reason is being endangered, such tax liability shall become due and payable immediately upon assessment or determination of the amount of taxes due, as authorized in this section.

(2) Under any of the circumstances set out in subsection (1) of this section, the cabinet may make a tentative assessment or determination of the taxes due, and may proceed immediately to bring garnishment, attachment or any other legal proceedings to collect the taxes so assessed or determined to be due. No bond shall be required of the department in such proceedings. The taxpayer may stay legal proceedings by filing a bond in an amount sufficient in the opinion of the cabinet to cover the taxes, penalties, interest and costs. If no legal proceedings have been instituted, the department may require a bond adequate to cover all taxes, penalties and interest. On making bond, exception to the assessment or determination of tax liability may be filed in the same manner and time as provided in KRS 131.110. If no exceptions are filed to the tentative assessment or determination, it shall become final.

(3) The cabinet may require any such taxpayer to file with it forthwith the reports required by law or regulation, or any additional reports or other information necessary to assess the property or determine the amount of tax due.

(4) If the cabinet fails to exercise the authority conferred by this section, such taxpayer shall report and pay all taxes due as otherwise provided by law. (4114h-9.)

Compiler's Notes. Former subsection (3) of this section was repealed by Acts 1964, ch. 141, § 39 and the remaining subsections re-numbered.

Cited: Commonwealth ex rel. Lockett v. Kettenacker, 335 S.W.2d 339 (Ky. Ct. App. 1960).

131.330. Clerk of board of tax appeals — Appointment — Qualifications. — The Kentucky board of tax appeals, subject to the provisions of KRS 18A.005 to 18A.185, shall appoint a clerk of the Kentucky board of tax appeals with the qualifications hereinafter prescribed, and such clerical assistance as authorized by the finance and administration cabinet. The clerk of the Kentucky board of tax appeals shall be a person holding a degree from an accredited college or university. (Enact. Acts 1964, ch. 141, § 5(1); 1982, ch. 448, § 66, effective July 15, 1982.)

131.340. Jurisdiction of board — Notice of rulings of county or state agencies — Appeals to board — Procedure. — (1) The Kentucky board of tax appeals is hereby vested with exclusive jurisdiction to hear and determine appeals from final rulings, orders and determinations of any agency of state or county government affecting revenue and taxation.

(2) Any state or county agency charged with the administration of any taxing or licensing measure which is under the jurisdiction of the board shall mail by certified mail notice of its ruling, order or determination within three (3) working days from the date of the decision.

(3) Any party, including the attorney general, on behalf of the Commonwealth, aggrieved by any ruling, order or determination of any state or county agency charged with the administration of any taxing or licensing measure, may prosecute an appeal to the board by filing a complaint or petition of appeal before the board within thirty (30) days from the date of the mailing of the agency's ruling, order, or determination.

(4) In the event the revenue cabinet is aggrieved by the decision of any county board of assessment appeals on an assessment recommended by the cabinet and prosecutes an appeal to the Kentucky board of tax appeals as authorized herein, the secretary of revenue shall, within twenty (20) days, certify in writing to the Kentucky board of tax appeals the assessment recommended.

(5) The Kentucky board of tax appeals shall immediately forward copies of the certification to the parties to the appeal. Such assessed value shall be prima facie evidence of the value at which the property should be assessed. (Enact. Acts 1964, ch. 141, § 6; 1984, ch. 111, § 71, effective July 13, 1984; 1986, ch. 410, § 1, effective July 15, 1986.)

131.345. Conduct of proceedings before board — Persons who may be compensated for representation.

(1) Appeals to the Kentucky Board of Tax Appeals shall be in accordance with rules prescribed by the board. All proceedings before the board shall be de novo. Findings by the board shall be restricted to those issues raised by the parties to the appeal. If the board finds that other issues are necessary to a full determination of the controversy, it may remand the whole proceeding to the agency from which the appeal was prosecuted for further determination. The parties may stipulate to the determination of the other issues without remand.

(2) Any person receiving compensation to represent a property owner in an appeal before the board of a real property assessment shall be an attorney, a certified public accountant, a certified real estate appraiser, a Kentucky licensed real estate broker, an employee of the property owner, or any other individual possessing a professional appraisal designation recognized by the Board of Tax Appeals. A person representing a property owner before the Kentucky Board of Tax Appeals shall present written authorization from the property owner which sets forth his professional capacity and shall disclose to the Kentucky Board of Tax Appeals any personal or private interests he may have in the matter, including any contingency fee agreements, provided, however, attorneys shall not be required to disclose the terms and conditions of any contingency fee arrangement.

(Enact. Acts 1964, ch. 141, § 7; 1992, ch. 449, § 2, effective April 13, 1992; 1994, ch. 85, § 2, effective July 15, 1994.)

131.350. Subpoenas — Depositions — Enforcement of process — Administration of oaths. — (1) Any member of the Kentucky board of tax appeals, on the request of any party to the proceedings before it or his attorney, shall issue subpoenas requiring the attendance of witnesses and the giving of testimony and subpoena duces tecum requiring the production of any returns, books, papers, documents, correspondence, and other evidence pertaining to the matter under inquiry in accordance with the Rules of Civil Procedure.

(2) Any party to a proceeding before the board or his attorney may cause depositions to be taken of witnesses who reside within or without the state in the manner prescribed under the Rules of Civil Procedure.

(3) If any person fails or refuses to obey any lawful process of the board it may apply ex parte to the Franklin Circuit Court or the circuit court of the county in which it is sitting for an order of contempt to be enforced as a contempt of court.

(4) Any member or any employee of the board may be designated in writing by the chairman to administer oaths. (Enact. Acts 1964, ch. 141, § 8.)

131.370. Judicial review of board decisions — Procedure — Scope of review — Appeal — Stay of collection of tax.

(1) Any party aggrieved by any final order, decision, or determination of the Kentucky Board of Tax Appeals, except on appeals from a county board of assessment appeals, may appeal on any question of law to the Franklin Circuit Court or to the Circuit Court of the county in which the party aggrieved resides or conducts his place of business. Any final orders entered on the rulings of a county board of assessment appeals may be appealed in like manner to the Circuit Court of the county in which the appeal originated. All parties to the proceedings before the Board of Tax Appeals shall be made parties to the proceedings on appeal.

(2) A notice of appeal shall be filed with the Board of Tax Appeals within thirty (30) days after any final order, decision, or determination by the board. Within thirty (30) days thereafter, a statement of appeal shall be filed with the appropriate Circuit Court together with the certified record of the Kentucky Board of Tax Appeals. The statement of appeal shall substantially conform to that required to be filed in the Kentucky Supreme Court. The appeal shall be docketed by the Circuit Court clerk upon the filing of the statement of appeal and the Kentucky Board of Tax Appeals' certified record.

(3) If the appeal is from an order sustaining a tax assessment, collection of the tax may be stayed by the filing of a supersedeas bond in the manner directed by the Rules of Civil Procedure, or by payment of the tax as provided in KRS 134.580.

(4) No new or additional evidence may be introduced in the Circuit Court except as to the fraud or misconduct of some person engaged in the administration of the revenue laws and affecting the order, ruling or award, but the court shall otherwise hear the cause upon the record as certified by the board and shall dispose of the cause in summary manner, its review being limited to determining whether or not:

- (a) The board acted without or in excess of its powers;
- (b) The order, decision, or award was procured by fraud;
- (c) The order, decision, or award is not in conformity to the law; and
- (d) If findings of fact are in issue, whether the findings of fact support the order, decision, or award.

(5) The court shall enter judgment affirming, modifying, or remanding the order in its discretion. The court may, before judgment, upon the showing of sufficient cause, remand the entire matter to the board for further consideration.

(6) Any party may appeal to the Court of Appeals as provided by the Rules of Civil Procedure.

(Enact. Acts 1964, ch. 141, § 12; 1968, ch. 152, § 99; 1978, ch. 233, § 33, effective June 17, 1978; 1990, ch. 140, § 1, effective July 13, 1990; 1994, ch. 65, § 21, effective July 15, 1994.)

132.360. Reopening and increase of assessment — Notice — Protest — Appeal. — (1) Any assessment of accounts receivable, notes, stocks or bonds or other intangible or tangible personal property that were listed with the property valuation administrator or with the revenue cabinet as provided by KRS 132.220 may be reopened by the revenue cabinet within five (5) years after the date as of which they were assessed, unless the assessed value thereof is the face value in the case of accounts receivable and notes or the quoted value in the case of stocks and bonds, or has been established by a court of competent jurisdiction. If upon reopening the assessment the cabinet finds that the assessment was less than the fair cash value and should be increased, it shall give notice thereof to the taxpayer, who may within thirty (30) days thereafter protest to the cabinet and offer evidence to show that no increase should be made. After the cabinet has disposed of the protest, the taxpayer may appeal from any such additional assessment as provided by KRS 131.110 and 131.340.

(2) Upon such assessment becoming final the cabinet shall certify the amount due to the taxpayer. The tax bill shall be handled and collected as an omitted tax bill, and the additional tax shall be subject to the same penalties and interest as the tax on omitted property voluntarily listed. (4019a-10a, 4019a-10d: amend. Acts 1949 (Ex. Sess.), ch. 2, § 4; 1954, ch. 147, § 2; 1958, ch. 65, § 2; 1966, ch. 255, § 128; 1988, ch. 303, § 5, effective July 15, 1988.)

LEVY AND ASSESSMENT OF PROPERTY TAXES

132.486. Assessment system for tangible and intangible personal property — Regulations — Appeals. — (1) The revenue cabinet shall develop and administer a centralized ad valorem assessment system for intangible personal property and tangible personal property. This system shall be designed to provide on-line computer terminals and accessory equipment in every property valuation administrator's office in the state in order to create and maintain a centralized personal property tax roll data base.

(2) State income tax returns and return preparation instructions shall be revised to facilitate the preparation of the personal property tax return; however, the personal property tax return shall be a separate document and shall be listed with the property valuation administrator in the county of taxable situs according to the provisions of KRS 132.220(1) or with the revenue cabinet. The revenue cabinet shall prescribe, promulgate and provide such administrative regulations, forms and records as it deems appropriate for the listing and assessment of personal property.

(3) Appeals of personal property assessments shall not be made to the county board of assessment appeals. Personal property taxpayers shall be served notice under the provisions of KRS 132.450(4) and shall have the protest and appeal rights granted under the provision of KRS 131.110. (Enact. Acts 1986, ch. 371, § 1, effective July 15, 1986; 1988, ch. 303, § 6, effective July 15, 1988.)

133.110. Correction of clerical errors in assessment.

- (1) After submission of the final real property recapitulation or certification of the personal property assessment, the property valuation administrator may correct clerical, mathematical, or procedural errors in an assessment or any duplication of assessment. Changes in assessed value based on appraisal methodology or opinion of value shall not be valid. All corrections shall be reviewed by the Revenue Cabinet and those changes determined by the cabinet to be invalid shall be rescinded. Any taxpayer affected by this rescission shall not be subject to additional penalties.
 - (2) Notwithstanding other statutory provisions, for property subject to a tax rate that is set each year based on the certified assessment, any loss of property tax revenue incurred by a taxing district due to corrections made after the tax rate has been set may be recovered by making an adjustment in the tax rate to be set for the next tax year.
- (4250: amend. Acts 1978, ch. 384, § 263, effective June 17, 1978; 1992, ch. 263, § 6, effective July 14, 1992.)

- (11) The county attorney shall represent the interest of the state and county in all hearings before the board of assessment appeals and on all appeals prosecuted from its decision. If the county attorney is unable to represent the state and county, he or the fiscal court shall arrange for substitute representation.
 - (12) Taxpayers shall have the right to make audio recordings of the hearing before the county board of assessment appeals. The property valuation administrator may make similar audio recordings only if prior written notice is given to the taxpayer. The taxpayer shall be entitled to a copy of the cabinet's recording as provided in KRS 61.874.
 - (13) The county board of assessment appeals shall physically inspect a property upon the request of the property owner or property valuation administrator.
- (Enact. Acts 1942, ch. 131, § 16, 32; 1944, ch. 99; 1949 (Ex. Sess.), ch. 2, § 7; 1950, ch. 18, § 1; 1964, ch. 141, § 34; 1974, ch. 326, § 6; 1976 (Ex. Sess.), ch. 20, § 6, effective January 2, 1978; 1978, ch. 384, § 264, effective June 17, 1978; 1980, ch. 317, § 5, effective July 15, 1980; 1982, ch. 452, § 7, effective July 1, 1982; 1988, ch. 303, § 11, effective July 15, 1988; 1990, ch. 411, § 11, effective July 13, 1990; 1990, ch. 476, Pt. V, § 339, effective July 13, 1990; 1992, ch. 397, § 3, effective July 14, 1992; 1992, ch. 449, § 6, effective April 13, 1992; 1994, ch. 85, § 5, effective July 15, 1994.)

- (3) The board of assessment appeals shall hold a public hearing for each individual taxpayer appeal in protest of the assessment by the property valuation administrator filed in accordance with the provisions of subsection (2) of this section, and after hearing all the evidence, shall fix the assessment of the property at its fair cash value. The cabinet may be present at the hearing and present any pertinent evidence as it pertains to the appeal. The taxpayer shall provide factual evidence to support his appeal. If the taxpayer fails to provide reasonable information pertaining to the value of the property requested by the property valuation administrator, the cabinet, or any member of the board, his appeal shall be denied. This information shall include, but shall not be limited to, the physical characteristics of land and improvements, insurance policies, cost of construction, real estate sales listings and contracts, income and expense statements for commercial property, and loans or mortgages. The board of assessment appeals shall only hear and consider evidence which has been submitted to it in the presence of both the property valuation administrator or his designated deputy and the taxpayer or his authorized representative.
- (4) Any person receiving compensation to represent a property owner in an appeal before the board shall be an attorney, a certified public accountant, a certified real estate appraiser, a Kentucky licensed real estate broker, an employee of the taxpayer, or any other individual possessing a professional appraisal designation recognized by the cabinet. A person representing a property owner before the county board of assessment appeals shall present a written authorization from the property owner which sets forth his professional capacity and shall disclose to the county board of assessment appeals any personal or private interests he may have in the matter, including any contingency fee arrangements. Provided however, attorneys shall not be required to disclose the terms and conditions of any contingency fee arrangement.
- (5) The board shall provide a written opinion justifying its action for each assessment either decreased or increased in the record of its proceedings and orders required in KRS 133.125 on forms or in a format provided or approved by the cabinet.
- (6) The board shall report to the property valuation administrator any real property omitted from the tax roll. The property valuation administrator shall assess the property and immediately give notice to the taxpayer in the manner required by KRS 132.450(4), specifying a date when the board of assessment appeals will hear the taxpayer, if he so desires, in protest of the action of the property valuation administrator.
- (7) The board of assessment appeals shall have power to issue subpoenas, compel the attendance of witnesses, and adopt rules and regulations concerning the conduct of its business. Any member of the board shall have power to administer oaths to any witness in proceedings before the board.
- (8) The powers of the board of assessment appeals shall be limited to those specifically granted by this section.
- (9) No appeal shall delay the collection or payment of any taxes based upon the assessment in controversy. The taxpayer shall pay all state, county, and district taxes due on the valuation which he claims as true value and stated in the petition of appeal filed in accordance with the provisions of subsection (1) of this section. When the valuation is finally determined upon appeal, the taxpayer shall be billed for any additional tax and interest at the tax interest rate as defined in KRS 131.010(6) from the date when the tax would have become due if no appeal had been taken. The provisions of KRS 134.390 shall apply to the tax bill.
- (10) Any member of the county board of assessment appeals may be required to give evidence in support of the board's findings in any appeal from its actions to the Kentucky Board of Tax Appeals. Any persons aggrieved by a decision of the board, including the property valuation administrator, taxpayer, and cabinet, may appeal the decision to the Kentucky Board of Tax Appeals. Any taxpayer failing to appeal to the county board of assessment appeals, or failing to appear before the board, either in person or by designated representative, shall not be eligible to appeal directly to the Kentucky Board of Tax Appeals.

133.120. Appeal procedure.

- (1) Any taxpayer desiring to appeal an assessment on real property made by the property valuation administrator shall first request a conference with the property valuation administrator or his designated deputy. The conference shall be held prior to or during the inspection period provided for in KRS 133.045. Any person receiving compensation to represent a property owner at a conference with the property valuation administrator for a real property assessment shall be an attorney, a certified public accountant, a certified real estate broker, a Kentucky licensed real estate broker, an employee of the property owner, or any other individual possessing a professional appraisal designation recognized by the cabinet. A person representing a property owner before the property valuation administrator shall present written authorization from the property owner which sets forth his professional capacity and shall disclose to the property valuation administrator any personal or private interests he may have in the matter, including any contingency fee arrangements. Provided however, attorneys shall not be required to disclose the terms and conditions of any contingency fee arrangement. During this conference, the property valuation administrator or his deputy shall provide an explanation to the taxpayer of the constitutional and statutory provisions governing property tax administration, including the appeal process, as well as an explanation of the procedures followed in deriving the assessed value for the taxpayer's property. The property valuation administrator or his deputy shall keep a record of each conference which shall include, but shall not be limited to, the initial assessed value, the value claimed by the taxpayer, an explanation of any changes offered or agreed to by each party, and a brief account of the outcome of the conference. At the request of the taxpayer, the conference may be held by telephone.
- (2) Any taxpayer still aggrieved by an assessment on real property made by the property valuation administrator after complying with the provisions of subsection (1) of this section may appeal to the board of assessment appeals. The taxpayer shall appeal his assessment by filing

in person or sending a letter or other written petition stating the reasons for appeal, identifying the property for which the appeal is filed, and stating to the county clerk the taxpayer's opinion of the fair cash value of the property. The appeal shall be filed no later than one (1) workday following the conclusion of the inspection period provided for in KRS 133.045. The county clerk shall notify the cabinet of all assessment appeals and of the date and times of the hearings. The board of assessment appeals may review and change any assessment made by the property valuation administrator upon recommendation of the county judge/executive, mayor of any city using the county assessment, or the superintendent of any school district in which the property is located, if the recommendation is made to the board in writing specifying the individual properties recommended for review and is made no later than one (1) work day following the conclusion of the inspection period provided for in KRS 133.045, or upon the written recommendation of the cabinet. If the board of assessment appeals determines that the assessment should be increased, it shall give the taxpayer notice in the manner required by subsection (4) of KRS 132.450, specifying a date when the board will hear the taxpayer, if he so desires, in protest of an increase. Any real property owner who has listed his property with the property valuation administrator at its fair cash value may ask the county board of assessment appeals to review the assessments of real properties he believes to be assessed at less than fair cash value, if he specifies in writing the individual properties for which the review is sought and factual information upon which his request is based, such as comparable sales or cost data and if the request is made no later than one (1) work day following the conclusion of the inspection period provided for in KRS 133.045. Nothing in this section shall be construed as granting any property owner the right to request a blanket review of properties or the board the power to conduct such a review.

133.130. Protest to Revenue Cabinet when property erroneously assessed against person other than owner.

- (1) Any person claiming to be erroneously charged with any tax upon property not owned by him may, after he has received notice of the same by demand made upon him to pay the tax, offer evidence in support of the complaint to the property valuation administrator of the county in which the assessment was made. If the property valuation administrator finds that he was not the owner of the property assessed, he may correct the same by releasing him from the payment of the tax, and shall assess the property immediately against the rightful owner.
 - (2) A protest may be made to the Revenue Cabinet under the provisions of KRS 131.110 from any action of the property valuation administrator made under this section or under KRS 133.110.
- (4250: amend. Acts 1974, ch. 326, § 8; 1976 (Ex. Sess.), ch. 14, § 147, effective January 2, 1978; 1978, ch. 384, § 266, effective June 17, 1978; 1992, ch. 263, § 7, effective July 14, 1992.)

134.580. "Agency" defined — Refund of taxes, other than ad valorem and unconstitutional taxes. — (1) As used in this section, unless the context requires otherwise, "agency" means the agency of state government which administers the tax to be refunded or credited.

(2) When money has been paid into the State Treasury in payment of any state taxes, except ad valorem taxes, whether payment was made voluntarily or involuntarily, the appropriate agency shall authorize refunds or credits, to the person who paid the tax, or to his heirs, personal representatives or assigns, of any overpayment of tax and any payment where no tax was due. When a bona fide controversy exists between the agency and the taxpayer as to the liability of the taxpayer for the payment of tax claimed to be due by the agency, the taxpayer may pay the amount claimed by the agency to be due, and if an appeal is taken by the taxpayer from the ruling of the agency within the time provided by KRS 131.340 and it is finally adjudged that the taxpayer was not liable for the payment of the tax or any part thereof, the agency shall authorize the refund or credit as the Kentucky Board of Tax Appeals or courts may direct.

(3) Refunds or credits shall be authorized with interest as provided in KRS 131.183. The refunds authorized by this section shall be made in the same manner as other claims on the State Treasury are paid. They shall not be charged against any appropriation, but shall be deducted from tax receipts for the current fiscal year.

(4) Nothing in this section shall be construed to authorize the agency to make or cause to be made any refund except within four (4) years of the due date of the return or the date the money was paid into the State Treasury, whichever is the later, except that, in any case where the assessment period has been extended by written agreement between the taxpayer and the cabinet, the limitation contained in this subsection shall be extended accordingly. Nothing in this section shall be construed as requiring the agency to authorize any refund or credit to a taxpayer without demand from the taxpayer, if in the opinion of the agency the cost to the state of authorizing the refund or credit would be greater than the amount that should be refunded or credited.

(5) The terms "overpayment" and "payment where no tax was due," as used in this section, shall be construed as referring to tax liability under the terms of the applicable statute without reference to the constitutionality of the statute. This section shall not apply to any case in which the statute may be held unconstitutional, either in whole or in part.

(6) In cases in which a statute has been held unconstitutional, taxes paid thereunder may be refunded to the extent provided by KRS 134.590, and by the statute held unconstitutional. (4114h-7: amend. Acts 1966, ch. 187, part I, § 1; 1970, ch. 216, § 2; 1976, ch. 155, § 1; 1982, ch. 452, § 9, effective July 1, 1982; 1990, ch. 177, § 1, effective July 13, 1990; 1990, ch. 423, § 7, effective July 13, 1990.)

134.590. Refund of ad valorem taxes or taxes held unconstitutional.

- (1) When it appears to the appropriate agency of state government that money has been paid into the State Treasury for ad valorem taxes when no such taxes were in fact due, or for taxes of any kind paid under a statute held unconstitutional, the agency of state government which administers the tax shall refund the money, or cause it to be refunded, to the person who paid the same. This shall not authorize a refund to a person who has made payment of the tax due on any tract of land, unless the entire tax due the state on such land has been paid.
- (2) No refund shall be made unless application for same is made in each case within two (2) years from the time payment was made. No refund for ad valorem taxes, except those held unconstitutional, shall be made unless the taxpayer has properly followed the administrative remedy procedures established through the protest provisions of KRS 131.110, the appeal provisions of KRS 133.120, the correction provisions of KRS 133.110 and 133.130, or other administrative remedy procedures.
- (3) When it has been determined that city, urban-county, county, school district, or special district ad valorem taxes have been paid to a city, urban-county, county, school district, or special district when, in fact, no taxes were due, or the amount paid was in excess of the amount finally determined to be due, the taxes shall be refunded to the person who paid the tax.
- (4) Refunds of ad valorem taxes shall be authorized by the mayor or chief finance officer of any city or urban-county government for the city or urban-county government or for any special district for which the city or urban-county government is the levying authority; by the county judge/executive of any county for the county or special district for which the fiscal court is the levying authority; or by the chairman or finance officer of any district board of education.
- (5) Upon proper authorization the sheriff or collector shall refund the taxes from current tax collections in his possession. If there are no such funds, refund shall be made by the finance officer of the district. The sheriff or collector shall receive credit for any refunds made by him on his next collection report to the district.
- (6) No refund shall be made unless application is made in each case within two (2) years from the date payment was made. If the question of the amount of taxes due is in litigation, the application for refund shall be made within two (2) years from the date the amount due is finally determined. No refund for ad valorem taxes, except those held unconstitutional, shall be made unless the taxpayer has properly followed the administrative remedy procedures established through the protest provisions of KRS 131.110, the appeal provisions of KRS 133.120, the correction provisions of KRS 133.110 and 133.130, or other administrative remedy procedures.
- (7) Notwithstanding other statutory provisions, for property subject to a tax rate that is set each year based on the certified assessment, any loss of ad valorem tax revenue suffered by a taxing district due to the issuance of refunds may be recovered by making an adjustment in the tax rate for the following tax year.

(162, 163, 4114h-7: amend. Acts 1954, ch. 5, § 1; 1966, ch. 187, part I, § 2; 1980, ch. 270, § 1, effective July 15, 1980; 1990, ch. 177, § 2, effective July 13, 1990; 1992, ch. 391, § 5, effective July 14, 1992.)

139.620. Time for assessing taxes shown owing by the return. —

(1) As soon as practicable after each return is received, the cabinet shall examine and audit it. If the amount of tax computed by the cabinet is greater than the amount returned by the taxpayer, the excess shall be assessed by the cabinet within four (4) years from the date the return was filed, except as provided in subsection (2), and except that in the case of a failure to file a return or of a fraudulent return the excess may be assessed at any time. A notice of such assessment shall be mailed to the taxpayer. The time herein provided may be extended by agreement between the taxpayer and the cabinet.

(2) For the purposes of this section, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.

(3) When a business is discontinued, a determination may be made at any time thereafter within the periods specified in subsection (1) as to liability arising out of that business, irrespective of whether the determination is issued prior to the due date of the liability as otherwise specified in this chapter. (Enact. Acts 1960, ch. 5, Art. I, § 59, effective February 5, 1960; 1978, ch. 233, § 29, effective June 17, 1978; 1990, ch. 414, § 4, effective July 13, 1990.)

139.760. Revocation or suspension of permit — Prohibition of suit to delay or restrain collection of tax. —

(1) Whenever any person fails to comply with any provisions of this chapter or any rule or regulation of the cabinet relating to the provisions of this chapter, the cabinet may revoke or suspend any one (1) or more of the permits held by the person.

(2) The cabinet shall not issue a new permit after the revocation of a permit unless it is satisfied that the former holder of the permit will comply with the provisions of this chapter and the regulations relating thereto.

(3) No suit shall be maintained in any court to restrain or delay the collection or payment of any tax levied by this chapter. (Enact. Acts 1960, ch. 5, Art. I, § 74; 1964, ch. 141, § 39.)

141.210. Auditing of returns — Assessment of additional tax — Taxpayer to notify cabinet of audit of federal income tax returns.

- (1) As used in this section and KRS 141.235, unless the context requires otherwise:
 - (a) "Conclusion of the federal audit" means the date that the adjustments made by the Internal Revenue Service to net income as reported on the taxpayer's federal income tax return become final and unappealable; and
 - (b) "Final determination of the federal audit" means the revenue agent's report or other documents reflecting the final and unappealable adjustments made by the Internal Revenue Service.
- (2) As soon as practicable after each return is received, the cabinet shall examine and audit it. If the amount of tax computed by the cabinet is greater than the amount returned by the taxpayer, the additional tax shall be assessed and a notice of assessment mailed to the taxpayer by the cabinet within four (4) years from the date the return was filed, except as otherwise provided in this subsection.
 - (a) In the case of a failure to file a return or of a fraudulent return the additional tax may be assessed at any time.
 - (b) In the case of a return where a taxpayer other than a corporation understates his net income or omits an amount properly includable in net income or both which understatement or omission or both is in excess of twenty-five percent (25%) of the amount of net income stated in the return the additional tax may be assessed at any time within six (6) years after the return was filed.
 - (c) In the case of a return where a corporation understates its taxable net income or omits an amount properly includable in taxable net income or both, which understatement or omission or both is in excess of twenty-five percent (25%) of the amount of taxable net income stated in the return, the additional tax may be assessed at any time within six (6) years after the return was filed.
 - (d) In the case of an assessment of additional tax relating directly to adjustments resulting from a final determination of a federal audit, the additional tax may be assessed before the expiration of the times provided in this subsection, or six months from the date the cabinet receives the final determination of the federal audit from the taxpayer, whichever is later.
 - (e) In the case of the assessment of additional tax resulting from a decrease of a net operating loss deduction or a capital loss deduction, resulting from the carryback of a loss which occurs in a taxable year beginning after December 31, 1993, the additional tax may be assessed at any time before the expiration of the times provided for in this subsection for assessing additional tax for the taxable year which resulted in the net operating loss or capital loss carryback.

The times provided in this subsection may be extended by agreement between the taxpayer and the cabinet. For the purposes of this subsection, a return filed before the last day prescribed by law for filing the return shall be considered as filed on the last day. For taxable years beginning after December 31, 1993, any extension granted for filing the return shall also be considered as extending the last day prescribed by law for filing the return.
- (3) If any additional tax is assessed on account of any income which has been returned for taxation by any other taxpayer, the cabinet, with the consent of the other taxpayer, his personal representatives, or heirs, shall reduce the amount of the additional tax assessed for each year by the amount of the income tax paid for that year by the other taxpayer on account of the income in question.
- (4) Every taxpayer shall :
 - (a) Notify the cabinet in writing of every audit of the taxpayer's federal income tax return within thirty (30) days after the taxpayer has or should have had knowledge of the beginning of the audit by the Internal Revenue Service, and
 - (b) Submit a copy of the final determination of the federal audit within thirty (30) days of the conclusion of the federal audit.

(4281b-26: amend. Acts 1948, ch. 93, § 7; 1952, ch. 194, § 10; 1954, ch. 79, § 16; 1956 (4th Ex. Sess.), ch. 4, § 10; 1966, ch. 176, part I, § 9; 1970, ch. 216, § 7; 1974, ch. 163, § 6; 1994, ch. 106, § 2, effective July 15, 1994.)

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LAWYER'S NOTES

