Annual Report

Department of Revenue

2005-2006

Ernie Fletcher
Governor
Commonwealth of Kentucky

John Farris
Secretary
Finance and Administration Cabinet

Marian Davis
Commissioner
Department of Revenue

Kentucky
UNBRIDLED SPIRIT™

As part of the Finance and Administration Cabinet the mission of the Kentucky Department of Revenue is to administer tax laws, collect revenue, and provide services in a fair, courteous, and efficient manner for the benefit of the Commonwealth and its citizens.

The cost of printing this report was paid by the Kentucky Department of Revenue.

FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE

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John Farris
Secretary

Marian Davis
Commissioner

December 7, 2006

The Honorable Ernie Fletcher, Governor
Commonwealth of Kentucky
The State Capitol
Frankfort, Kentucky 40601

Dear Governor Fletcher:

I am pleased to present the Annual Report of the Department of Revenue for the fiscal year ended June 30, 2006. This report reflects the dedicated work of the many fine professionals who comprise the Revenue workforce.

Tax Modernization legislation passed under your leadership presented the Department with its greatest implementation challenge in a number of years. Revenue staff stepped up to meet the challenge, and as a result the 2006 tax filing season has been progressing well.

Over 50 percent of individual income tax returns were electronically filed. There were 913,963 returns filed electronically, an increase of 6 percent for the year. In addition, 244,252 2D barcode returns, and 574,342 paper returns for a total of 1,732,557 returns were filed for tax year 2005.

On behalf of all of Revenue, we want to thank you for your continued support of the Department of Revenue and its employees and for your confidence in our abilities.

Sincerely,

Marian S. Davis

Marian Davis, Commissioner
Kentucky Department of Revenue

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Reprinted from the Governor's Office for Economic Anlaysis

Fourth Quarter Report—Annual Edition

Fiscal Year 2006

General Fund

General Fund receipts in the fourth quarter of FY06 totaled $2,367.2 million compared to $2,141.1 million in the fourth quarter of FY05, for a net gain of 10.6 percent. Collections in the major revenue categories are shown in summary form in Table 1.

Table 1
Fourth Quarter, FY06
(million $)

	FY06	FY05	Diff ($)	Diff (%)
Sales and Use	696.7	660.0	36.7	5.6
Individual Income	812.7	895.3	-82.6	-9.2
Corp. Inc. & License	481.4	290.5	190.9	65.7
Coal Severance	61.2	53.7	7.5	14.0
Tobacco Taxes	44.1	21.7	22.4	103.2
Property	57.7	51.0	6.7	13.2
Lottery	62.0	41.5	20.5	49.4
Other	151.4	127.4	24.0	18.8
TOTAL	**2,367.2**	**2,141.1**	**226.1**	**10.6**

Changes in tax laws in 2005 due to the passage of HB 272 (JOBS for Kentucky) had an impact on collections during the fourth quarter. Principal changes affecting revenues were in the areas of the cigarette tax and individual as well as corporation income taxes. These changes will be discussed below in the appropriate category. Variations in the quarterly receipts are often affected by differences in the timing of payments and refunds in revenue accounts. In the fourth quarter, individual and corporation income taxes were affected by these timing changes.

The sales and use tax posted growth of 5.6 percent in the fourth quarter of FY06. Receipts of $696.7 million compare to the $660.0 million collected in the fourth quarter of FY05.

Individual income tax receipts fell 9.2 percent in the fourth quarter of FY06 compared to collections in the fourth quarter of FY05. Receipts of $812.7 million were $82.6 million less than was collected in the fourth quarter of the previous fiscal year. Changes enacted by JOBS for Kentucky shifted some receipts from this source to the corporation income tax.

Corporation income and license taxes posted robust growth of 65.7 percent during the fourth quarter of FY06. Receipts totaled $481.4 million compared to the $290.5 million received a year earlier. Corporation income taxes were boosted by the shift in revenues from the individual income tax, but also from strength in corporate profitability.

The coal severance tax continued its recent strong growth by increasing 14.0 percent in the fourth quarter. Coal prices have escalated sharply in tandem with other energy prices, and this has boosted severance tax revenues. Receipts of $61.2 million compare to $53.7 million collected in the fourth quarter of FY05.

Tobacco taxes rose sharply in the fourth quarter, affected by both the rate increase and the imposition of taxes on snuff and other tobacco products. Receipts of $44.1 million were 103.2 percent greater than collected in the fourth quarter of FY05. General Fund cigarette taxes include the original cigarette excise tax of 3-cents per pack and the 26-cent per pack surtax.

Property Taxes were up by 13.2 percent in the fourth quarter of FY06. Collections of $57.7 million compare to $51.0 million received in the final quarter of the prior fiscal year.

Lottery receipts rose by 49.4 percent in the fourth quarter of FY06 with revenues of $62.0 million. Lottery revenues were affected by unusually large Powerball sales.

The *other* category represents the remaining accounts in the General Fund and combined for growth of 18.8 percent with receipts of $151.4 million.

Revenue from the individual income tax and the sales tax comprised 64 percent of the General Fund. The next largest source of revenue was the combination of the corporation income tax and the corporation license tax. *Other taxes* combine for the next-largest source. The largest components in this category include insurance premium taxes, the inheritance tax, beer wholesale sales and use tax, the natural gas severance tax, investment income, telecommunications tax, and fines and forfeitures. Coal severance taxes and lottery receipts each composed 3 percent of total General Fund receipts. Property and tobacco taxes each made up 2 percent of the General Fund.

Road Fund

The Road Fund posted growth of 4.9 percent in the fourth quarter of FY06. Receipts totaled $313.4 million compared to the $298.9 million received in the fourth quarter of last year.

Summary data are contained in Table 2.

Motor fuels and motor fuels use tax receipts increased 7.7 percent during the fourth quarter of FY06. Receipts were $136.2 million and compare to $126.5 collected during the fourth quarter of last year. Motor fuels tax revenues were affected by an increase in the formula-driven tax rate tied to the price of gasoline.

Table 2
Summary Road Fund Receipts
Fourth Quarter, FY06
(million $)

	FY06	FY05	Diff ($)	Diff (%)
Motor Fuels	136.2	126.5	9.7	7.7
Motor Vehicle Usage	107.1	105.4	1.7	1.6
Motor Vehicle License	32.5	31.1	1.4	4.3
Motor Vehicle Operators	3.9	1.6	2.3	149.4
Weight Distance	21.2	20.7	0.5	2.6
Investment Income	3.2	3.2	0.0	1.1
Other	9.3	10.4	-1.1	-10.6
TOTAL	**313.4**	**298.9**	**14.5**	**4.9**

Motor vehicle usage tax receipts increased by 1.6 percent during the fourth quarter. Receipts were $107.1 million compared to $105.4 million collected during the same period last year.

Weight distance tax receipts of $21.2 million showed a growth of 2.6 percent over receipts of $20.7 million during the fourth quarter of last year.

Motor vehicle license tax receipts increased by 4.3 percent during the fourth quarter of FY06. Receipts of $32.5 million compare to $31.1 million received during the fourth quarter of FY05.

Investment income was up by 1.1 percent in the fourth quarter of FY06, but in rounded figures both periods posted revenues of $3.2 million.

The remainder of the accounts in the Road Fund combined for a decrease of 10.6 percent. Receipts for the *other* category totaled $9.3 million during the fourth quarter, compared to $10.4 million in the fourth quarter of FY05.

Motor fuels taxes and motor vehicle usage taxes comprised 78 percent of Road Fund revenues in the fourth quarter. The next-largest source of revenue was the motor vehicle license tax with 10 percent, followed by weight distance taxes with 7 percent. The other category accounted for 3 percent, while investment income and motor vehicle operators were each 1 percent.

ANNUAL TOTALS, FY06
General Fund

The General Fund grew by 9.6 percent in FY06, exactly the same rate of growth as in FY05. Receipts totaled $8,376.1 million compared to $7,645.0 million for the previous year. Collections in the major revenue categories are shown in summary form in Table 3.

The year began with strong growth that slowed in the third quarter but rebounded in the final quarter. Most major taxes except those that were cut by JOBS for Kentucky exhibited increases in FY06. Principal changes affecting revenues were in the areas of the cigarette tax, and individual as well as corporation income taxes. These changes will be discussed below in the appropriate category.

The sales tax growth rate for FY06 was 6.0 percent, matching last year's growth rate. Receipts of $2,749.8 million compare to prior year receipts $2,595.0 million.

Individual income tax receipts fell by 3.9 percent for FY06, for an decrease of $117.6 million from last year. Individual income tax receipts fell as a result of tax shifts mandated by JOBS for Kentucky. The tax modernization bill reduced individual income tax rates, especially for low-income Kentuckians, and shifted taxes on business income from the individual to the corporation level for pass-through entities. Receipts totaled $2,918.6 million and compare to $3,036.2 million collected last year.

Corporation income tax revenue rose sharply in FY06, as a result of both increased corporate profits and changes by JOBS for Kentucky. Revenues from the corporation income tax grew by 109.3 percent with total collections of $1,001.6 million. Corporate license taxes, meanwhile, were down sharply, falling by 67.6 percent. (The corporate license tax was abolished for taxpayers whose tax year ended on or after Dec. 31, 2005.) The increase in corporation income tax revenue is not unique to Kentucky and reflects the strength seen recently at both the federal level as well as by most states. The surge in year-end tax receipts continues a trend that began in 2005. In addition, the change in reporting requirement for pass-through entities has boosted this tax at the expense of the individual income tax.

Revenue Receipts

Table 3
FY06 General Fund Revenues Compared to Previous Years
(million $)

				Growth Rate %		
	FY06	**FY05**	**FY04**	**FY06**	**FY05**	**FY04**
Sales and Use	2,749.8	2,595.0	2,447.6	6.0	6.0	3.5
Individual Income	2,918.6	3,036.2	2,796.3	-3.9	8.6	1.8
Corp. Inc. and License	1,045.1	612.6	427.4	70.6	43.3	-0.7
Coal Severance	224.5	184.4	147.5	21.7	25.0	4.1
Tobacco Taxes	184.2	33.7	17.1	447.0	97.1	4.3
Property	502.5	472.6	448.8	6.3	5.3	3.2
Lottery	190.0	161.3	173.8	17.8	-7.2	1.6
Other	561.4	549.2	519.1	2.2	5.8	8.5
TOTAL	**8,376.1**	**7,645.0**	**6,977.6**	**9.6**	**9.6**	**2.9**

Coal severance tax collections continued a recent trend of sharp increases by posting a gain of 21.7 percent for FY06. Receipts totaled $224.5 million compared to $184.4 million collected during FY05. Coal severance taxes have risen primarily due to increases in coal prices that have persisted for the last two years.

Tobacco tax receipts rose during the fiscal year as a result of an increase in the rate of the cigarette tax, the imposition of a floor stock tax, and the imposition of tax on snuff and other tobacco products. The cigarette tax was increased from 3 cents per pack to 30 cents in June 2005. Tobacco taxes for the year as a whole increased by 447.0 percent over the previous fiscal year. FY06 receipts totaled $184.2 million and compare to $33.7 million for FY05.

Total property taxes experienced an increase of 6.3 percent during this fiscal year. Receipts totaled $502.5 million compared to $472.6 million collected in FY05. A change in the calculation of the state real property tax rate (new property is excluded from the statutory 4 percent growth limit) resulted in increased real property tax collections.

Lottery receipts grew by 17.8 percent from the previous year. Receipts of $190.0 million compare to $161.3 million remitted to the state last fiscal year. Lottery receipts were positively affected by unusually large Powerball sales.

The *other* category finished the year with growth of 2.2 percent. Receipts of $561.4 million compare to $549.2 million collected in FY05. Principally responsible for the growth were the imposition of the telecommunications tax and investment income.

General Fund collections for FY06 exceeded the official revenue estimate (defined as the Dec. 2005 consensus estimate as modified by legislation from the 2006 General Assembly) by $138.8 million. This was 1.7 percent more than anticipated in the official estimate. The largest excess occurred in the corporation income and license tax, which was $116.4 million above forecasted levels. On the other hand, the sales and use, individual income, property and cigarette taxes as well as lottery receipts came in near forecasted levels.

Two-thirds of General Fund revenues were in the areas of the individual income tax and the sales tax. The next-largest source of revenue was the combination of the corporation income tax and the corporation license tax. *Other taxes* combine for 7 percent. The largest components in this category include insurance premium taxes, bank franchise tax, inheritance tax, beer wholesale sales tax, the natural gas severance tax, departmental fees, and fines and forfeitures. Property taxes made up 6 percent of the General Fund in the entire fiscal year. Coal severance taxes composed 3 percent by virtue of their recent rise. Lottery revenues and tobacco taxes each were 2 percent of the General Fund.

Overall, growth was strong in the first two quarters, weakening in the third quarter, before rallying in the fourth. The major accounts with highest growth rates consistently throughout the year were corporation income and license taxes, coal severance taxes, and tobacco taxes. Sales tax also experienced good growth throughout the year.

Kentucky's General Fund receipts largely reflect the overall economy, and for that reason this report includes in a later section a discussion of economic conditions in FY06. In the past two fiscal years the General Fund growth has been about twice as fast as the growth in personal income, which is an anomaly from its long-term pattern.

Road Fund

Total Road Fund receipts rose by 3.4 percent during FY06. Total receipts of $1,165.4 million compare to $1,126.6 million collected in this fund during FY05. Road Fund collections are detailed in Table 5.

Motor fuels and motor fuels use taxes increased by 7.6 percent on receipts of $528.3 million, compared to $490.8 million collected during the previous fiscal year. Motor fuels taxes for the entire fiscal year were impacted by a statutory rate increase tied to the wholesale price of gasoline.

Motor vehicle usage tax receipts of $395.6 million represent a fall of 2.9 percent compared to the $407.5 million collected in FY05. Usage tax receipts have fallen as a result of fewer vehicle purchases compared to earlier years.

Weight distance tax revenues rose by 2.7 percent with receipts of $85.3 million compared to $83.1 million collected in the previous fiscal year.

Motor vehicle license tax receipts were up by 2.1 percent with collections of $93.9 million, compared to $91.9 million collected in FY05.

Investment income rose by 15.4 percent as Road Fund balances increased in FY06. Receipts totaled $6.4 million, compared to $5.5 million in FY05.

The other category fell by 1.4 percent over the previous fiscal year. Total receipts in this category were $41.3 million, which compares to $41.9 million collected in FY05.

Road Fund collections for FY06 were $4.3 million below the official revenue estimate (the consensus estimate of Dec. 2005). This was 0.4 percent less than anticipated in the official estimate. The largest excess occurred in the motor vehicle license tax, which was $3.7 million above forecasted levels. In terms of percentages, the largest excess was in investment income, which was 68.4 percent higher than forecasted. The largest shortfall was in the motor vehicle usage tax which was $5.6 million below the estimate.

Nearly four-fifths of the Road Fund comes from motor vehicle usage taxes and motor fuels taxes. Following these, the motor vehicle license tax was the next-largest source of revenue, followed by the weight distance tax. Other taxes combined to account for 4 percent, and motor vehicles operators license tax and investment income each were one percent of Road Fund revenue.

Table 5 details the growth rates in Road Fund revenue by each fiscal quarter in FY06. Overall, growth was strong in the first half of the fiscal year, negative in the third quarter, and strong again in the final quarter. The major accounts with the strongest growth included motor fuels taxes, which were impacted by a rate increase of an additional 1.1 cents per gallon, in effect for the entire fiscal year. Growth in the motor vehicle operators account was bolstered by an increase in license fees. The weight distance tax was also up in all four quarters, whereas all other major sources had varying signs.

Unlike the General Fund, growth in the Road Fund does not follow the growth in Kentucky personal income. In the four fiscal years prior to FY06, Road Fund growth was the strongest in FY02, when it rose 5.2 percent in the face of weak personal income performance.

Table 4
FY06 Road Fund Revenues Compared to Previous Years
(million $)

	FY06	**FY05**	**FY04**	**FY06**	**FY05**	**FY04**
Motor Fuels	528.3	490.8	460.0	7.6	6.7	1.3
Motor Vehicle Usage	395.6	407.5	429.2	-2.9	-5.1	-0.8
Motor Vehicle License	93.9	91.9	93.4	2.1	-1.6	22.6
Motor Vehicle Operators	14.6	5.9	5.6	146.7	5.4	0.2
Weight Distance	85.3	83.1	79.6	2.7	4.4	3.5
Investment Income	6.4	5.5	7.5	15.4	-26.7	-74.2
Other	41.3	41.9	41.4	-1.4	1.2	-12.9
TOTAL	**1,165.4**	**1,126.6**	**1,116.7**	**3.4**	**0.9**	**-0.6**

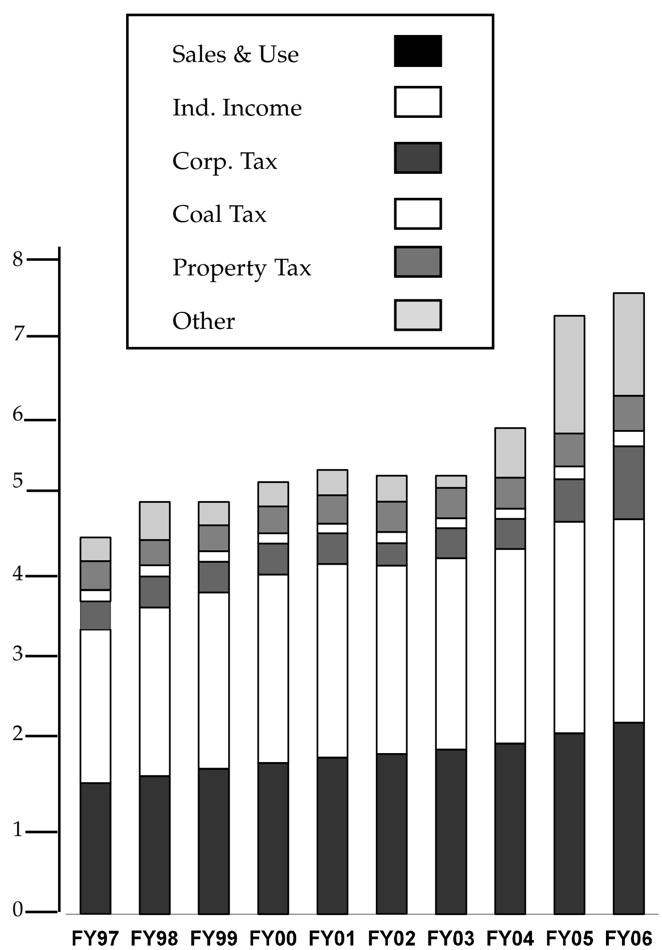
Revenue Receipts

GENERAL FUND

GENERAL FUND TOTAL RECEIPTS

Fiscal Year	Receipts	Percent Change
2005-06	$8,376,083,216	9.6
2004-05	7,645,046,634	9.6
2003-04	6,977,623,200	2.9
2002-03	6,783,458,295	3.4
2001-02	6,560,216,551	-1.4
2000-01	6,653,897,653	2.7
1999-00	6,478,385,032	4.5
1998-99	6,198,387,525	3.1
1997-98	6,011,806,561	6.1
1996-97	5,663,553,289	6.1

General Fund Receipts by Major Sources
Millions of Dollars



ALCOHOLIC BEVERAGE TAXES

Malt Beverage

Fiscal Year	Receipts	Percent Change
2005-06	$51,600,592	8.6
2004-05	44,203,035	1.0
2003-04	43,760,805	3.4
2002-03	42,304,059	4.4
2001-02	40,883,326	5.2
2000-01	38,854,920	1.2
1999-00	38,385,890	4.1
1998-99	36,870,323	2.6
1997-98	35,937,878	3.2
1996-97	34,830,419	1.0

Distilled Spirits

Fiscal Year	Receipts	Percent Change
2005-06	$33,518,873	8.2
2004-05	27,432,580	5.4
2003-04	26,030,680	4.7
2002-03	24,854,482	5.9
2001-02	23,477,073	1.7
2000-01	23,077,057	3.3
1999-00	22,349,780	4.3
1998-99	21,432,736	2.2
1997-98	20,979,849	2.1
1996-97	20,548,503	0.3

Wine

Fiscal Year	Receipts	Percent Change
2005-06	$12,456,900	8.2
2004-05	10,115,015	8.6
2003-04	9,312,250	7.1
2002-03	8,698,754	6.3
2001-02	8,183,587	4.3
2000-01	7,846,391	2.3
1999-00	7,672,648	8.8
1998-99	7,049,136	7.6
1997-98	6,551,316	7.6
1996-97	6,085,828	8.5

Revenue Receipts

CIGARETTE TAX[1]

Fiscal Year	Receipts	Percent Change
2005-06	$172,069,493	589.2
2004-05	24,966,880	45.7
2003-04	17,136,198	4.7
2002-03	16,367,947	17.4
2001-02	13,943,208	-0.5
2000-01	14,007,582	-1.2
1999-00	14,184,888	-3.3
1998-99	14,673,839	-3.0
1997-98	15,130,443	-5.7
1996-97	16,044,967	2.3

COAL SEVERANCE TAX

Fiscal Year	Receipts	Percent Change
2005-06	$224,490,111	21.7
2004-05	184,436,935	25.0
2003-04	147,498,230	4.1
2002-03	141,664,981	-11.5
2001-02	160,160,116	13.1
2000-01	141,553,087	-2.5
1999-00	145,139,909	-6.0
1998-99	154,476,772	-5.7
1997-98	163,731,038	0.1
1996-97	163,545,844	-5.3

CORPORATION INCOME TAX

Fiscal Year	Receipts	Percent Change
2005-06	$1,001,618,543	109.3
2004-05	478,504,505	57.8
2003-04	303,262,821	9.1
2002-03	278,035,794	34.1
2001-02	207,353,777	-28.5
2000-01	289,931,017	-5.4
1999-00	306,442,050	-1.8
1998-99	312,066,675	-6.5
1997-98	333,666,393	14.0
1996-97	292,753,126	2.8

CORPORATION LICENSE TAX

Fiscal Year	Receipts	Percent Change
2005-06	$ 43,516,942	-67.6
2004-05	134,149,794	9.3
2003-04	124,096,012	8.1
2002-03	152,595,257	29.9
2001-02	117,500,770	-20.3
2000-01	147,515,402	6.0
1999-00	139,127,819	10.5
1998-99	125,912,523	11.7
1997-98	112,763,160	4.9
1996-97	107,498,746	18.8

INDIVIDUAL INCOME TAX

Fiscal Year	Receipts	Percent Change
2005-06	$2,918,610,982	-3.9
2004-05	3,036,230,706	8.6
2003-04	2,796,331,049	1.8
2002-03	2,746,386,944	1.6
2001-02	2,702,510,022	-2.7
2000-01	2,778,541,444	2.8
1999-00	2,701,613,908	6.7
1998-99	2,532,005,348	4.7
1997-98	2,418,144,438	9.7
1996-97	2,205,022,964	6.3

INHERITANCE AND ESTATE TAX

Fiscal Year	Receipts	Percent Change
2005-06	$45,990,266	-27.2
2004-05	63,174,866	-4.4
2003-04	66,083,705	-31.1
2002-03	95,864,480	15.0
2001-02	83,359,872[1]	-0.1
2000-01	83,461,499	12.0
1999-00	74,489,981	8.5
1998-99	81,483,083	22.8
1997-98	105,538,130	10.8
1996-97	95,287,282	17.0

[1]*Phase out of estate tax begins.*

Revenue Receipts

LOTTERY RECEIPTS

Fiscal Year	Receipts	Percent Change
2005-06	$190,000,000	17.8
2004-05	161,252,000	-7.2
2003-04	173,800,000	1.6
2002-03	171,000,000	1.2
2001-02	169,000,000	7.6
2000-01	157,030,000	0.5
1999-00	156,300,000	1.6
1998-99	153,800,000	0.5
1997-98	153,000,000	1.3
1996-97	151,000,000	2.7

MINERALS AND NATURAL GAS TAX

Fiscal Year	Receipts	Percent Change
2005-06	$50,701,858	7.7
2004-05	38,801,666	7.1
2003-04	36,223,062	32.7
2002-03	27,294,398	10.7
2001-02	24,656,955	-17.9
2000-01	30,030,552	34.2
1999-00	22,369,419	18.0
1998-99	18,954,883	-6.1
1997-98	20,192,086	0.7
1996-97	20,051,609	15.4

OIL PRODUCTION TAX

Fiscal Year	Receipts	Percent Change
2005-06	$6,386,501	35.6
2004-05	4,710,832	39.1
2003-04	3,387,884	8.7
2002-03	3,116,954	20.3
2001-02	2,590,722	-22.9
2000-01	3,358,036	13.2
1999-00	2,967,395	120.6
1998-99	1,344,942	-37.0
1997-98	2,135,211	-29.9
1996-97	3,044,497	15.1

PARI-MUTUEL TAX

Fiscal Year	Receipts	Percent Change
2005-06	$5,626,849	19.5
2004-05	4,710,111	29.8
2003-04	3,629,292	-39.0
2002-03	5,953,247	14.9
2001-02	5,179,952	-16.2
2000-01	6,182,083	-7.0
1999-00	6,645,098	-7.4
1998-99	7,179,163	48.1
1997-98	4,845,921	-18.0
1996-97	5,911,958	-17.3

PROPERTY TAXES—REAL ESTATE

Fiscal Year	Receipts	Percent Change
2005-06	$215,351,439	6.5
2004-05	202,182,555	5.0
2003-04	192,534,530	3.5
2002-03	186,000,177	3.5
2001-02	179,678,050	4.8
2000-01	171,524,695	2.5
1999-00	167,326,472	3.5
1998-99	161,723,137	4.8
1997-98	154,245,453	-9.3
1996-97	170,063,059[1]	19.2

[1] *Some tangible property tax receipts were erroneously credited to real property receipts accounts.*

PROPERTY TAXES—TANGIBLE

Fiscal Year	Receipts	Percent Change
2005-06	$165,622,948	3.6
2004-05	159,883,091	7.2
2003-04	149,155,206	-0.2
2002-03	149,426,286	-1.2
2001-02	151,308,795	7.7
2000-01	140,466,295	7.3
1999-00	130,960,896	4.3
1998-99	125,564,658	-0.2
1997-98	125,753,465	0.9
1996-97	124,637,468[1]	-9.6

[1] *Some tangible property tax receipts were erroneously credited to real property receipts accounts.*

Revenue Receipts

PROPERTY TAXES—INTANGIBLE

Fiscal Year	Receipts	Percent Change
2005-06	$30,955,124	15.0
2004-05	26,912,813	-2.3
2003-04	27,547,183	6.4
2002-03	25,883,197	12.0
2001-02	23,113,567	2.5
2000-01	22,551,153	-0.8
1999-00	22,721,743	25.5
1998-99	18,103,920	-14.3
1997-98	21,129,328[1]	-54.7
1996-97	46,631,437[1]	-29.9

[1] *Shares of stock were exempted from property tax.*

SALES AND USE TAX

Fiscal Year	Receipts	Percent Change
2005-06	$2,749,765,011	6.0
2004-05	2,594,966,373	6.0
2003-04	2,447,584,698	3.5
2002-03	2,364,182,478	2.8
2001-02	2,299,990,621	2.3
2000-01	2,248,471,100	3.5
1999-00	2,171,397,969	4.1
1998-99	2,085,899,677	5.3
1997-98	1,981,297,580	5.2
1996-97	1,882,681,995	5.5

BANK FRANCHISE TAX

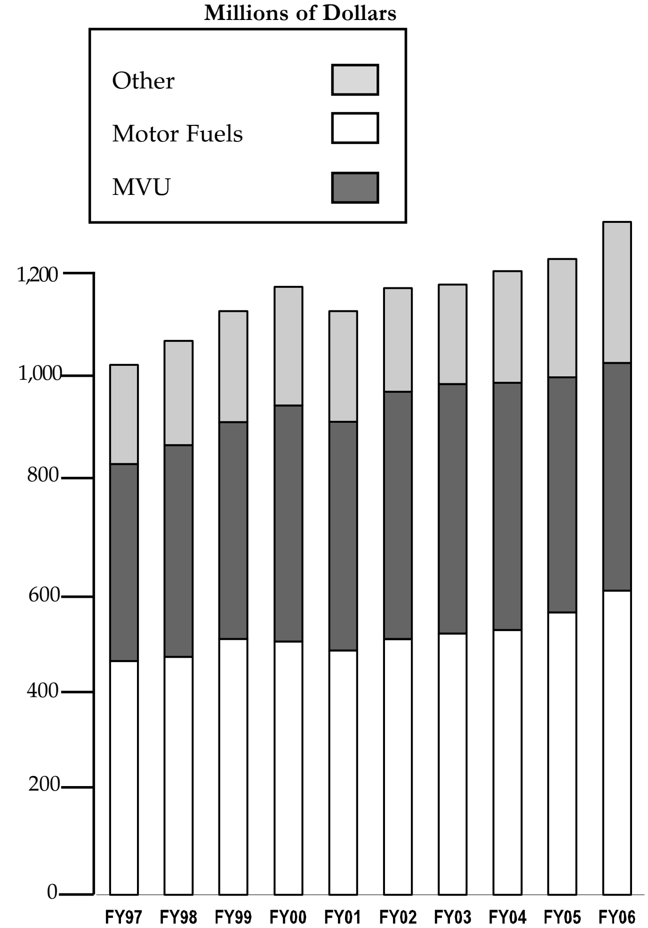
Fiscal Year	Receipts	Percent Change
2005-06	$59,603,147	-6.6
2004-05	63,837,587	15.1
2003-04	55,467,195	3.2
2002-03	53,747,906	6.3
2001-02	50,549,168	1.9
2000-01	49,610,220	-6.5
1999-00	53,061,789	12.8
1998-99	47,059,959	34.2
1997-98	35,059,801	-14.2
1996-97	40,878,664	-----

ROAD FUND

ROAD FUND TOTAL RECEIPTS

Fiscal Year	Receipts	Percent Change
2005-06	$1,165,409,505	3.4
2004-05	1,126,554,402	0.9
2003-04	1,116,734,272	-0.6
2002-03	1,123,103,133	0.4
2001-02	1,119,005,317	5.2
2000-01	1,064,181,565	-2.4
1999-00	1,090,777,822	3.2
1998-99	1,056,596,153	4.4
1997-98	1,011,789,675	5.4
1996-97	960,183,780	2.2

Road Fund Receipts by Major Sources
Millions of Dollars



MOTOR FUELS TAXES

Motor Fuels Normal

Fiscal Year	Receipts	Percent Change
2005-06	$501,927,927	6.9
2004-05	469,621,779[1]	6.4
2003-04	441,382,996	0.6
2002-03	438,564,438	2.0
2001-02	429,812,296	5.1
2000-01	408,801,115	-3.6
1999-00	423,876,351	-0.9
1998-99	427,848,100	8.0
1997-98	396,123,781	1.4
1996-97	390,688,336	3.3

[1]*Rate increase $0.01.*

Motor Fuels Normal Use and Surtax

Fiscal Year	Receipts	Percent Change
2005-06	$25,982,599	25.2
2004-05	20,748,200	14.1
2003-04	18,185,947	21.5
2002-03	14,969,884	6.0
2001-02	14,124,035	-8.8
2000-01	15,492,738	-2.6
1999-00	15,905,613	-5.6
1998-99	16,853,163	-3.6
1997-98	17,473,744	14.1
1996-97	15,316,702	-32.1

MOTOR VEHICLE OPERATOR'S LICENSE FEE

Fiscal Year	Receipts	Percent Change
2005-06	$14,553,623	146.7
2004-05	5,899,247	4.9
2003-04	5,623,874	0.2
2002-03	5,610,829	0.8
2001-02	5,564,009	-0.5
2000-01	5,592,769	-1.7
1999-00	5,689,329	5.3
1998-99	5,400,685	3.0
1997-98	5,241,595	-2.1
1996-97	5,355,648	4.8

MOTOR VEHICLE USAGE TAX

Fiscal Year	Receipts	Percent Change
2005-06	$395,582,626	-2.9
2004-05	407,525,361	9.6
2003-04	390,976,367	0.5
2002-03	388,959,153	2.0
2001-02	381,398,176	10.5
2000-01	345,120,799	-4.0
1999-00	359,437,723	8.5
1998-99	331,187,817	1.8
1997-98	325,308,554	6.7
1996-97	304,868,491	2.1

Major Accomplishments in Fiscal Year 2005-2006

Taxpayer Service

- Offered extended office hours in April 2006 to accommodate taxpayers with questions regarding individual income tax returns, withholding, and sales and use taxes.
- Continued the partnership with the University of Kentucky and the IRS in presenting up-to-date individual income tax information for Kentucky tax practitioners, CPAs, attorneys, insurance adjusters, realtors and other interested parties.
- Continued to participate in the University of Louisville's Louis A. Grief Tax Institute by presenting up-to-date individual income tax information to tax practitioners, CPAs, attorneys and other interested persons.
- Continued a foreign and sign language directory for DOR employees to better assist taxpayers who are unable or limited in speaking English.
- Continued partnerships with the IRS to provide education and training for volunteers participating in community-based partnerships that provide free tax preparation and electronic filing for the elderly and low-income taxpayers.
- Participated in some training at the county clerks' conference.
- Received 159,830 telephone inquiries for individual income tax and 47,271 telephone inquiries for withholding tax for a total of 207,101 telephone inquiries received by the Division of Individual Income Tax.
- Processed 1,258,701 timely and correctly filed individual income tax returns requesting refunds by June 4, 2006.
- Issued 375,990 direct deposit refunds for individual income tax returns.
- Processed 1,137,658 returns filed through electronic media representing an increase of 3.9 percent over the previous processing cycle.

Collection of Tax Revenues

- Collected in excess of $169 million, exceeding the previous year record total by over $28 million.
- Collected over $6 million in delinquent child support compared to $2.3 million in FY05.
- Conducted pilot projects with six other state agencies related to the collection of debt owed to those agencies as provided by KRS 45.241(1))(a).
- Implemented a system to facilitate the referral of delinquent property tax debt to the DOR for enforced collection action.

Enterprise Collections Update

- **Child Support**—The Child Support Program is having positive results and is on target to collect $2.25 million this fiscal year utilizing three full-time employees. Based on these numbers, those collections are equivalent to $750,000 per collector. To date, DOR has also reduced Cabinet for Health and Family Services (CHFS) accounts receivable by $11 million. Currently DOR's case inventory is approximately 6,000-6,500 cases with receivables totaling $55 million. CHFS estimates an additional 15,000–20,000 cases will qualify for referral over the next year. In addition, CHFS staff has informed DOR that they will be meeting with Jefferson County in the near future to discuss their participation in the program. The number of referrals from Jefferson County is currently unknown.

  Under the current budget for FY06, CHFS provided funding for two additional child support positions. The three collectors assigned to handle child support cases were previously responsible for the collection of delinquent tax.

  DOR submitted and CHFS approved the operating budget for FY06. This budget provides funding for two additional full-time employees for a total of seven for the program.

- **Property Tax**—DOR is currently collecting for seven counties. To date, collections total $1.5 million. With three full-time employees assigned to property tax, this equates to $500,000 per collector. In Magoffin County, DOR has billed 2,400 taxpayers totaling $1.7 million. Collections from July 2004 to date total $532,070 as compared to $91,764 for the same period last year.

- **Community Based Service (CBS)** ($21.6 million in liquidated debt)—DOR has an inventory of 380 cases valued at $282,000 it is manually collecting for CBS. Debts being collected are Aid with Families and Dependent Children (AFDC) and Food Stamps. Collections total approximately $23,602. DOR staff has initiated 56 payment plans for which the combined case total is $42,832. DOR is currently issuing levies on qualified cases. To date, out of the total collected, $6,414 has been collected from levies issued. While the program is still in its infancy, DOR and CBS staff believe there is great collection potential. Due to the positive results that have occurred thus far, CBS has adopted the DOR warning language into one of their automated collection letters.

Department of Workforce Investment (DWI), Division of Unemployment Services (Tax and Benefits) ($36.4 million in liquidated debt)–DOR has been working with both the tax and benefit staff on this initiative.

DWI statutes on benefits' debts currently do not allow for any administrative collection action beyond that of billing and filing a lien. DWI sent warning letters to all 9,200 claimants on their system. A warning letter collected $55,156 and 523 claimants requested payment agreement information.

Out of those that did not respond, 200 cases were assigned to DOR for collection action. To date, DOR has issued 167 Final Notice Before Seizure letters. Claimants have 45 days to respond to this letter. To date, DOR has collected $530 and set up 11 payment agreements on cases with a total dollar value of $31,397.

DWI continues to work on their placement criteria for their tax debts and is sending approximately 250 cases for DOR to collect.

Business Practices

- Processing has been completed on all timely filed individual income tax returns. DOR deposited in excess of $586 million into the General Fund.
- Work continues with the implementation of tax modernization changes. All system developments progressed as planned. DOR and Commonwealth Office of Technology (COT) staff worked extensively on documenting business and system requirements for systems scheduled to be rolled out by year's end.

Technological Advances

- Utility gross receipts license tax (school tax) system and the telecommunications tax system were successfully implemented. Both of these systems are Web based and represent significant use of technology to facilitate taxpayer registration and filing capabilities.

Use of Electronic Filing Increases

- Taxpayers using electronic filing for sales and use tax returns increased during the year. KY E-Tax, which allows taxpayers to file their return online, saw an approximate 80 percent increase in registrants and returns. As of fiscal year end, there were 7,807 taxpayers who registered to file their returns using KY E-Tax, and 31,062 sales and use tax returns were received and processed electronically for the year.

Compliance Initiatives

- External training seminars for tax professionals were held with a presentation for over 500 CPAs already held in Louisville in May. Additional two-day seminars sponsored in conjunction with the Kentucky Society of CPAs were scheduled at seven sites throughout the state in Oct., Nov. and Dec. In addition, the Commissioner's Tax Practitioners Council continues to meet monthly and discuss the impacts of tax modernization. The DOR Web site is updated daily to reflect changes in the development of tax modernization including new forms, tax planning information and a link to the DOR tax modernization Web site at *kentucky.gov*.

- The Division of Sales and Use Tax prepared and mailed four newsletters, the Kentucky Sales Tax Facts, with sales and use tax returns. Information included legislative updates, updates on business specific issues and addressed frequently asked questions. Several different forums or seminars were also attended where sales tax staff provided educational updates on taxes administered by the division. Most of the educational seminars related to the 2005 Tax Modernization issues which began in the summer of 2005.

Division of Registration and Data Integrity

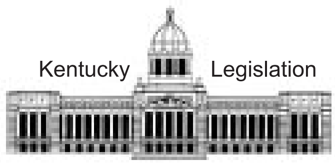
- Due to the tax modernization law changes in April 2005, over 60,000 limited liability entities became responsible for corporation income tax. The legislature backdated the provisions of the statute to be effective Jan. 2005, presenting the Registration Branch with the task of registering over 60,000 limited liability entities for accounts prior to the 2005 tax year filing season. Although the registration of these additional taxpayers was equivalent to four years work, the project was completed within nine months time frame. This project was completed in addition to the Registration Branch's normal annual work load. The end result was the registration of 68,700 businesses for corporation income tax. Only 17 percent came from voluntary registrations. The remaining 57,000 accounts were forced by the Registration Branch. As of June 30, 2006 these accounts paid in excess of $84.6 million to the commonwealth.

FEIN number match

- The Registration Compliance Section, within the Registration Branch, signed a memorandum of understanding with the IRS to allow the DOR to receive information on newly issued federal identification numbers to businesses or individuals with Kentucky addresses. Employees worked on the development and testing of a new Federal Discovery Program allowing for the tracking of case leads as well as conforming to federal regulations for the safe guarding of federal data. As of the end of June 2006, 7,905 new accounts were registered and over $2.5 million generated.

2005 General Assembly

A Review of Tax Law Changes
Enacted by the 2005 General Assembly



NOTE: This 2005 legislative summary presents only general information concerning the major tax provisions the General Assembly has enacted and does not represent a complete analysis or specific interpretations of the law changes. The Department of Revenue (DOR) will provide more specific information as it implements these changes. Full text of enacted bills is available on the legislative home page, www.lrc.ky.gov.

The 2005 Kentucky General Assembly created, amended or repealed numerous statutes. A total of 743 bills and 308 resolutions were introduced. In the end, 172 became law, an enactment rate of 23.15 percent. The governor vetoed one bill and 13 items in the budget bill.

Eighteen bills had substantive tax implications, with some affecting more than one tax. This review describes the tax portion of each bill. Effective dates are shown when specifically stated in the legislation. Otherwise, changes were effective June 20, 2005.

Administrative

DOR Reorganization—The Revenue Cabinet is abolished and the DOR within the Finance and Administration Cabinet is created. The bill also establishes major divisions within the DOR. ***(SB 49)***

Electronic Records—DOR auditors may request taxpayer records in an electronic format when taxpayers already have them in such a format. ***(HB 497)***

Fraud—The definition of *fraud* is clarified to mean not only a taxpayer's failure to file required information, but also a taxpayer's intentional filing of false information. ***(HB 497)***

Utility Gross Receipts License Tax—The utility gross receipts license tax, which the DOR began administering for local school districts in July 2005, is required to be filed and paid electronically. A taxpayer may request a waiver of this requirement. The bill also permits the DOR to share utility gross receipts license tax information with the school districts on a confidential basis. (***HB 497)***

Refund Claims—This bill amends various statutes to clarify that a taxpayer must file an individual refund claim setting forth the specific grounds upon which the refund claim is based. Tax refund claims may not be obtained by a class action lawsuit and the filing of a class action lawsuit does not constitute the timely filing of a refund claim for each member of the alleged class. ***(HB 498)***

Alcoholic Beverages Tax

Increase—(Effective June 1, 2005.) Alcohol wholesale tax is increased from 9 percent to 11 percent. ***(HB 272)***

Corporation Tax

Corporation Tax Base Expansion—(Effective for tax periods beginning on or after Jan. 1, 2005.) The corporation tax base is expanded to include all limited liability entities (corporations, LLPs, LLCs, including single member LLCs, limited partnerships, and S corporations). General partnerships and sole proprietorships will not be subject to the expanded corporation tax. Publicly traded partnerships and their limited partnership and limited liability company affiliates will be taxed as general partnerships. There is no pass-through of income, loss or credit to nonindividual owners of pass-through entities subject to corporation income tax. Individual partners, members or shareholders of pass-through entities subject to corporation tax will receive credit for tax paid at the entity level. ***(HB 272)***

Rate Reduction—(Effective for tax periods beginning on or after Jan. 1, 2005.) The top corporate rate is reduced and lower brackets expanded. The 4 percent bracket applies to taxable net income up to $50,000 and the 5 percent bracket applies to taxable net income between $50,000 and $100,000. For taxable years beginning on or after Jan. 1, 2005, and prior to Jan. 1, 2007, the top corporate rate will be 7 percent on all taxable net income over $100,000. For tax years beginning on or after Jan. 1, 2007, the top rate will be 6 percent on all taxable net income over $100,000. ***(HB 272)***

Reference to Internal Revenue Code (IRC)—(Effective for tax periods beginning on or after Jan. 1, 2005, except where otherwise indicated.) The IRC reference date is updated to

Dec. 31, 2004, except that depreciation and Section 179 expenses are calculated based on the IRC in effect on Dec. 31, 2001. By updating the reference date, Kentucky's tax laws conform more closely with federal laws, providing ease of filing for taxpayers and ease of administration for the DOR. (***HB 272)***

Alternative Minimum Calculation (AMC)—(Effective for tax periods beginning on or after Jan. 1, 2005.) Taxpayers must pay the greater of the income tax, the alternative minimum tax or $175. Taxpayers may choose between two methods to calculate the alternative minimum: 9.5 cents per $100 of the corporation's gross receipts or 75 cents per $100 of the corporation's Kentucky gross profits. Kentucky gross profits mean Kentucky gross receipts reduced by returns and allowances attributable to Kentucky gross receipts, less Kentucky cost of goods sold. Cost of goods sold includes direct labor and the cost of specialized transportation for gasoline and special fuels. ***(HB 272)***

Mandatory Nexus Consolidated Returns—(Effective for tax periods beginning on or after Jan. 1, 2005, except as otherwise noted.) All corporations with nexus in Kentucky that are connected through an ownership interest of 80 percent or more must file a consolidated Kentucky return. This includes the expanded definition of corporation with limited liability entities included in the affiliated group. ***(HB 272)***

Intangible Property, Management Fees and Other Related Party Expenses—Certain deductions relating to transactions with one or more related members of an affiliated group may be disallowed unless:

1. The corporation and the related member are included in the same consolidated Kentucky corporation income tax return for the relevant taxable year;
2. A disclosure is made and evidence provided to establish that the transaction was at arm's length, that the payment made to a related member was subject to income tax in another jurisdiction, and the related member has substantial business activities other than the management or ownership of intangible property;
3. A disclosure is made and evidence provided that the recipient regularly engages in transactions with one or more unrelated parties on terms identical to that of the subject transactions; or
4. The DOR and taxpayer agree in writing to an alternative method of apportionment. ***(HB 272)***

Doing Business **Nexus Standard—**(Effective for tax periods beginning on or after Jan. 1, 2005.) The standard in Kentucky changes from a physical presence standard to a *doing business* standard. ***(HB 272)***

Net Operating Losses (NOL)—(Effective for tax periods beginning on or after Jan. 1, 2005.) Corporations may no longer carry NOLs back to previous years. ***(HB 272)***

Multiple Taxing Jurisdictions (Apportionment)—(Effective for tax periods beginning on or after Jan. 1, 2005.) All limited liability entities subject to corporation income tax that do business within and without Kentucky and general partnerships that do business within and without Kentucky will be required to utilize a three-factor apportionment formula to apportion income to Kentucky. ***(HB 272)***

Phase II Tobacco Payments—(Effective for tax periods beginning on or after Jan. 1, 2005.) State funds that may be paid out as an addition to or a replacement of Phase II tobacco payments are exempt from corporation income tax. ***(HB 272)***

Conversion—An ordinary corporation may convert to a nonprofit, nonstock corporation under KRS Chapter 273. ***(SB 142)***

Corporation License Tax

Repeal—(Effective for tax periods ending on or after Dec. 31, 2005.) The corporation license tax is repealed. Returns and tax for prior periods remain due. The anticipated increases resulting from the ***Illinois Tool Works*** court decision, 00-CI-623, will not apply for any year. ***(HB 272)***

Economic Development Incentives and Credits

New Limits on Kentucky Investment Fund Act (KIFA) Credits—(Effective July 1, 2005.) KIFA tax credits available to any single investment fund are limited to $1.3 million for all investors and all taxable years. Total KIFA tax credits available for all investors in all investment funds shall not exceed $5 million per fiscal year. ***(HB 267)***

Clean Coal Incentive Credit—(Effective for tax periods ending on or after Dec. 31, 2006.) A potential credit is available to an electricity generation facility certified as using clean coal equipment and technology and burning coal subject to Kentucky's severance tax. The credit may be taken against corporation income, individual income, corporation license and public service property taxes at the rate of $2 per ton of qualifying coal burned. The credit applies to electricity generation facilities with an investment of more than $150 million that meet Environmental and Public Protection Cabinet standards. ***(HB 272)***

Environmental Remediation (Brownfield) Credit—(Effective for tax periods beginning after Dec. 31, 2004.) Taxpayers who agree to clean up or develop an existing abandoned brownfield area may qualify for a credit against corporation or individual income taxes in a maximum amount of $150,000. ***(HB 272)***

Environmental Stewardship Credit—(Effective for tax years ending on or after Jan. 31, 2007.) A credit is available against the corporation and individual income taxes for a corporation or individual that undertakes an environmental stewardship project with a minimum investment of at least $5 million. The Cabinet for Economic Development must approve these projects. The taxpayer must meet certain wage requirements in order to qualify. The credit will cover 100 percent of eligible skills upgrade training costs and up to 25 percent of eligible equipment costs. The project must produce an environmental stewardship product, which is defined to mean a new manufactured product or substantially improved existing manufactured product that has a lesser or reduced adverse effect on human health and the environment. It may also be used for improvement to human health and the environment when compared with existing products or competing products that serve the same purpose. The maximum amount of credit claimed for any single fiscal year may not exceed 25 percent of the total authorized inducement. ***(HB 272)***

Biodiesel Credit—(Effective for tax periods beginning on or after Jan. 1, 2005.) Credits may be taken against corporation or individual income taxes for producing or blending biodiesel fuels of up to $1 per gallon produced or blended, limited to a maximum statewide credit of $1.5 million. The credit may not be carried forward. ***(HB 272)***

Recycling Tax Credits—(Effective for tax periods beginning after Dec. 31, 2004.) Corporation and individual income tax recycling credits available are expanded for major recyclers who make a significant investment in plant and equipment and who meet certain employment standards. Credits are allowed for up to 50 percent of the cost of new and expanded recycling equipment, limited each taxable year to 50 percent of the total tax liability for the year the credit is claimed over the tax liability for the most recent taxable year ending prior to Jan. 1, 2005 or $2.5 million, whichever is less. This bill also provides for the recapture of the credit if the equipment is no longer used in a qualifying manner or is sold or disposed of within five years from the date it is purchased, based upon the useful life of the equipment and year of disposition. An exception to the recapture exists in the case of transfers due to death or change in business ownership or organization as long as the equipment remains qualifying equipment. ***(HB 272)***

Historic Preservation Restoration Credit—(Effective for tax periods ending on or after Dec. 31, 2005.) This bill allows a credit against corporation or individual income taxes for a portion of the cost of restoring a qualified residential and commercial structure listed on the National Registry of Historic Places. The credit is equal to 30 percent of the rehabilitation expenses in the case of owner-occupied residential property and 20 percent of the rehabilitation expenses in the case of all other property. The total credit available is capped at $3 million annually, with each individual owner-occupied property receiving no more than $60,000. ***(HB 663)***

Enterprise Initiatives

Enterprise Initiative Act—(Effective Jan. 1, 2006.) A new statewide tax incentive program replaces the Enterprise Zone program. It extends to eligible companies the opportunity to receive refunds of sales and use tax paid on the purchase of building materials and research and development materials. The bill limits eligible expenditures to tourist attractions, services, technology, manufacturing and company headquarters in any industry. The plan gives preference to companies in existing enterprise zones; the minimum investment is $100,000 for companies within enterprise zone boundaries; $500,000 elsewhere. It also creates a statewide cap in each year of $20 million for building materials and $5 million for research and development on all approved projects. ***(HB 272)***

Health Care Provider Tax

Nursing Homes—(Retroactive to July 1, 2004.) All state-operated veterans' nursing homes are excluded or exempted from paying health care provider tax. ***(HB 439)***

Classifications—(Effective July 1, 2005.) Three new classifications to health care provider tax base are created: regional community mental health and retardation services (taxed at 4 percent of gross revenues received); psychiatric residential treatment facility services; and Medicaid managed care services (taxed at 5.5 percent of gross revenues received). ***(HB 461)***

Individual Income Tax

Reference to IRC—(Effective for tax periods beginning on or after Jan. 1, 2005, except where otherwise indicated.) This bill updates the IRC reference date to Dec. 31, 2004, with three exceptions, as the basis for Kentucky income taxes. The exceptions are: (1) for property placed in service after Sept. 10, 2001, only the depreciation and expense deductions allowed under Sections 168 and 179 of the IRC are in effect on Dec. 31, 2001, exclusive of any amendments made subsequent to that date, shall be allowed; (2) the provisions of the Military Family Tax Relief Act of 2003, Pub. L. No. 108-121, are effective on the dates specified in that act; and (3) Kentucky will not allow the deduction for sales and use taxes in lieu of state income taxes.

By updating the reference date, Kentucky's tax laws conform more closely with federal laws, providing ease of filing for taxpayers and administration for the DOR. ***(HB 272)***

Family Size Tax Credit—(Effective for tax periods beginning on or after Jan. 1, 2005.) Low-income taxpayers will have increased relief. The current low-income tax credit is repealed for taxable years beginning on or after Jan. 1, 2005. The new Family Size Tax Credit is based on modified gross income (MGI) and size of the family household up to four members. Single and married taxpayers whose MGI is at or below federal poverty level for their family size will receive 100 percent tax credit. For 2005, MGI levels that qualify for the 100 percent tax credit are as follows:

Size of Family Unit	Amount
1	$ 9,570
2	$12,830
3	$16,090
4	$19,350

The Family Size Tax Credit provides benefit to individuals and families at incomes up to 133 percent of the federal poverty level through a phase-down of the credit. ***(HB 272)***

Rate Reduction—(For taxable years beginning after Dec. 31, 2004.) The tax rate for taxable income between $8,000 and $75,000 drops to 5.8 percent with taxable income over $75,000 continuing to be taxed at 6 percent. ***(HB 272)***

Net Operating Losses (NOL)—(Effective for tax periods beginning on or after Jan. 1, 2005.) Individuals may no longer carry NOLs back to previous years. ***(HB 272)***

Phase II Tobacco Payments—(Effective for tax periods beginning on or after Jan. 1, 2005.) State funds that may be paid out as an addition to or a replacement of Phase II tobacco payments are exempt from individual income tax.

Pensions—(Effective Jan. 1, 2005.) The pension exclusion is capped at $41,110, the 2005 amount, and KRS 141.105, which provided for the cost of living adjustment, is repealed. ***(HB 272)***

Education Tuition Tax Credit—(Effective for tax periods beginning on or after Dec. 31, 2004.) A credit equal to 25 percent of the amount of the federal Hope Scholarship and the lifetime learning credit is available. The credit applies only to undergraduate studies, phases out for higher incomes and applies to most higher education opportunities within Kentucky. ***(HB 272)***

Health Savings Accounts—(Effective for tax periods beginning on or after Jan. 1, 2005.) As a part of the IRC update, Kentucky allows the same tax advantages currently available at the federal level for health savings accounts. Benefits include permitting pretax treatment of contributions to health savings accounts and more potential uses of funds than are allowed with flexible spending accounts. ***(HB 272)***

Refund Designation—Taxpayers may now contribute all or a portion of their individual refund to the Breast Cancer Research and Education Trust Fund. The fund replaces the Bluegrass State Games and U. S. Olympic Committee Fund on the Kentucky individual income tax return. ***(HB 7)***

Motor Fuels Tax

Refunds—A motor fuels refund may only be requested on fuel purchased after the effective date of the refund permit. ***(HB 494)***

Underground Storage Tank Fees—The underground storage tank fee exclusion extends to include all the special fuels for which a credit is provided for by KRS 138.358. ***(HB 494)***

Bulk Sales—The motor fuels exemption for sales to the federal government is clarified as applying only to bulk sales and not retail sales. ***(HB 494)***

Payments—Motor fuels dealers in good financial standing may either pay by a dealer's check or electronic funds transfer payments. ***(HB 494)***

Financial Instruments—Substitutes the words *financial instrument(s)* for *bond(s)* in HB 662, 2002 Session. ***(HB 494)***

Average Wholesale Price of Gas—For purposes of the motor fuels tax calculation, the *average wholesale price* is deemed to not be less than $1.22 per gallon; amended from $1.11 per gallon. ***(HB 267)***

Motor Vehicle Usage Tax

Collection of Motor Vehicle Usage Tax at Titling— (Effective July 1, 2005.) Collection of motor vehicle usage tax is required when an owner titles, rather than registers, a vehicle. This allows an owner to submit an affidavit of nonhighway use to prevent payment of motor vehicle usage tax on vehicles that will not be operated on Kentucky highways. It requires collection of sales and use tax on vehicles not used on the highway. It provides credit against motor vehicle usage tax for Kentucky sales and use tax paid when an affidavit is submitted. ***(HB 267)***

Charter Buses—(Effective Aug. 1, 2005.) Charter buses are exempt from the motor vehicle usage tax. ***(HB 267)***

Pari-Mutuel Tax

International Horse Racing Events—(Effective Jan. 1, 2006.) An excise tax will not be imposed on pari-mutuel wagering on live racing occurring on any one day that a Kentucky track hosts an international horse racing event that distributes in excess of $10 million in purses. This tax exemption remains in effect for any such succeeding event if the event returns within three years of the previously held event. ***(HB 350; HB 497)***

Property Tax

Property Owned by Another State—(Effective July 1, 2005.) All real and personal property owned by another state and used exclusively for public purposes is exempt from taxation if that state comparably exempts the commonwealth's property. ***(HB 267)***

Local School Districts—(Effective July 1, 2005.) Local school districts that are deemed *hold harmless* pursuant to Fiscal Year 2005-2006 Support Education Excellence in Kentucky (SEEK) tentative calculation shall not be required to levy a property tax rate lower in Fiscal Year 2005-2006 than the previous year's rate. ***(HB 267)***

Intangible Property Tax Repealed—(Effective Jan. 1, 2006.) Most intangible property taxes are repealed, other than some of the intangible taxes paid by financial institutions and other businesses. ***(HB 272)***

State Real Property Tax Rate—(Effective for tax years beginning on or after Jan. 1, 2005.) Revenue and assessment growth resulting from new property is excluded from the 4 percent growth limit established by HB 44. (***HB 272)***

School Funding—(Effective for assessments on or after Jan. 1, 2006.) A district board of education may levy a general tax rate that produces revenue from real property, exclusive of revenue from new property, that is 4 percent over the amount of revenue produced by the compensating rate as defined in KRS 132.010. ***(HB 272)***

Biotechnology Products—(Effective Jan. 1, 2002.) Biotechnology products are exempted from assessments for local property taxes and provide a definition of biotechnology products. ***(HB 308)***

Barge Lines—(Effective Jan. 1, 2001 to Jan. 1, 2006.) This bill simplifies the ad valorem reporting and payment requirements of affected commercial watercraft companies. ***(HB 350)***

School Tax Recall—(Applies to orders, ordinances, resolutions or motions passed after July 15, 2005.) A school tax recall petition in a district in a consolidated local government must include 5 percent of registered and qualified voters voting in the last presidential election. Each sheet must include names of voters from one precinct and an invalid signature shall not disqualify the entire page but result in striking the invalid signature only. ***(SB 13)***

Airport Authorities—KRS 382.135 now exempts deeds conveying real property to airport authorities from certain filing requirements. ***(SB 111)***

Environmental Remediation (Brownfields) Incentive— (Applies to tax years beginning on or after Jan. 1, 2005.) This bill reduces the real property tax rate to 0.015 cents per $100 of value for approved properties for three years. ***(HB 272)***

Sales and Use Tax

Donated Goods—(Effective Aug. 1, 2005.) A sales tax refund equal to 25 percent (up to $1 million) of the tax collected on sales of donated goods by resident nonprofit educational, charitable or religious institutions is available if the entity uses the refund exclusively as reimbursement for capital construction costs of additional retail locations in this state. ***(HB 267)***

Repair and Replacement Parts for Charter Buses— (Effective Aug. 1, 2005.) Repair and replacement parts for directly operating and maintaining a charter bus certified by the Transportation Cabinet are exempt. ***(HB 267)***

Vendor Compensation—(For tax periods after June 30, 2005.) The compensation a taxpayer may receive for collecting and remitting sales and use tax is limited to $1,500 per month. ***(HB 267)***

Commercial Printers or Mailers—(Effective July 1, 2005.) Commercial printers or mailers engaged in business in this state are not required to collect use tax on sales of printing or direct mail advertising materials that are both printed out of state and delivered out of state to the postal service for mass mailing to third-party Kentucky residents who do not purchase the advertising materials. ***(HB 267)***

Natural Gas—(Effective June 1, 2005.) The sales and use tax is levied upon distributing, transmitting or transporting natural gas for storage, use or other consumption in this state, excluding natural gas classified for residential use or to a seller or reseller of natural gas. Charges for related distribution, transmission and transportation for energy that is billed to the user will be included in the cost of production when calculating the 3 percent cost of production for energy direct pay. ***(HB 267)***

Water Withdrawal Fees—(Effective July 1, 2005.) The DOR may not subject water withdrawal fees imposed by the Kentucky River Authority to state and local taxes. ***(HB 267)***

Breeder Incentives—(Effective June 1, 2005.) Sales tax receipts from stud fees for breeding of horses in this state are earmarked for use in creating breeder incentives. The sales tax will be deposited into special funds for future disbursement by the Kentucky Horse Racing Authority. ***(HB 272)***

Nexus—(Effective Aug. 1, 2005.) The sales tax nexus standard will broaden to include remote sellers that use in-state affiliates to facilitate remote sales. This change specifically addresses remote sellers (mail-order and Internet) that allow returns to be made to an affiliated store or location within Kentucky. ***(HB 272)***

Study—(Findings to be reported Dec. 1, 2006.) Legislative Research Commission will study the effectiveness of sales tax exemptions. ***(HB 272)***

Streamlined Sales Tax Agreement—(Effective July 1, 2005.) Various sections of KRS Chapter 139 are amended to conform to the Streamlined Sales and Use Tax Agreement. The bill also amends KRS 139.472 to exempt mobility enhancing equipment from sales and use tax. ***(HB 495)***

County Fair Admissions—The first $50,000 in county fair admissions are exempt from sales and use tax. ***(HB 497)***

Telephones/Pay Phones (See Telecommunications Services)—(Effective Jan. 1, 2006.) Switch access and pay phone receipts are no longer subject to sales tax. ***(HB 272)***

Telecommunications Services

Excise Tax—(Effective Jan. 1, 2006.) An excise tax of 3 percent is imposed on multichannel video and audio programming services. Telephone services remain subject to the sales and use tax at a rate of 6 percent. Local governments will receive a guaranteed, fixed amount to replace the franchise fees and unit valuation property taxes that they will no longer receive. ***(HB 272)***

Gross Revenues Tax—(Effective Jan. 1, 2006.) An internal gross revenues tax is levied against telephone providers at a rate of 1.3 percent of gross revenues and against multichannel video and audio programming providers at a rate of 2.4 percent of gross revenues. ***(HB 272)***

Tobacco Taxes

Cigarettes—(Effective June 1, 2005.) A 26-cent per pack surtax is added to the existing excise tax of 3 cents per pack. Vendor compensation remains based on the previous, rather than the increased amount, except that an additional allowance for six months will follow the imposition of the surtax. ***(HB 272)***

NOTE: An additional 1-cent cigarette tax levy is in ***HB 267***, the budget bill, which will be deposited in a special fund to be matched by the University of Kentucky and the University of Louisville, to be used for cancer research.

Inventory Floor Tax—(Encompasses products on the shelf and in facilities on May 31, 2005.) An inventory floor tax is imposed on cigarettes and allows for payment of the tax in three equal installments over a three-month period. ***(HB 272)***

Other Tobacco Products—(Effective Aug. 1, 2005.) A 7.5 percent gross receipts tax is imposed on other tobacco products of any wholesaler derived from wholesale sales of other tobacco products, except snuff, made within the commonwealth and 0.095 cents per unit of snuff. ***(HB 272)***

Cigarette Compensation—(Effective June 1, 2005 to Nov. 30, 2005.) Additional compensation, for a limited time, equal to 12 cents face value for each $3 of tax evidence purchased at face value on or after June 1, 2005 and before Dec. 1, 2005 is allowed. The additional compensation shall sunset at midnight, Nov. 30, 2005. The qualifying compensation is limited to 150 percent of the amount of stamps purchased for the period of Dec. 1, 2004 and ending before May 31, 2005. ***(HB 272)***

Tobacco Research Trust Fund—The tobacco research trust fund will receive at least $3.14 million regardless of whether the half-cent cigarette tax levy produces that amount. ***(HB 497)***

Tourism

Transient Room Tax—(Effective June 1, 2005.) A 1 percent state transient room tax on all room charges statewide in addition to the current 6 percent sales tax is created. Funds generated from the tax are deposited in a new fund separate from the General Fund. Language in the bill delineates the use of funds generated by this tax. ***(HB 272)***

State or National Parks—Enhanced tourism development credits are available for facilities in state or national parks. ***(HB 497)***

Boxing and Wrestling—The gross receipts tax on broadcast, television or motion picture rights for boxing and wrestling matches is repealed. ***(HB 272)***

Utility Gross Receipts License Tax

Utility Gross Receipts License Tax—(Effective July 1, 2005.) New language adds direct broadcast satellite and wireless cable service to the tax base for school districts that impose the tax on cable services on or after July 1, 2005. ***(HB 272)***

Excise Tax Changes Legislation Affecting Cigarette Retailers (HB 272)

A new section of KRS Chapter 138.130 to 138.205 is created to require that every retailer or cigarette licensee with cigarette inventories shall take a physical inventory of all cigarette packages bearing Kentucky tax stamps and all unaffixed cigarette tax stamps possessed by them or in their control at 11:59 p.m. on May 31, 2005, and pay a one-time inventory floor tax at the rate of 27 cents per pack of 20 cigarettes (proportionate rate for packs of 25). Vendors may establish the inventory of cigarettes in vending machines by: (1) taking an actual physical inventory; (2) estimating the cigarettes in vending machines by reporting one-half of the normal fill capacity of the machines as reflected in individual inventory records maintained for vending machines; or (3) using a combination of these two methods.

Form 73A421, Cigarette Inventory Floor Tax, will be mailed. The return with payment must be filed with the DOR on or before June 10, 2005. (Taxpayers have the option to remit payment in three equal monthly installments beginning with the June 10 payment.) **This legislation does not affect the sales and use tax return, but applies to any retailer or cigarette licensee with cigarette inventories.**

Legislation Affecting Hotels, Motels and Other Lodging Businesses (HB 272)

A new section of KRS Chapter 142 creates a transient room tax (lodging tax) imposed at the rate of 1 percent of the rent on every occupancy of any suite, room, rooms or cabins charged by all persons, companies, corporations, groups or organizations doing business as motor courts, motels, hotels, inns, tourist camps or like or similar accommodations businesses. Receipts from this tax will be deposited into the Tourism, Meeting and Convention Marketing Fund administered by the Commerce Cabinet. Retailers operating as motor courts, motels, hotels, inns, tourist camps or similar accommodations businesses will be contacted separately with filing requirements and instructions. The transient room tax is in addition to the current 6 percent sales tax and any locally assessed transient room tax and will be reported separately each month on Form 73A850, Transient Room Tax Monthly Return. **For the purposes of state sales tax calculations, the 1 percent transient room tax should be reported as part of taxable receipts just as the locally assessed transient room tax is currently reported.**

Legal Issues

Office of Legal Services for Revenue (OLS)

OLS (formerly the Division of Legal Services of the Revenue Cabinet) represents DOR in judicial actions and in administrative proceedings before such tribunals as the Kentucky Board of Tax Appeals(KBTA) and Board of Claims. Its representation of DOR extends to all levels of the state and federal court systems.

OLS performs a wide range of other services and functions, which include: rendering advice and written legal opinions to DOR personnel and other government personnel and officials, as well as taxpayers; reviewing and drafting proposed statutes and regulations; analyzing tax laws and assisting with and advising on their implementation and administration; assisting with the preparation of DOR informational publications; handling open records and disclosure matters; and providing assistance and advice in connection with audits, protest conferences, and other stages of the enforcement and administration of the tax laws. OLS is not responsible for personnel, bankruptcy, collection and criminal matters, which are handled elsewhere in DOR or the Finance and Administration Cabinet.

During this past year, OLS has continued to handle a substantial caseload presenting a variety of legal issues affecting DOR and requiring work at all levels of the court system and administrative appeals process. The cases it handles frequently have a substantial potential fiscal impact or significant precedential value.

Legal Developments and Court Decisions

The Office of Legal Services for Revenue ("OLS") represents DOR in all cases and appeals other than personnel, bankruptcy, collection, and criminal cases. In fulfilling this role, the Division's attorneys appear on behalf of DOR before the Kentucky Board of Tax Appeals (KBTA) and Board of Claims and at all levels of the state and federal court systems. This representation of DOR embraces the handling of all phases of the litigation process, including discovery, trials, oral argument, motion practice, briefing, hearings, and appeals.

During this past year, OLS again handled a number of cases having significant fiscal impact or precedential value. These cases presented a wide range of issues and involved a number of the taxes administered by DOR. OLS continues to experience an increase in both the complexity of the issues and amounts of money at stake in the cases it handles.
The cases handled by the OLS address issues, or have resulted in precedents, of significant importance and interest to taxpayers and the commonwealth. A number of these cases are discussed below.

King Drugs, Inc. v. Revenue Cabinet, Kentucky Supreme Court

On Sept. 2, 2005, the Kentucky Court of Appeals ruled in DOR's favor in this case involving the sales and use tax exemption provided in KRS 139.472 for prosthetic devices and physical aids. The taxpayer contended that the exemption applied to any artificial device prescribed by a licensed physician.

The Court of Appeals' Sept. 2, 2005 opinion rejected the taxpayer's interpretation. Considering KRS 139.472's history, the Court concluded that the addition of the words "prescribed by a licensed physician" by the Kentucky General Assembly in 1986 "evidence[d] a legislative intent to exempt the types of devices enumerated in the original version ('artificial devices…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' and 'artificial limbs, artificial eyes, hearing aids…for the use of a particular disabled person'), whether such devices were prescribed, or, without a prescription, if individually designed, constructed, or altered." The Court accordingly held that for the exemption claimed by the taxpayer to apply, an artificial device prescribed by a licensed physician must be "for the use of a crippled person so as to become a brace, support, supplement, correction, or substitute for the bodily structure including the extremities of the individual."

This decision is not yet final. The Supreme Court has granted the taxpayer's motion for discretionary review.

Revenue Cabinet v. GTE South, Inc., 2004-SC-00519 and 2005-SC-00223 Kentucky Supreme Court

On April 2, 2004, the Court of Appeals held that a sales and use tax assessment had not been issued in a timely manner in accordance with KRS 139.620. DOR had sent the taxpayer two documents concerning the assessment: (1) an assessment letter setting forth the basis and amount of the assessment and including as enclosures an auditor's narrative report with supporting schedules; and (2) formal notices of tax due stating the amounts of taxes, penalties and interest due.

The Court of Appeals ruled that the assessment letter was issued in a timely manner. The KBTA's decision to the contrary was not supported by substantial evidence. The timeliness of the assessment letter, however, did not result in compliance with KRS 139.620, the Court of Appeals concluded. Instead, the Court ruled that to pass muster under KRS 139.620(1), the notification of an assessment must contain all of the information specified in KRS 131.081(8). The assessment letter did not include the amounts of the penalties and interest due and thus did not satisfy KRS 131.081(8). The notices of tax due did state these amounts, but these notices were mailed beyond the four year deadline prescribed by KRS 139.620(1).

Nevertheless, the Court of Appeals ruled that the taxpayer was not necessarily entitled to the refund it sought for the period for which the assessment had been made. Under KRS 134.580, the taxpayer was entitled to a refund only if it could establish that it overpaid its taxes for the period in question. The Court of Appeals held that even though the assessment in question was barred by KRS 139.620(1), DOR still had the right to retain payments of tax already received for the period in question to the extent those payments did not exceed the amount that might have been properly assessed and collected. In other words, the fact of the underpayment represented by the time-barred assessment could nevertheless be used by DOR to establish that there was no overpayment for the period in question and thus no entitlement to a refund.

DOR's motion for discretionary review of the Court of Appeals' opinion was granted on March 9, 2005. On May 11, 2005, the Supreme Court granted the taxpayer's cross motion for discretionary of that facet of the Court of Appeals' opinion adverse to it. Therefore, the decision of the Court of Appeals in this case is not final.

Rudolph v. Johnson Controls, Inc., 2006-SC-00416, Kentucky Supreme Court

At issue in this corporation income tax case is the constitutionality of a 2000 amendment to KRS 141.200 (HB 541), which provided that [n]o claim for refund of a tax overpayment for any taxable year ending on or before Dec. 31, 1995, made by an amended return or any other method after Dec. 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return, shall be effective or recognized for any purpose.

KRS 141.200(9). A similar provision was contained in KRS 141.200(10). The taxpayers challenging these provisions in this case had filed amended returns seeking refunds under the unitary business concept after Dec. er 22, 1994.

The Court of Appeals rejected the taxpayers' contentions that the statutory provisions in question amounted to special legislation in violation of Ky. Const. § 59, contravened the separation of powers sections of the Kentucky Constitution (§§ 27 and 28) and denied them equal protection of the laws under the Kentucky and United States Constitutions. The Court did agree with the taxpayers that the 2000 amendment (HB 541) deprived them of due process of law under the Fourteenth Amendment to the United States Constitution, holding that "the period of retroactivity contained in HB 541 is so lengthy as to constitute a due process violation."

This decision is not yet final. The DOR has filed a motion for discretionary review with the Kentucky Supreme Court.

Department of Revenue v. Davis, 2006-SC-00105, Kentucky Supreme Court

The plaintiffs in this case challenge on Commerce Clause grounds Kentucky's income taxation of interest income from government bonds. In particular, Kentucky exempts from taxation the income from bonds and obligations issued by the commonwealth and its political subdivisions while taxing interest income from bonds issued by other states and their political subdivisions. The plaintiffs contend that this discriminates against interstate commerce in violation of the U.S. Constitution's Commerce Clause. They also assert that this violates the U.S. Constitution's Equal Protection Clause.

On Jan. 6, 2006, the Kentucky Court of Appeals ruled that Kentucky's taxation of the income of government bonds violated the Commerce Clause of the United States Constitution.

On Aug. 17, 2006, the Kentucky Supreme Court denied DOR's motion for discretionary review of the Court of Appeals' decision. The decision is not yet final, however, as DOR is in the process of seeking review by the United States Supreme Court.

Finance and Administration Cabinet v. Beyer, 193 S.W.3d 755 (Ky. App. 2006)

On March 10, 2006, the Kentucky Court of Appeals ruled in favor of the DOR in this motor vehicle usage tax case that had originated by an action for a refund filed in the McCracken District Court pursuant to KRS 138.500.

The taxpayers had purchased a new motor vehicle and paid based upon the vehicle's retail price, which included the trade-in allowance, as provided in KRS 138.450(12)(a). Had the taxpayer purchased a used motor vehicle, KRS 138.450(12)(f) would have excluded *any amount allowed as a trade-in allowance by the seller* from the retail price. The taxpayers contended that this difference in treatment between used and new motor vehicles violated the Equal Protection Clause of the United States Constitution and Section 2 of the Kentucky Constitution.

Reversing rulings of the McCracken District Court and Circuit Court, the Court of Appeals held that no constitutional violation was presented by this case. To survive the taxpayers' constitutional challenge, the distinction made by the motor vehicle usage tax law must be rationally related to a legitimate state interest. This standard is satisfied so long as there is a plausible policy reason for the classification. The Court of Appeals' decision stated that the distinction made by the motor vehicle usage tax law between used and new motor vehicles "rationally further[ed]the goal of stimulating the used car industry" by making *the purchase of a used motor vehicle more economically attractive*.

Griffin Industries, Inc. v. Revenue Cabinet, 2004-CA-001812, Kentucky Court of Appeals

Two issues were before the Court of Appeals in this sales and use tax case. The first was whether the taxpayer's purchases of machinery qualified for the recycling exemption of KRS 139.480(23). The second issue was whether the taxpayer's purchase of repair and replacement parts for this machinery qualified for the recycling exemption.

In a decision rendered on March 10, 2006, the Court of Appeals ruled for DOR on the second issue, but against DOR on the first.

The taxpayer operated two rendering plants in Kentucky. At these plants, the taxpayer would take animal waste (e.g., body parts, collected from poultry processing plants, slaughterhouses, meat packing plants and grocery stores) and bakery waste (e.g., dough, crackers and bread) and process them into *marketable products*. The Court held that the taxpayer's activities fell within the definition of *recycling* contained in KRS 139.095 and thus its purchases of machinery for use in those activities were exempt under KRS 139.480(23).

The Court of Appeals concluded that the taxpayer's purchases of repair and replacement parts for this machinery were not exempt under KRS 139.480(23). The Court reasoned that "[s]ince the General Assembly expressly included repair and replacement parts in only ten of thirty-one subsections [of KRS 139.480] but did not mention exclusion of said parts in any subsection, the inclusion of repair and replacement parts was the exception not the rule" and consequently "[h]ad the General Assembly meant to extend the recycling exemption to repair and replacement parts it would have expressly done so."

This decision is now final.

Conseco Finance Corporation and Wells Fargo Financial Corporation v. Revenue Cabinet, 2005-SC-001011, Kentucky Supreme Court

Conseco Finance Corporation and Wells Fargo Financial Kentucky, Inc., the appellants, financed consumer purchases of tangible personal property such as manufactured homes, boats, motorcycles, and recreational vehicles. The purchases were made pursuant to retail installment contracts with Kentucky retailers. The consumer would apply to the taxpayers for financing. For those consumers whose credit was acceptable, the appellants would remit the contract price, including the amount of sales tax due, to the retailer, who would remit the tax to the DOR. The retailer would in turn assign its rights under the installment contracts so financed to the appellants.

On occasion, a consumer would default on the retail installment contract. The appellants would attempt to recover the balances due through various means, but these efforts would not always be successful and the appellants would determine these amounts to be worthless and charge them off for income tax purposes. The appellants in turn claimed sales and use tax deductions pursuant to KRS 139.350 for these worthless accounts and these deductions formed the basis for the taxpayers' refund claims.

Legal Issues

In an opinion rendered on Nov. 23, 2005, the Kentucky Court of Appeals ruled that the appellants were not entitled to take the bad debt deduction of KRS 139.350. The bad debt deduction was allowed only to a retailer who "ha[d] previously paid the amount of tax." The appellants did not pay the sales taxes due on the transactions in question to the commonwealth and thus did not qualify.

This decision is now final. The appellants' motion for discretionary review has been denied by the Kentucky Supreme Court.

ADMINISTRATIVE COSTS
FISCAL YEAR 2005-2006

	General Fund	Road Fund	Agency Fund	Tobacco Settlement Fund	Total
Regular Salaries and Wages	$28,897,854	$ 1,279,283	$ 2,333,379		$ 32,510,516
Seasonal Salaries and Wages	$ 806,470				$ 806,470
Overtime/Block 50's	$ 334,464		$ 7,362		$ 341,826
Fringe Benefits	$ 8,445,630	$ 138,229	$ 336,303		$ 8,920,162
Workers' Compensation	$ 188,735				$ 188,735
Unemployment Compensation	$ 59,792				$ 59,792
Employee Training and Tuition Assistance	$ 75,331		$ 2,126		$ 77,457
Bonds	$ 343				$ 343
Legal/Auditing Services	$ 252,198				$ 252,198
Advertising/Misc. Services	$ 571				$ 571
Security	$ 108,330				$ 108,330
Janitorial	$ 272,871				$ 272,871
Temporary Services	$ 456,412				$ 456,412
Total Personnel	**$39,899,001**	**$ 1,417,513**	**$ 2,679,170**	**$ —**	**$ 43,995,684**
Utilities	$ 288,714				$ 288,714
Rent/Rentals	$ 2,867,957		$ 2,918		$ 2,870,875
Carpool (State Motor Pool)	$ 14,100		$ 18,472		$ 32,572
Maintenance & Repairs	$ 862,720				$ 862,720
Postage	$ 2,123,833				$ 2,123,833
Printing	$ 1,030,052		$ 34,581	$ 163,100	$ 1,227,734
Insurance	$ 13,106				$ 13,106
Miscellaneous Services	$ 52,863		$ 11,504		$ 64,367
Technology Services & Equipment	$12,446,632		$ 929,681		$ 13,376,313
Office Supplies	$ 308,404		$ 3,020		$ 311,423
Computer Equipment	$ 906				$ 906
Furniture	$ 46,490		$ 1,299		$ 47,789
Banking Services	$ 199,899		$ 11,865		$ 210,763
Storage Fees	$ 11,611				$ 11,611
Travel	$ 847,514		$ 59,270		$ 906,784
Filing/Lien/Collection Fees	$ (50,388)		$ 283,920		$ 233,532
Dues/Subscription Services	$ 369,561		$ 9,910		$ 379,471
Total Operating	**$21,432,972**	**$ —**	**$ 1,366,440**	**$ 163,100**	**$ 22,962,513**
Education Assistance			$ 867		$ 867
Total Grants, Loans, and Benefits	**$ —**	**$ —**	**$ 867**	**$ —**	**$ 867**
Motor Vehicles			$ 175,865		$ 175,865
Total Capital	**$ —**	**$ —**	**$ 175,865**	**$ —**	**$ 175,865**
Total Administrative Expenditures	**$61,331,973**	**$ 1,417,513**	**$ 4,222,342**	**$ 163,100**	**$ 67,134,928**

DOR Offices, Divisions and Their Duties

The DOR is the state agency that administers the tax laws of the commonwealth and bills and collects the tax revenue necessary to support state services.

Disclosure Branch

The Disclosure Branch is the liaison between the DOR and the Internal Revenue Service, and other agencies of federal, local and state government. The branch administers the provisions of KRS 131.190 to ensure the confidentiality of taxpayer information and protect against unauthorized use or release. Additionally, this branch is responsible for granting electronic security access to DOR information systems and physical access to DOR facilities.

Division of Legislative Services

The Division of Legislative Services provides technical support and research assistance; performs studies, surveys and research projects to assist in policy-making decisions; coordinates development and drafts proposed tax legislation and regulations; coordinates review of tax legislation; and testifies before legislative committees on tax matters.

Office of Processing and Enforcement

The Office of Processing and Enforcement is responsible for promoting the enterprise services available to the commonwealth related to document processing, depositing of funds and collecting debt. Additionally, the office is responsible for coordinating, planning and implementing a data integrity strategy. The office consists of the following three divisions:

> The **Division of Operations** is responsible for opening all incoming tax returns, preparing the returns for data capture, coordinating the data capture process, depositing receipts and maintaining the tax data. Additionally, the division assists other agencies with similar operational aspects as negotiated with that agency.
>
> The **Division of Collections** is responsible for enforced collection activities related to tax and other debts owed to the commonwealth. The division also collects delinquent child support referred by the Cabinet for Families and Children.
>
> The **Division of Registration and Data Integrity** is responsible for registering taxpayers and ensuring that the data entered into the tax systems is accurate and complete. The Registration Branch processes all business tax applications and assists registrants as needed. This branch also ensures that all taxpayers, who may have overlooked their tax registration obligations, are contacted and brought into compliance. The Program Improvement Branch is responsible for maintaining data integrity for DOR processes and prepares requested reports and statistics for both DOR personnel, cabinet personnel, and any legislative inquiries. Both branches assist the taxing areas in proper procedures to make sure that data remains accurate over time.

Office of Taxpayer Ombudsman

The Office of Taxpayer Ombudsman is responsible for carrying out the spirit and specific purposes of the Taxpayer Bill of Rights, including: coordinating the resolution of taxpayer complaints and problems; providing recommendations for new or revised informational publications and taxpayer and department employee education programs; and providing recommendations for simplification or other improvements needed in tax laws, regulations, forms, systems and procedures to promote better understanding and voluntary compliance by taxpayers.

Office of Property Valuation

The Office of Property Valuation is responsible for administering all matters related to property and severance taxes. This includes technical tax research, compliance, taxpayer assistance, tax specific training, public announcements, publications, forms and any other matter related to those taxes. The office consists of the following divisions:

> The **Division of State Valuation** is responsible for administering all centrally assessed taxes including public service property tax, motor vehicle property tax and the tangible/intangible program.
>
> The **Division of Local Valuation** is responsible for overseeing the real property tax assessment and collection process throughout the state in the 120 PVA and sheriffs' offices.

The **Division of Minerals Taxation and GIS Services** is responsible for administering the taxes related to severance tax and the unmined minerals property tax. It also coordinates the DOR's GIS mapping efforts. It contains three branches: mineral resource valuation; mineral assessment compliance; and cartography/GIS.

Office of Sales and Excise Taxes

The Office of Sales and Excise Taxes is responsible for administering all matters related to sales and use tax and the miscellaneous excise taxes. This includes technical tax research, compliance, taxpayer assistance, tax specific training, public announcements, publications, forms and any other matter related to those taxes. It includes the divisions of Sales and Use Tax and Miscellaneous Taxes.

The **Division of Sales and Use Tax** is responsible for administering the sales and use tax and telecommunications excise and gross revenue taxes. It has two branches: Program Compliance and Taxpayer Assistance. The branches are responsible for conducting office audits, administering various exemption programs, initiating compliance activities, assisting taxpayers and discovery of nonfiler populations.

The **Division of Miscellaneous Taxes** is responsible for administering the following taxes: alcoholic beverage taxes; cigarette enforcement fee, license, excise tax and surtax; gasoline tax; health care provider tax; inheritance and estate tax; insurance premiums and insurance surcharge taxes; state bank franchise tax; legal process; marijuana and controlled substance; motor vehicle tire fee; motor vehicle usage taxes; PSC annual assessment; pari-mutuel excise, racing license and admissions taxes; RECC and RTCC; special fuels taxes; other tobacco products and snuff taxes; transient room tax; utility gross receipts tax and underground storage fee. It consists of two branches: Road Fund Branch and Miscellaneous Tax Branch.

Office of Income Taxation

The Office of Income Taxation is responsible for administering all matters related to the individual income, withholding, corporation income and corporation license taxes, including technical tax research, compliance, taxpayer assistance, tax specific training, public announcements, publications, forms and any other matter related to those taxes. It consists of the following divisions:

The **Division of Individual Income Tax** is responsible for administering the taxes for returns filed by the following taxpayers: individual income, fiduciary, employer withholding, pass-through entity withholding and partnership. It consists of two branches: Individual Income Tax Branch and Withholding Tax Branch.

The **Division of Corporation Tax** is responsible for administering the following taxes and programs: corporation income tax; corporation license tax; pass-through entity withholding; and partnerships. It consists of two branches: Corporation Income and License Tax Branch; and Pass-Through Entity Branch.

Office of Field Operations

The Office of Field Operations is responsible for managing the regional taxpayer service centers and field audit program.

The **Audit Support and Training Branch** is responsible for supporting the work of DOR field auditors and compliance officers throughout the commonwealth, including the support related to computer-assisted audits, audit selection and training.

The 10 regional offices are geographically divided among three regional managers to oversee the field operations of the commonwealth. Region 1 consists of Ashland, Northern Kentucky and Pikeville Taxpayer Service Centers. Region 2 consists of Louisville, Corbin and Bowling Green Taxpayer Service Centers; and the Audit Selection Section. Region 3 consists of Hopkinsville, Central Kentucky, Owensboro and Paducah Taxpayer Service Centers.

PVA Offices (Accounting)

This office provides budget, fiscal, personnel and payroll administration for all 120 PVAs and more than 680 deputies throughout the commonwealth. It also coordinates open enrollment for health and life insurance and directs property tax educational KY-Courses. It conducts workshops at summer and fall PVA conferences and meetings.

MANAGEMENT—KENTUCKY DEPARTMENT OF REVENUE
JUNE 30, 2006

Marian Davis
Commissioner

DEPARTMENT of REVENUE

Marian Davis–Commissioner

- **Division of Legislative Services**
  Eddie Mattingly - Director
- **Disclosure Branch**
  Paula Fallis
- **Office of Taxpayer Ombudsman**
  Cathy Freeman
- **Office of Processing & Enforcement**
  Mack Gillim
  Exec Dir.
  - Division of Operations
  - Division of Collections
  - Division of Registration and Data Integrity
- **Office of Property Valuation**
  Marsha McQueary
  Exec Dir.
  - Division of Local Valuation
  - Division of State Valuation
  - Division of Minerals Taxation and GIS Services
- **Office of Sales & Excise Taxes**
  Richard Dobson Exec Dir.
  - Division of Sales and Use Tax
  - Division of Miscellaneous Tax
- **Office of Income Taxation**
  Gary Morris
  Exec Dir.
  - Division of Individual Income Tax
  - Division of Corporation Tax
- **Office of Field Operations**
  Wayne Byrd
  Exec Dir.
  - Region 1
  - Region 2
  - Region 3
  - Audit & Support Training

Taxes Administered (In effect as of June 30, 2006)

Alcoholic Beverage Wholesale Sales Tax (KRS 243.884)
11 percent of wholesale sales of distilled spirits, wine and malt beverages. A wholesale sales tax on alcoholic beverage wholesalers/distributors to be reported monthly. There are statutory exemptions.

Bank Franchise Tax (KRS 136.500 et seq.)
1.1 percent of net capital. Minimum tax is $300 per year. Tax is imposed on every financial institution regularly engaged in business in Kentucky at any time during the calendar year. A financial institution is presumed to be regularly engaged in business in Kentucky if during any taxable year it obtains or solicits business with 20 or more persons within Kentucky, or if receipts attributable to sources in Kentucky equal or exceed $100,000. Tax is in lieu of all city, county and local taxes except for the real estate transfer taxes, real property and tangible personal property taxes upon users of utility services and the local deposit franchise tax.

Beer Consumer Tax (KRS 243.720 et seq.)
$2.50 per barrel of 31 gallons. An excise tax imposed on distributors or retailers of malt beverages who purchase malt beverages directly from a brewer. There are statutory exemptions and credits. There is a 50 percent discount for domestic brewers up to 300,000 barrels per annum.

Cigarette Enforcement and Administration Fee (KRS 365.390)
0.001 cent per pack (rate subject to change annually). Fee paid by cigarette wholesalers and unclassified acquirers to provide for the expenses of the DOR in administering the cigarette tax law.

Cigarette Licenses (KRS 138.195)
Resident wholesaler—$500; Nonresident wholesaler—$500; Subjobber—$500; Vending machine operator—$25; Transporter—$50; Unclassified acquirer—$50. Annual license fee imposed upon various dealers and handlers of cigarettes. More than one license may be required by the DOR for any dealer or handler depending upon the diversity of his business and the number of established places of business.

Cigarette Excise Tax (KRS 138.130 et seq.)
3 cents per 20 cigarettes, proportioned for other quantities. An excise tax on cigarettes paid by resident and nonresident wholesalers and unclassified acquirers. The tax is paid by purchasing stamps within 48 hours after cigarettes are received by a resident wholesaler. The unclassified acquirer pays the tax by purchasing and affixing stamps within 24 hours of receipt of the cigarettes. A nonresident wholesaler must affix the tax stamps prior to importing them into Kentucky.

Cigarette Inventory Floor Stocks Tax (KRS 138.143)
$0.27 per 20 cigarettes. A one-time surtax on cigarette inventory on hand at 11:59 p.m. on May 31, 2005.

Cigarette Paper Tax—(KRS 138.140(6))
Effective June 1, 2006, $0.25 per 32 sheets of cigarette papers or proportionally for units other than 32 sheets. This tax is paid by the wholesaler.

Cigarette Surtax (KRS 138.140)
$0.27 per 20 cigarettes, proportioned for other quantities. A surtax on cigarettes paid concurrently with the cigarette excise tax at the time of stamp purchases. A portion is allocated to cancer research.

Other Tobacco Products Tax—(KRS 138.140(4))
Effective Aug. 1, 2005, 7.5 percent of the gross receipts from the wholesale sale of other tobacco products.

Snuff Tax—(KRS 138.140(5))
Effective Aug. 1, 2005, $0.095 per unit of snuff sold. A unit is defined as a hard container containing no more than 1 1/2 ounce of snuff. This tax is paid by the wholesaler.

Coal Severance Tax (KRS 143.010, 143.020 et seq.)
50 cents per ton minimum or 4.5 percent of gross value. (The minimum tax shall not apply to a taxpayer who only processes coal.) Tax is based on the gross value of coal severed and/or processed in Kentucky. Partial or whole exemptions from the tax may apply to newly permitted production from *thin seams*.

Corporation Tax (KRS 141.010 et seq., 155.170)
For tax years beginning on or after Jan. 1, 2005 and before Jan. 1, 2007, *corporation* means a C corporation, S corporation, Limited Liability Company (LLC), Professional Limited Liability Partnership (PLLP), Limited Partnership (LP), Limited Liability Partnership (LLP), Real Estate Investment Trust (REIT), Regulated Investment Company (RIC), Real Estate Mortgage Investment Conduit (REMIC), Finance Asset Securitization Investment Trust (FASIT), or similar entities created with limited liability for the partners, members, or shareholders. Corporation tax is the greater of the tax computed based on net income; alternative minimum calculation (AMC); or $175. Corporation income tax rates:

first $50,000 of net income—4 percent; next $50,000—5 percent; and all over $100,000—7 percent. The AMC is the lesser of $0.095 per $100 of a corporation's Kentucky gross receipts, or $0.75 per $100 of a corporation's Kentucky gross profits. For tax years beginning on or after Jan. 1, 2006, if gross receipts or gross profits from all sources are $3 million or less, no AMC is due. Also, marginal AMC tax relief is provided if gross receipts or gross profits from all sources are in excess of $3 million, but less than $6 million.

For taxable years ending on or after Dec. 31, 1995, and before Dec. 31, 2005, KRS 141.200 allows an affiliated group to elect to file a consolidated Kentucky income tax return with the election binding for 96 consecutive calendar months. KRS 141.200 prohibits affiliated groups from filing a combined Kentucky corporation income tax return using the unitary business concept.

For tax years beginning on or after Jan. 1, 2005, an affiliated group of corporations must file a nexus consolidated return as provided by KRS 141.200. An affiliated group that elected the 96 month period to file a consolidated return pursuant to Seciton 1502 of the IRC for years ending prior to Dec. 31, 2005, shall file a consolidated return pursuant to Section 1502 of the IRC for a period beginning with the first month of the first taxable year for which the election is made an ending with the conclusion of the taxable year in which the 96 consecutive calendar month expires.

Corporation License Tax (KRS 136.070 et seq.)
Repealed, effective for tax years beginning on or after Jan. 1, 2005.

Distilled Spirits Case Sales Tax (KRS 243.710)
5 cents per case. Excise tax on distilled spirits sold by wholesalers to retailers in Kentucky.

Distilled Spirits and Wine Consumer Taxes (KRS 243.720 et seq.)
Distilled spirits containing over 6 percent alcohol by volume: per gallon—$1.92; per liter—0.5069; distilled spirits containing 6 percent or less alcohol by volume: per gallon—$0.25; per liter—0.0660; wine—per gallon—$0.50; per liter—0.1320.

(Proportionate amount charged on smaller quantities, but not less than 4 cents on any retail container of wine.)

Excise tax imposed upon the use, sale or distribution by sale or gift of distilled spirits and wine. There are statutory exemptions.

Health Care Provider Tax (KRS 142.301 to 142.359)
2.5 percent of gross receipts for hospital services; 2.0 percent of gross receipts for home health agency services; 5.5 percent of gross receipts for Medicaid managed care services, ICF/MR services, and support for community living services; $1.50–$10.75 per non-Medicare patient bed day for nursing facilities services.

Effective July 1, 1993, a provider tax is imposed on providers of taxable medical services. Registration is required prior to the beginning of operations.

Individual Income Tax (KRS 141.010 et seq.)
First $3,000—2 percent; Next $1,000—3 percent; Next $1,000—4 percent; Next $3,000—5 percent; next $67,000—5.8 percent. In excess of $75,000—6 percent.
Graduated tax upon an individual's taxable income. Residents must pay on their entire taxable income. Nonresidents must pay on that portion of their income attributable to Kentucky sources. Fiduciaries must pay on that portion of income of an estate or trust not distributed or distributable to beneficiaries.

Tax base is the federal adjusted gross income adjusted for differences in Kentucky and federal laws, including U.S. government bond interest, limited pension/retirement income exclusion, Social Security benefits and Railroad Retirement Board benefits and deductions for long-term care and health insurance premiums. Taxable income is computed by using the standard deduction or Kentucky itemized deductions. Tax credits include personal credits of $20, child and dependent care, family size and various business credits. Standard deduction: 2005—$1,910 and 2006—$1,970.

Inheritance and Estate Taxes (KRS 140.010 et seq.)
Inheritance tax—4–16 percent; The Kentucky inheritance tax is a tax on the right to receive property upon the death of another person. The rate of tax and the exemptions allowed depend on the legal relationship of the beneficiary to the decedent. If the date of death is after June 30, 1998, the following list of beneficiaries are exempt from paying inheritance tax: (1) Surviving spouse, parent; (2) Child (adult or infant)—child by blood, stepchild, child adopted during infancy, or a child adopted during adulthood who was reared

by the decedent during infancy; (3) Grandchild—issue of child by blood, stepchild, child adopted during infancy, or of a child adopted during adulthood who was reared by decedent during infancy; (4) Brother, sister (whole or half).

Estate tax—an amount by which the state death tax credit allowable under the federal tax law exceeds the inheritance tax.

Insurance Premium Surcharge (KRS 136.392)
1.5 percent of premiums. An insurance premium surcharge on insured Kentucky risks. There are statutory exemptions.

Insurance Premium Taxes (KRS 136.320, 136.330 to 136.390, 299.530, 304.3-270, 304.4-030, 304.11-050, 304.49-220)
All domestic and foreign life companies 1.5 percent tax rate. Annuities are exempt from tax. All other insurance companies 2 percent tax rate. Fire insurance*—0.75 percent.

**Represents additional tax on applicable premiums.*

Annual tax imposed on insurance companies and risk retention groups based upon premium receipts on business done. There are statutory exemptions.

Legal Process Taxes (KRS 142.010 et seq.)
Conveyances of real property (deeds)—$3.00; mortgages, financial statements and security agreements—$3.00; marriage licenses*—$3.50; powers of attorney to convey real or personal property—$3.00; lien or conveyance of coal, oil, gas or other mineral right or privilege—$3.00. Taxes imposed on the filing of an instrument subject to tax or the issuance of a marriage license. Collected by county clerk.

*A $10 Spouse Abuse Shelter Fund fee levied on marriage licenses by KRS 209.160 is, by agreement between the DOR and the Cabinet for Health and Family Services, also reported and paid to the DOR by county clerks as part of the monthly report of legal process taxes due.

Marijuana and Controlled Substance Tax (KRS 138.870 et seq.)
$3.50 per gram on marijuana, loose. $1,000 per marijuana plant. $200 per gram controlled substance by weight. $2,000 per 50 dosage units of controlled substance. Growers, sellers, dealers, buyers and manufacturers must obtain a tax stamp to affix to the product. Commonwealth's or county attorneys who obtain a conviction of, or guilty or Alford plea from an offender must notify the DOR if the product which was the subject of the conviction or plea does not bear the tax stamp.

Motor Fuels Tax—Gasoline (KRS 138.210 et seq.)
9 percent of average wholesale price of gasoline, but not less than 11 cents per gallon. (Effective July 1, 2006, the rate cannot be less than 12.1 cents per gallons.) Rate determined quarterly. A 5 cent per gallon *Supplemental Highway User Motor Fuel Tax* also applies. An excise tax paid by licensed dealers on all gasoline received in this state. There are statutory provisions for tax credits and partial or full tax refunds for designated users.

Motor Fuels Tax—Liquefied Petroleum Gas (KRS 234.310 to 234.440)
Variable rate same as gasoline. The 5 cent per gallon supplemental tax also applies to liquefied petroleum gas. An excise tax paid by licensed dealers on all liquefied petroleum motor fuel withdrawn to propel motor vehicles on the public highways, unless the carburetion system has been approved by the Environmental and Public Protection Cabinet.

Motor Fuels Tax—Petroleum Storage Tank Environmental Assurance Fee (KRS 224.60-145)
1.4 cents per gallon. A petroleum storage tank environmental assurance fee is levied on all taxable gasoline and special fuel reported in this state by licensed dealers. There are provisions for exemptions or refunds for qualifying gasoline or special fuels not to be used on the public highways.

Motor Fuels Tax—Special Fuels (KRS 138.210 et seq.)
Variable rate same as gasoline. A 2 cent per gallon *Supplemental Highway User Motor Fuel Tax* also applies. An excise tax is levied on all special fuels received in this state by licensed dealers. There are statutory provisions for tax credits and partial or full tax refunds for designated users.

Motor Vehicle Tire Fee (KRS 224.50-868)
$1 per tire sold at retail. Applies to the retail sale of new motor vehicle tires sold in Kentucky. Does not apply to new cars brought into the state for sale or use. Sales of recapped tires are exempt from the fee.

Motor Vehicle Usage Tax (KRS 138.450 et seq.)
6 percent of the consideration given or retail value as defined in KRS 138.450. Value is dependent on the type of transaction. Optional tax payment method available for U-Drive-It

operators based on 6 percent of the gross rental or lease charges. Tax imposed on new and used motor vehicles when registered for the first time in this state and when ownership is transferred. There are statutory exemptions and credits. Regular usage tax payments are made to the county clerk and forwarded to the DOR. U-Drive-It usage tax payments are made directly to the Transportation Cabinet on a monthly basis.

Natural Resources Severance and Processing Taxes (Minerals, Natural Gas and Natural Gas Liquids) (KRS 143A.010, 143A.020 et seq.)
4.5 percent of gross value; 12 cents per ton (clay production). Limestone used in the manufacture of cement by an integrated miner and manufacturer of cement shall be limited to 14 cents per ton of limestone mined in Kentucky. Tax of 4.5 percent of the gross value is imposed on every taxpayer engaged in the business of severing and/or processing minerals (including natural gas and natural gas liquids) in Kentucky with the exception of clay. Clay production is taxed at 12 cents per ton. A credit equal to the tax of 12 cents per ton is granted to those taxpayers who sever or process clay sold to and used as a component of landfill construction by an approved waste disposal facility within this state. Also, no tax is imposed on the processing of ball clay.

This tax does not apply to fluorspar, lead, zinc and barite severed for any purposes; or to rock, limestone or gravel used for privately maintained but publicly dedicated roads; or limestone when sold or used by the taxpayer for agricultural purposes so as to qualify for exemption from sales and use tax.

A credit equal to the tax is allowed on the gross value of limestone which is severed or processed within this state and sold to a purchaser outside this state. This credit is extended only to taxpayers who sever or process limestone through the rip-rap construction aggregate of agricultural limestone stages and who sell in interstate commerce not less than 60 percent of such stone. The credit shall not be allowed to a taxpayer who processes the limestone beyond the agricultural limestone stages.

A gas well, which has been plugged and abandoned for a consecutive two-year period that resumes producing, qualifies for the Recovered Inactive Well Tax Credit equal to 4.5 percent of the gross value.

Oil Production Tax (KRS 137.120 et seq.)
4.5 percent of market value of crude petroleum produced in Kentucky. Tax on the production of crude petroleum is attached when the crude petroleum is first transported from the tanks or other receptacle located at the place of production. Transporter of crude petroleum, as agent, pays tax for all persons owning any interest in such oil.

An oil well, which has been plugged and abandoned for a consecutive two-year period that resumes producing, qualifies for the Recovered Inactive Well Tax Credit equal to 4.5 percent of the gross value.

Pass-Through Entities (KRS 141.206(3)(a))
6 percent of total net distributive share income.

Property Taxes

Agricultural Products
In Hands of Producer or Agent **(KRS 132.020(1), 132.200(6))**
1.5 cents (per $100 of assessment). State rate only.

Tobacco Not at Manufacturer's Plant (Storage)
(KRS 132.020(1), 132.200(6))
1.5 cents (per $100 of assessment). Also subject to county and city rates.

Other Agricultural Products Not at Manufacturer's Plant (Storage) **(KRS 132.020(1), 132.200(6))**
1.5 cents (per $100 of assessment). Also subject to county and city rates.

Aircraft
Not Used in the Business of Transporting Person or Property for Compensation or Hire **(KRS 132.020(12), 132.200(19))**
1.5 cents (per $100 of assessment). Local option.
For Hire Non-Public Service Company **(KRS 132.020(1))**
45 cents (per $100 of assessment). Subject to full local rates.

Annuities or Rights to Receive Income (KRS 132.215(2))
Repealed, effective Jan. 1, 2006.

Bank Deposits—Domestic and Out-of-State (KRS 132.030(1))
0.1 cent (per $100 of assessment). Tax is based on deposits as of Jan. 1 and is paid by the institution on behalf of the depositors. State rate only.

Taxes Administered (In effect as of June 30, 2006)

Brokers' Accounts Receivable (Also see **Margin Accounts) (KRS 132.050)**
Repealed, effective Jan. 1, 2006

Car Lines—Private (KRS 136.115–136.180)
Subject to annual adjustment. Local tax collected and distributed by the DOR.

Distilled Spirits (KRS 132.020(10), 130.180)
5 cents (per $100 of assessment). Subject to full local rates.

Farm Machinery Used in Farming (KRS 132.020(1), 132.200(1))
0.1 cent (per $100 of assessment). State rate only.

Goods Held for Sale in the Regular Course of Business (KRS 132.020(10))
5 cents (per $100 of assessment). Subject to local rates.

Intangible Property of Banks (KRS 132.020(2))
Repealed, effective Jan. 1, 2006.

Leasehold Interest (KRS 132.020(1))
Privately owned leasehold interest in industrial buildings. 1.5 cents (per $100 of assessment). State rate only.

Life Insurance Companies
(Domestic) Capital Reserves **(KRS 136.320)**
0.1 cent (per $100 of assessment). State rate only.

Livestock and Poultry (KRS 132.020(1))
0.1 cent (per $100 of assessment). State rate only.

Local Government Franchise Taxes on Bank Deposits (KRS 136.575)
No state rate. Tax due the following Jan. 31. Based on June 30 deposits. Tax is imposed on financial institutions measured by deposits in the institutions located within the jurisdiction of the county, city or urban county government at a rate not to exceed 0.025 percent of the deposits if imposed by counties and cities and at a rate not to exceed 0.050 percent of the deposits imposed by urban county governments.

Manufacturing Machinery (KRS 132.020(1), 132.200(4))
15 cents (per $100 of assessment). State rate only.

Mobile Homes—Real Property (KRS 132.751)
Subject to annual adjustment. Taxed at real estate rate. Subject to full local rates.

Motor Vehicles (KRS 132.487)
45 cents (per $100 of assessment). Full local rates. Collected upon registration.

Historic Motor Vehicles (KRS 132.020)
25 cents (per $100 of assessment). State rate only.

Pollution Control Facilities (KRS 132.020(1), 132.200(9))
15 cents (per $100 of assessment). State rate only.

Public Warehouses
Goods held for sale except goods in transit.
(KRS 132.020(10))
5 cents (per $100 of assessment). Full local rates.

Goods in transit to an out-of-state destination within six months. **(KRS 132.097, KRS 132.099)**
Exempt. Special taxing districts only.

Radio, Television and Telephonic Equipment (KRS 132.020(1), 132.200(5))
15 cents (per $100 of assessment). State rate only.

Railroads—Intrastate (KRS 132.020(11), 136.115–136.118)
10 cents (per $100 of assessment both real and tangible). Multiplier applied to local rates and subject to annual adjustment.

Raw Materials and Products in Course of Manufacture (KRS 132.020(10), 132.200(4))
5 cents (per $100 of assessment). State rate only.

Real Estate Not Elsewhere Specified (KRS 132.020(1))
Adjusted annually (by July 1) per KRS 132.020(8). The state real estate rate was 13.5 cents (per $100 assessment) for 2002, 13.3 cents for 2003, 13.1 cents for 2004 and 2005 and 12.8 cents for 2006. Full local rates.

Recreational Vehicles (KRS 132.485(1), 132.730, 132.751)
Classification depends on permanency of location. 45 cents (per $100 of assessment). Subject to full local rates.

Recycling Machinery (KRS 132.020(1), 132.200(16))
45 cents (per $100 of assessment). State rate only.

Savings and Loan Associations—Domestic (KRS 136.290, 136.300(1), 136.310(1))
10 cents (per $100 of assessment). State rate only.

Tangible Property Not Elsewhere Specified (KRS 132.020(1))
45 cents (per $100 of assessment). Full local rates.

Taxes Administered (In effect as of June 30, 2006)

Trucks, Tractors, Trailers, Semi-Trailers and Buses—Interstate (KRS 136.1873)
Subject to annual adjustment. Local tax collected and distributed by the DOR.

Unmined Coal, Oil and Gas Reserves and Other Mineral or Energy Resources Held Separately from Surface Real Property (KRS 132.820)
Adjusted annually (by July 1) per KRS 132.020(8). The state real estate rate was 12.8 for 2006, 13.1 cents for 2005, 13.1 cents for 2004, 13.3 cents for 2003 (per $100 assessment). Full local rates.

Watercraft
Commercial **(KRS 136.181)**
45 cents (per $100 of assessment). Full local rates.

Individual **(KRS 132.020(1), 132.020(13), 132.488)**
45 cents (per $100 of assessment). Full local rates.

Federally Documented **(KRS 132.200(20))**
1.5 cents (per $100 of assessment). Local option.

Public Service Commission Assessment (KRS 278.130 et seq.)
1.670 mills (subject to change annually up to 2 mills). Maximum assessment—2.0 mills; Minimum assessment—$50. Assessment imposed annually on utility companies under the jurisdiction of the Public Service Commission based on proportionate share of gross intrastate revenues by each company.

Public Service Company Property Taxes (KRS 136.115 et seq., 136.180)
Property of public service corporations taxed at the same rate as property owned by any individual or corporation (see rates under **Property Taxes**).

Racing Taxes

Average Daily Mutuel Handle (for preceding year)	Tax Rate Per Day
$ 0 —$ 25,000	$ 0
25,001 — 250,000	175
250,001 — 450,000	500
450,001 — 700,000	1,000
700,001 — 800,000	1,500
800,001 — 900,000	2,000
900,001 and above	2,500

License Tax (KRS 137.170 et seq.)
License tax imposed upon the operation of a track at which horse races are run under the jurisdiction of the Kentucky Horse Racing Authority. Reported and paid within 30 days of end of each race meeting. An annual recapitulation report is due on or before Dec. 31 each year for the race year ended Nov. 30.

Admission Tax (KRS 138.480 et seq., 139.100(2)(c))
Tracks under jurisdiction of the Kentucky Horse Racing Authority—15 cents/person. Excise tax on each paid admission to race track. There are statutory exemptions. Reported and paid within 30 days of end of each race meeting. Race track admission tax is in lieu of sales tax.

Pari-Mutuel Tax (KRS 138.510 et seq.)
3.5 percent of total wagered at all thoroughbred tracks under Kentucky Horse Racing Authority jurisdiction with average daily handle of $1.2 million or more; 1.5 percent if average daily handle is less than $1.2 million.

3.75 percent of total wagered at all standardbred tracks under Kentucky Horse Racing Authority jurisdiction with average daily handle of $1.2 million or more; 1.75 percent if average daily handle is less than $1.2 million.

3 percent of telephone account wagering and the total wagered at *receiving* tracks.
Excise tax is imposed on every person, corporation or association that operates a horse race track at which betting is conducted.

Excise tax is also imposed on receiving tracks participating in intertrack wagering on simulcast races.

Average daily handle is computed from the amount wagered at the **host** track, excluding money wagered at receiving tracks and all **telephone account** wagering.

A portion of the pari-mutuel tax is allocated to the following:
- Equine Drug Research;
- Equine Industry Program;
- Higher Education Equine Trust and Revolving Fund;
- Thoroughbred Development Fund; and
- Standardbred, Quarterhorse, Appaloosa and Arabian Development Fund

Reported and paid weekly.

Taxes Administered (In effect as of June 30, 2006)

Rural Cooperative Annual Tax (KRS 279.200, 279.530)
$10. Annual payment by corporations (RECCs and RTCCs) formed under KRS Chapter 279 in lieu of certain taxes.

Sales and Use Taxes (KRS 139.010 et seq.)
Sales tax—6 percent; Use tax—6 percent. Sales tax is imposed on the retailer for the privilege of making retail sales of tangible personal property or taxable services within Kentucky.

Use tax is imposed on the use, storage or other consumption in the state of tangible personal property purchased for use, storage or other consumption in this state. (KRS 139.310)

Use tax is imposed on machinery tools and other equipment brought into this state for construction, building or repair projects. (KRS 139.320)
There are statutory exemptions.

Effective for periods beginning July 1, 2005, the vendor's compensation is capped at $1,500 per return.

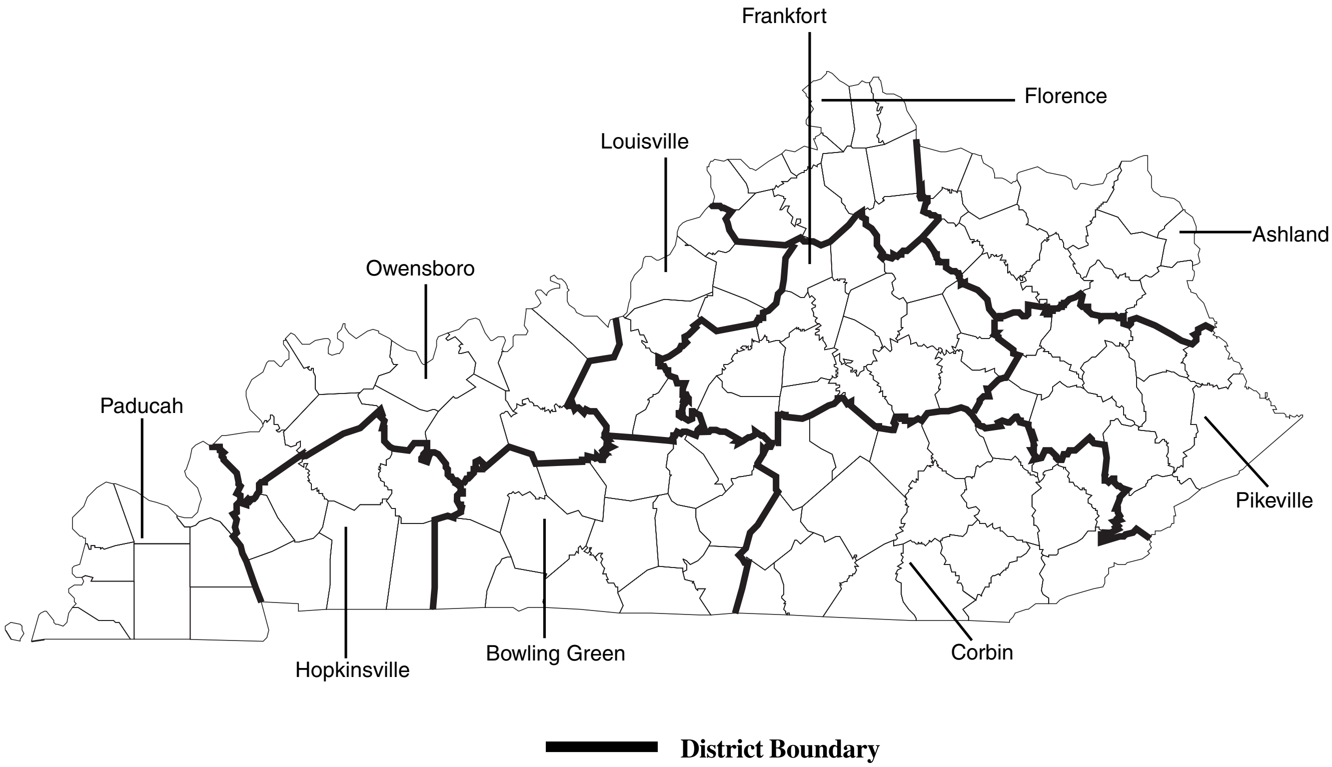
Transient Room Tax (KRS 142.400 et seq.)
1 percent of rent. A tax on every occupancy of any suite, room, rooms or cabins charged by all persons, companies, corporations, groups or organizations doing business as motor courts, motels, hotels, inns, tourist camps or like or similar accommodations businesses. The receipts from this tax are used for the tourism, meeting and convention marketing fund.

Telecommunications Tax—(KRS 136.600–136.600)
The telecommunications excise and gross revenues tax became effective Jan. 1, 2006. The telecommunications excise tax is imposed at the rate of 3 percent on the retail purchase of multichannel video programming services. The telecommunications gross revenues tax is imposed at the rate of 2.4 percent of gross revenues received for the provision of multichannel video programming services and at the rate of 1.3 percent of gross revenues received for the provision of communications services. The rates and tax computations are reported on one return that is due by the 20th day of the month following the end of the reporting period. Vendor's compensation is allowed up to $1,500 per return for the excise tax portion of the telecommunications tax return.

Utility Gross Receipts License Tax—KRS 160.613, 160.6131, 160.614, 160,6145, 160.615, 160.6151, 160.6152, 160.6153, 160.6154, 160.6155, 160.6156, 160.6157, 160.6158, 160.617
The rate is determined by each school district, but cannot exceed 3 percent Utility gross receipts license tax for schools is assessed on gross receipts derived from the furnishing of utility services and/or cable and direct broadcast satellite services within a school district. The service provider collects the tax based on the rate established by the local authority. The service provider or Energy Direct Pay holder submits payment to the DOR with a breakdown of the tax collected by school district. The DOR captures the district information and the corresponding tax collections and distributes the amount to the appropriate school district.

Withholding—Individual Income Tax (KRS 141.010 et seq.)
Deduction from salaries or wages based upon formula or tax tables. Employers are required to withhold individual income tax from payment of wages or salaries each pay period. Withholding tables and formulas are provided for common pay periods.

KENTUCKY TAXPAYER SERVICE CENTERS



Ashland, 41101-7670
134 Sixteenth Street
Telephone: (606) 920-2037
Fax: (606) 920-2039

Bowling Green, 42104-3278
201 West Professional Park Court
Telephone: (270) 746-7470
Fax: (270) 746-7847

Central Kentucky
200 Fair Oaks Lane, First Floor
Frankfort, 40620
Fax: (502) 564-8946

Corbin, 40701-6188
15100 North US25E
Suite 2
Telephone: (606) 528-3322
Fax: (606) 523-1972

Frankfort, 40620
200 Fair Oaks Lane, Second Floor
Taxpayer Assistance Branch
Telephone: (502) 564-4581
Fax: (502) 564-3685

Hopkinsville, 42240-7926
181 Hammond Drive
Telephone: (270) 889-6521
Fax: (270) 889-6563

Louisville, 40202-2446
620 South Third Street
Suite 102
Telephone: (502) 595-4512
Fax: (502) 595-4205

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Turfway Ridge Office Park
7310 Turfway Rd., Suite 190
Florence, 41042-4871
Telephone: (859) 371-9049
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Owensboro, 42301-0734
311 West Second Street
Telephone: (270) 687-7301
Fax: (270) 687-7244

Paducah, 42001-4024
2928 Park Avenue
Clark Business Complex, Suite G
Telephone: (270) 575-7148
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Pikeville, 41501-1275
126 Trivette Drive
Uniplex Center, Suite 203
Telephone: (606) 433-7675
Fax: (606) 433-7679