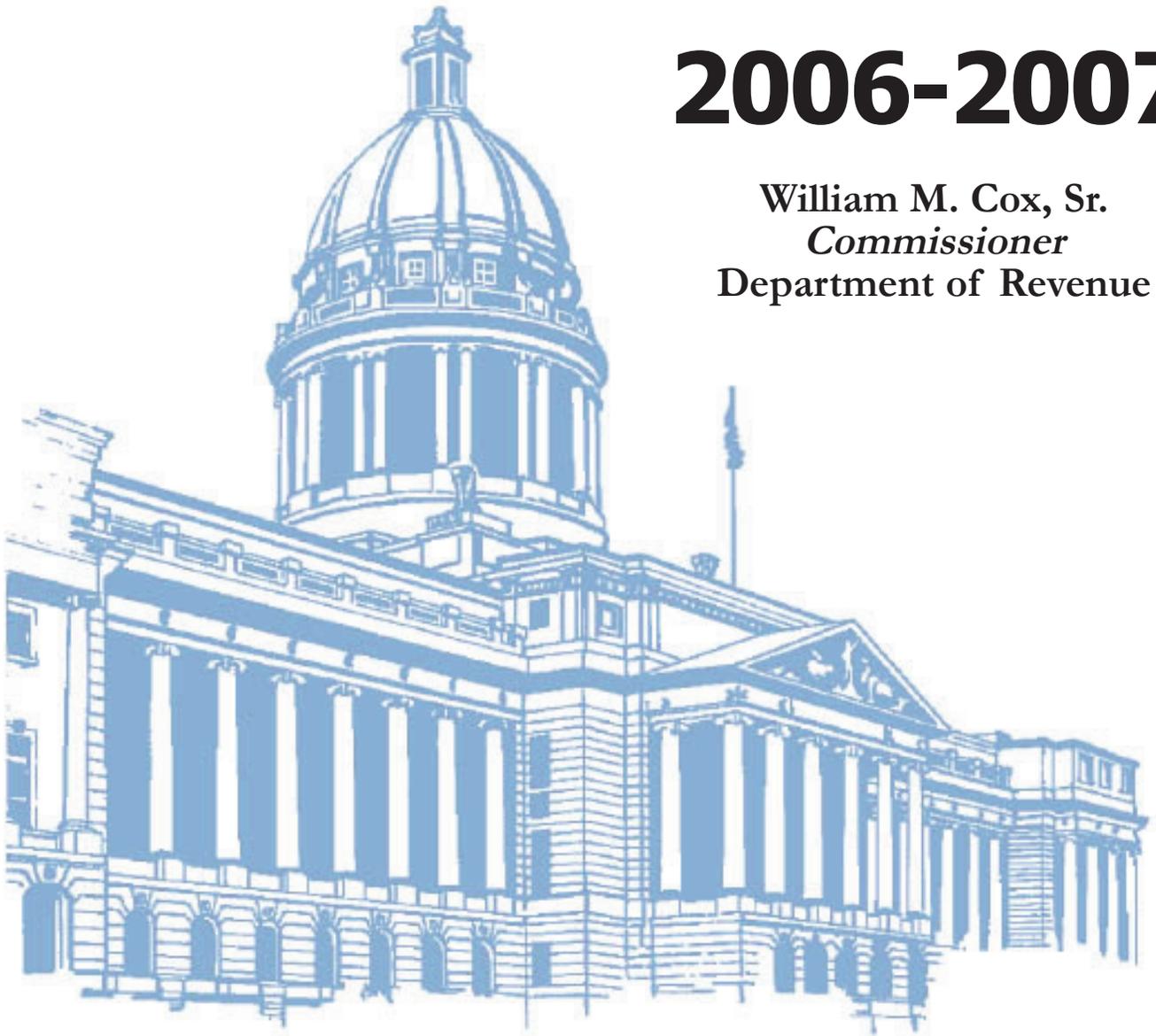


# Annual Report

## 2006-2007

William M. Cox, Sr.  
*Commissioner*  
Department of Revenue



Steven L. Beshear  
*Governor*  
Commonwealth of Kentucky

Jonathan Miller  
*Secretary*  
Finance and Administration Cabinet



**Kentucky Department of Revenue  
Mission Statement**

*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 Kentucky Department of Revenue does not discriminate on the basis of race, color, national origin, sex, religion, age or disability in employment or the provision of services.*



**Steven L. Beshear**  
Governor

**FINANCE AND ADMINISTRATION CABINET  
DEPARTMENT OF REVENUE**

**Jonathan Miller**  
Secretary

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**William M. Cox, Sr.**  
Commissioner

January 11, 2008

The Honorable Steven L. Beshear, Governor  
Commonwealth of Kentucky  
The State Capitol  
Frankfort, Kentucky 40601

Dear Governor Beshear:

I am pleased to present the Annual Report of the Department of Revenue for the fiscal year ended June 30, 2007. This report reflects the dedicated work of the many fine professionals who comprise the Department of Revenue workforce.

Over 50 percent of individual income tax returns were electronically filed. There were 1,014,498 electronically filed returns, an increase of 10 percent for the year. In addition, 224,477 2D barcode returns, and 547,366 paper returns were filed resulting in a total of 1,786,341 filed returns for tax year 2006.

Thank you for your support of the Department of Revenue and its employees and for your confidence in our abilities.

Very truly yours,

A handwritten signature in black ink that reads "William M. Cox, Sr.".

William M. Cox, Sr., Commissioner  
Kentucky Department of Revenue



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# Revenue Receipts

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*Reprinted from the Governor's Office for Economic Analysis*

## **Quarterly Economic & Revenue Report Fourth Quarter 2007 Fourth Quarter, FY 2007**

### **General Fund**

General Fund receipts in the fourth quarter of FY07 totaled \$2.364 billion compared to \$2.367 billion in the fourth quarter of FY06, for a net decrease of 0.1 percent.

The sales and use tax posted growth of 2.8 percent in the fourth quarter of FY07. Receipts of \$716.4 million compare to the \$696.7 million collected in the fourth quarter of FY06.

Individual income tax receipts rose 12.0 percent in the fourth quarter of FY07 compared to collections in the fourth quarter of FY06. Receipts of \$910.2 million were \$97.5 million more than was collected in the fourth quarter of the previous fiscal year. Changes enacted by House Bill 1 shifted some estimated tax receipts from the corporation income tax to this source.

Corporation income and license taxes posted a decline of 27.1 percent during the fourth quarter of FY07. Receipts totaled \$351.1 million compared to the \$481.4 million received a year earlier. Corporation income taxes were reduced by the shift in revenues to the individual income tax.

The coal severance tax decreased 3.8 percent in the fourth quarter. Receipts of \$58.9 million compare to \$61.2 million collected in the fourth quarter of FY06.

Tobacco taxes rose modestly in the fourth quarter. Receipts of \$46.4 million were 5.2 percent greater than collected in the fourth quarter of FY06. Tobacco taxes included in the General Fund include the original cigarette excise tax of 3-cents per pack, the 26-cents per pack surtax, and taxes on other tobacco products.

Property taxes were down by 24.7 percent in the fourth quarter of FY07.

Changes in tax laws due to the passage of HB 1 in the 2006 special session of the Kentucky General Assembly had an impact on collections during the fourth quarter. Principal changes affecting revenues were in the areas of the individual and 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 into and refunds out of revenue accounts. In the fourth quarter, individual and corporation income taxes were affected by these timing changes of \$43.4 million compare to \$57.7 million received in the final quarter of the prior fiscal year. Property taxes were affected by a change in timing of distributions made from omitted and delinquent property tax accounts.

Lottery receipts fell by 21.8 percent in the fourth quarter of FY07 with revenues of \$48.5 million. Lottery revenues in the previous year were aided by unusually large Powerball sales that were not matched in the fourth quarter of this year.

The *other* category represents the remaining accounts in the General Fund, and combined for growth of 25.2 percent with receipts of \$189.6 million. Chiefly boosting the growth rate were sales of abandoned property that escheated to the state, as well as higher investment income.

Sixty-nine percent 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 late payments from the abolished 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 tax, the natural gas severance tax, investment income, abandoned property, departmental fees, and fines and forfeitures. The coal severance tax, property tax, cigarette taxes and lottery receipts each composed 2 percent of total General Fund receipts.

# Revenue Receipts

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## Road Fund

The Road Fund posted growth of 7.1 percent in the fourth quarter of FY07. Receipts totaled \$335.7 million compared to the \$313.4 million received in the fourth quarter of last year.

Motor fuels and motor fuels use tax receipts increased 4.3 percent during the fourth quarter of FY07. Receipts were \$142.0 million and compare to \$136.2 collected during the fourth quarter of last year.

## Road Fund Receipts

The remainder of the accounts in the Road Fund combined for an increase of 7.5 percent. Receipts for the *other* category totaled \$10.0 million during the fourth quarter, compared to \$9.3 million in the fourth quarter of FY06.

Motor fuels taxes and motor vehicle usage taxes comprised 76 percent of Road Fund revenues in the fourth quarter. The next-largest source of revenue was the motor vehicle license tax with 12 percent, followed by weight distance taxes with 6 percent. The *other* category accounted for 3 percent, investment income composed 2 percent, and motor vehicle operators was 1 percent.

Motor fuels tax revenues were affected by an increase in the formula-driven tax rate tied to the average wholesale price of gasoline.

Motor vehicle usage tax receipts increased by 5.3 percent during the fourth quarter. Receipts were \$112.9 million compared to \$107.1 million collected during the same period last year.

Weight distance tax receipts of \$21.0 million showed a decline of 0.7 percent from receipts of \$21.2 million during the fourth quarter of last year.

Motor vehicle license tax receipts increased by 25.7 percent during the fourth quarter of FY07. Receipts of

\$40.8 million compare to \$32.5 million received during the fourth quarter of FY06. Growth in this tax was affected by reclassification of some other special fees.

Investment income was up sharply in the fourth quarter of FY07, yielding \$5.1 million.

## General Fund

The General Fund grew by 2.4 percent in FY07, much slower than the growth recorded in FY06 when revenues rose 9.6 percent. Receipts totaled \$8.574 billion compared to \$8.376 billion for the previous year.

The year began with moderate growth that turned negative in the final quarter.

Among the major taxes, only the individual income tax and the sales and use tax experienced positive growth. Reduced growth in FY07 was an anticipated outcome of tax changes implemented in 2005 and 2006. Some of these changes boosted growth in the prior fiscal year at the expense of FY07.

The sales tax growth rate for FY07 was 2.5 percent, less than half of last year's growth rate. Receipts of \$2.818 billion compare to prior year receipts \$2.750 billion.

Individual income tax receipts grew by 4.2 percent for FY07, for an increase of \$122.9 million from last year. Individual income tax receipts grew partly as a result of tax shifts mandated by House Bill 1 of the 2006 special session of the General Assembly. The bill reduced business taxes and shifted payments from the corporation income tax to the individual income tax for pass-through business entities, a reversal of a law change that occurred in 2005. Receipts totaled \$3.042 billion and compare to \$2.919 billion collected last year.

Corporation income tax revenue fell slightly in FY07, largely as a result of changes enacted in House Bill 1. Revenues from the corporation income tax dipped by 1.4 percent with total collections of \$988.1 million.

# Revenue Receipts

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Corporate license taxes, meanwhile, were down sharply, falling by 73.0 percent. (The corporate license tax was abolished for taxpayers whose tax year ended on or after Dec. 31, 2005. Late payments continued to be received throughout FY07 for this tax.)

Coal severance tax collections leveled off following a trend of sharp increases by dropping 1.1 percent for FY07. Receipts totaled \$222.0 million compared to \$224.5.

## Road Fund

Total Road Fund receipts rose by 5.2 percent during FY07. Total receipts of \$1.226 billion compare to \$1.165 billion collected in this fund during FY06. Motor fuels and motor fuels use taxes increased by 6.6 percent on receipts of \$563.4 million, compared to \$528.3 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 \$411.3 million represent a rise of 4.0 percent compared to the \$395.6 million collected in FY06. Usage tax receipts have rebounded following a decrease in the previous fiscal year.

Weight distance tax revenues were nearly flat with just a 0.1 percent rise and receipts of \$85.4 million compared to \$85.3 million collected in the previous fiscal year.

Motor vehicle license tax receipts were up by 8.3 percent with collections of \$101.7 million, compared to \$93.9 million collected in FY06. A reclassification of special fees boosted this revenue source.

Investment income rose by 152.6 percent as Road Fund balances increased in FY07. Receipts totaled \$16.1 million, compared to \$6.4 million in FY06.

The *other* category fell by 22.0 percent from the previous fiscal year. Total receipts in this category were \$32.2 million, which is down from the \$41.3 million collected in FY06.

Road Fund collections for FY07 were less than budgeted receipts by \$12.7 million, but were \$10.8 million above the official revenue estimate (the consensus estimate of January 2007). This was 0.9 percent more than anticipated in the official estimate. The largest excess occurred in the motor vehicle license tax, which was \$6.8 million above forecasted levels and 7.2 percent above the forecasted value.

Fully 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 3 percent, and motor vehicles operators tax and investment income each were 1 percent of Road Fund revenue.

Overall, the Road Fund began the year very weakly, but was strong in the final three quarters. The major accounts with the strongest growth included motor fuels taxes, which were impacted by the rate increase in effect for the entire fiscal year. Growth in the motor vehicle license account was strong in the fourth quarter which raised its overall growth for the fiscal year. The weight distance tax began the year strongly, but decreased slightly in the final two quarters.

# Revenue Receipts

## GENERAL FUND TOTAL RECEIPTS

| Fiscal Year | Receipts        | Percent Change |
|-------------|-----------------|----------------|
| 2006-07     | \$8,573,819,250 | 2.4            |
| 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            |

## ALCOHOLIC BEVERAGE TAXES—Distilled Spirits

| Fiscal Year | Receipts     | Percent Change |
|-------------|--------------|----------------|
| 2006-07     | \$35,332,563 | 6.0            |
| 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            |

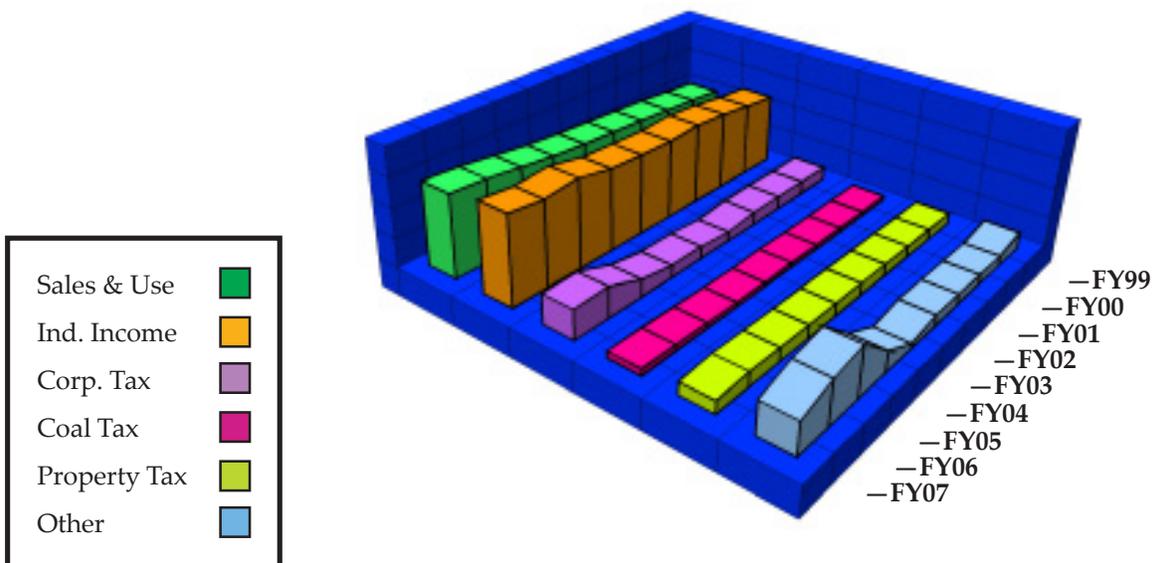
## ALCOHOLIC BEVERAGE TAXES—Malt Beverage

| Fiscal Year | Receipts     | Percent Change |
|-------------|--------------|----------------|
| 2006-07     | \$53,150,265 | 3.0            |
| 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            |

## ALCOHOLIC BEVERAGE TAXES—Wine

| Fiscal Year | Receipts     | Percent Change |
|-------------|--------------|----------------|
| 2006-07     | \$13,718,442 | 10.0           |
| 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            |

General Fund Receipts by Major Sources  
Millions of Dollars



# Revenue Receipts

## CIGARETTE TAX

| Fiscal Year | Receipts      | Percent Change |
|-------------|---------------|----------------|
| 2006-07     | \$168,778,213 | -2.0           |
| 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           |

## CORPORATION LICENSE TAX

| Fiscal Year | Receipts     | Percent Change |
|-------------|--------------|----------------|
| 2006-07     | \$11,734,452 | -73.0          |
| 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            |

## COAL SEVERANCE TAX

| Fiscal Year | Receipts      | Percent Change |
|-------------|---------------|----------------|
| 2006-07     | \$221,952,516 | -1.1           |
| 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            |

## INDIVIDUAL INCOME TAX

| Fiscal Year | Receipts        | Percent Change |
|-------------|-----------------|----------------|
| 2006-07     | \$3,041,535,604 | 4.2            |
| 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            |

## CORPORATION INCOME TAX

| Fiscal Year | Receipts      | Percent Change |
|-------------|---------------|----------------|
| 2006-07     | \$988,064,957 | -1.4           |
| 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     | 2,135,211     | -29.9          |

## INHERITANCE AND ESTATE TAX

| Fiscal Year | Receipts                | Percent Change |
|-------------|-------------------------|----------------|
| 2006-07     | \$43,578,107            | -5.2           |
| 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 <sup>1</sup> | -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           |

<sup>1</sup>Phase out of estate tax begins.

# Revenue Receipts

## LOTTERY RECEIPTS

| Fiscal Year | Receipts      | Percent Change |
|-------------|---------------|----------------|
| 2006-07     | \$186,625,113 | -1.8           |
| 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            |

## PARI-MUTUEL TAX

| Fiscal Year | Receipts    | Percent Change |
|-------------|-------------|----------------|
| 2006-07     | \$5,489,552 | -2.4           |
| 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          |

## MINERALS AND NATURAL GAS TAX

| Fiscal Year | Receipts     | Percent Change |
|-------------|--------------|----------------|
| 2006-07     | \$47,161,910 | -7.0           |
| 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            |

## PROPERTY TAXES—REAL ESTATE

| Fiscal Year | Receipts      | Percent Change |
|-------------|---------------|----------------|
| 2006-07     | \$228,282,174 | 6.0            |
| 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           |

## OIL PRODUCTION TAX

| Fiscal Year | Receipts    | Percent Change |
|-------------|-------------|----------------|
| 2006-07     | \$6,198,342 | -2.9           |
| 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          |

## PROPERTY TAXES—TANGIBLE

| Fiscal Year | Receipts      | Percent Change |
|-------------|---------------|----------------|
| 2006-07     | \$192,343,695 | 16.1           |
| 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            |

# Revenue Receipts

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## PROPERTY TAXES—INTANGIBLE

| Fiscal Year | Receipts                | Percent Change |
|-------------|-------------------------|----------------|
| 2006-07     | \$48,841                | -99.8          |
| 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 <sup>1</sup> | -54.7          |

<sup>1</sup>Shares of stock were exempted from property tax.

## SALES AND USE TAX

| Fiscal Year | Receipts        | Percent Change |
|-------------|-----------------|----------------|
| 2006-07     | \$2,817,652,253 | 2.5            |
| 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            |

## BANK FRANCHISE TAX

| Fiscal Year | Receipts     | Percent Change |
|-------------|--------------|----------------|
| 2006-07     | \$63,912,315 | 7.2            |
| 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          |

# Revenue Receipts

| ROAD FUND<br>TOTAL RECEIPTS |                 |                   | MOTOR FUELS TAXES—Motor Fuels Normal Use &<br>Surtax |              |                   |
|-----------------------------|-----------------|-------------------|--|--------------|-------------------|
| Fiscal<br>Year              | Receipts        | Percent<br>Change | Fiscal<br>Year                                       | Receipts     | Percent<br>Change |
| 2006-07                     | \$1,225,943,515 | 5.2               | 2006-07  | \$24,600,438 | -5.3              |
| 2005-06                     | 1,165,409,505   | 3.4               | 2005-06  | 25,982,599   | 25.2              |
| 2004-05                     | 1,126,554,402   | 0.9               | 2004-05  | 20,748,200   | 14.1              |
| 2003-04                     | 1,116,734,272   | -0.6              | 2003-04  | 18,185,947   | 21.5              |
| 2002-03                     | 1,123,103,133   | 0.4               | 2002-03  | 14,969,884   | 6.0               |
| 2001-02                     | 1,119,005,317   | 5.2               | 2001-02  | 14,124,035   | -8.8              |
| 2000-01                     | 1,064,181,565   | -2.4              | 2000-01  | 15,492,738   | -2.6              |
| 1999-00                     | 1,090,777,822   | 3.2               | 1999-00  | 15,905,613   | -5.6              |
| 1998-99                     | 1,056,596,153   | 4.4               | 1998-99  | 16,853,163   | -3.6              |
| 1997-98                     | 1,011,789,675   | 5.4               | 1997-98  | 17,473,744   | 14.1              |

## MOTOR FUELS TAXES—Motor Fuels Normal

| Fiscal<br>Year | Receipts                 | Percent<br>Change |
|----------------|--------------------------|-------------------|
| 2006-07        | \$538,568,693            | 7.3               |
| 2005-06        | 501,927,927              | 6.9               |
| 2004-05        | 469,621,779 <sup>1</sup> | 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               |

## MOTOR VEHICLE OPERATOR'S LICENSE FEE

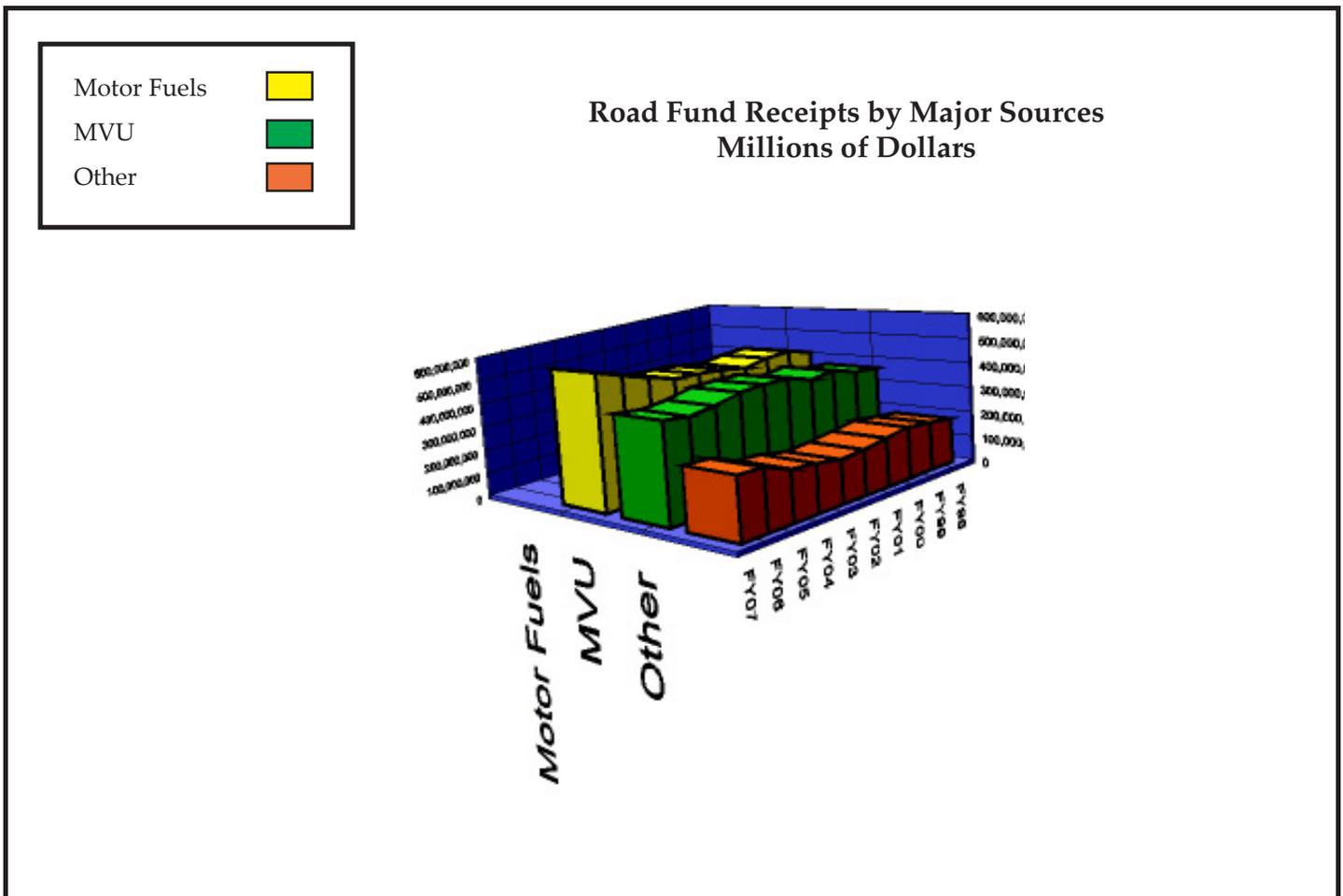
| Fiscal<br>Year | Receipts     | Percent<br>Change |
|----------------|--------------|-------------------|
| 2006-07        | \$15,811,880 | 8.6               |
| 2005-06        | 14,553,623   | 146.7             |
| 2004-05        | 5,899,247    | 4.9               |
| 2003-04        | 5,623,874    | 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              |

<sup>1</sup>Rate increase \$0.01.

# Revenue Receipts

## MOTOR VEHICLE USAGE TAX

| Fiscal Year | Receipts      | Percent Change |
|-------------|---------------|----------------|
| 2006-07     | \$411,251,997 | 4.0            |
| 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            |



# Accomplishments

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## MAJOR ACCOMPLISHMENTS IN FISCAL YEAR 2006-2007

### Office of Sales and Excise Taxes

#### Taxpayer Service

- Taxpayer Assistance Branch staff answered 44,571 telephone calls relating to sales and use tax inquiries.
- Staff from the Office of Sales and Excise Taxes planned and participated in 12 seminars around the state giving guidance to county clerks regarding the implementation of collection of use tax by the clerks as a result of HB 380, as well as the changes to motor vehicle usage tax collection as a result of HB 267.
- Office staff participated in training at the county clerks' conference.
- Management from the Division of Sales and Use Tax gave presentations to Kentucky automobile dealers at seminars in Owensboro, Louisville and Frankfort regarding the implementation of HB 380 relative to the collection of sales tax by motor vehicle dealers which became effective Aug. 2006.
- The Division of Sales and Use Tax made 12 distributions of the Telecommunications tax to over 1,300 local political subdivisions. Staff also hosted two Oversight Committee hearings involving 11 tax complaints during the fiscal year.
- The Division of Sales and Use Tax continued to administer the collection and transfer of sales tax paid on equine breeding fees pursuant to KRS 230.800. For FY07, the division transferred \$19,571,538 to the Kentucky Horse Racing Authority, an increase of 20 percent over FY06.
- The Division of Miscellaneous Tax administered the Utility Gross Receipts License Tax and distributed \$187,979,162 to 159 local school districts throughout the commonwealth.

- Participated in Commonwealth Credit Union's 50 Plus Festival to provide citizens with inheritance tax information.

#### Technological Advances

Responded to 484 Live Chat conversations from taxpayers requesting sales and use tax assistance.

#### 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 50 percent increase. As of fiscal year end, there were 46,558 returns received and processed electronically. There was also a 355 percent increase in taxpayer's usage of DOR's Interactive Voice Response (IVR) system to file no tax due returns. There were 7,257 sales tax returns filed using IVR.
- In addition, staff in the Taxpayer Assistance Branch of the Division of Sales and Use Tax handled 4,290 telephone calls and 3,497 e-mails directly related to electronic filing of sales and use tax returns.

#### Compliance Initiatives

- Participation in the Streamlined Sales Tax (SST) program continued to yield beneficial results. During FY07, the capability for Certified Service Providers to file returns for SST taxpayers became available. As of fiscal year end, there were 343 newly registered SST filers who remitted \$3,336,382 of tax to Kentucky. The tax paid by all SST filers for the fiscal year totaled \$7,065,440.
- External training seminars for tax professionals were held in Louisville with a presentation for over 500 CPAs. Additional two-day seminars sponsored in conjunction with the Kentucky Society of CPAs were scheduled throughout the state.
- The Division of Sales and Use Tax prepared and mailed four newsletters, the Kentucky Sales Tax Facts,

# Accomplishments

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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.

- The 10A100 (Taxpayer Registration Applications) was revised for taxpayers ease of use.
- There were 34,756 applications completed and \$39,626,226 in revenues attributed to the compliance efforts of the Registration Compliance Branch.

## Office of Income Taxation

- Completed the implementation of electronic capture of all filed 2005 corporation income tax returns for the purpose of compliance and taxpayer assistance programs.
- Completed the review of 4,769 requests for letters of good standing submitted by entities needing reinstatement with the Secretary of State.
- Continued the partnership with the University of Kentucky and the IRS in presenting up-to-date income tax information for Kentucky tax practitioners, CPA's, 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 income tax information to tax practitioners, CPA's, attorneys and other interested parties.
- Received 171,760 telephone inquiries for individual income tax and 49,619 telephone inquiries for withholding tax for a total of 221,379 telephone inquiries received by the Division of Individual Income Tax.
- Offered extended taxpayer assistance hours in April 2007 to accommodate taxpayers with questions regarding individual income tax returns.

## Division of Registration and Data Integrity

- Several new training programs were implemented including New Employee Orientation, Computer Systems, NAICS Determination and Skiptracing.

## Division of Local Valuation

Coordinated the purchase of delinquent real property tax bills by the Finance and Administration Cabinet in 16 counties in accordance with the provisions of KRS 134.450. Whenever third parties make offers to purchase these delinquencies that exceed 10 percent of the total amount delinquent in a county, the Finance Cabinet must purchase all of the bills for which an offer was received. Division personnel worked closely with sheriffs, county clerks, county attorneys and Finance personnel who handle investments to ensure this process was completed timely. A total of \$19,336,317 was invested in these delinquent tax bills. Payments will be received from the property owners in the county clerk's offices and those offices will remit the appropriate amounts to the commonwealth on a monthly basis.

Extensive property tax training was provided to new sheriffs and county clerks at various conferences and special training sessions held by their associations.

## Division of State Valuation

Locally assessed tangible personal property assessments totaled \$43.7 billion. These assessments yielded an estimated \$67.9 million in state and local taxes.

Omitted personal property tax assessments totaled \$75.4 million and approximately \$32.4 million in state and local property taxes were collected on these omitted assessments.

Motor vehicle assessments increased 5 percent over the previous year to \$24.4 billion. Combined state and local motor vehicle property tax collections for FY07 were \$307.7 million.

# Accomplishments

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Beginning Jan. 1, 2007 the apportioned vehicle property tax was replaced with a Kentucky annual fee collected nationwide and across Canada at the time of registration in conjunction with the International Registration Plan. This has streamlined this area of property tax administration and resulted in increased collections and compliance. Additionally, as part of this overhaul, the property tax on semi-trailers operated by motor carriers was eliminated.

Public service company assessments were set at \$24.2 billion and are expected to yield approximately \$61.4 million in state and local property tax revenues.

Implemented the commercial watercraft property tax system which streamlined the collection and distribution of local property taxes.

A system to collect reimbursements from local taxing districts for the cost of administering telecommunication company assessments was initiated this fiscal year.

## Division of Minerals Taxation and GIS Services

With assistance from Cartography Branch personnel, 119 counties have completed digitizing their parcel maps. Currently, out of 2.17 million parcels statewide, 2.165 million parcels (99.8 percent) have been digitized.

Division personnel continued their training efforts with property valuation administrator offices in two computer mapping classes: Introduction to GeoSync and Advanced GeoSync.

Severance tax receipts for FY07 totaled \$275,332,526. One half of these receipts are distributed back to counties with mining activity.

The coal severance tax has been selected as one of the first tax types to be integrated into the new Comprehensive Tax System and development work is underway.

## Minerals Resource Valuation Branch

Total unmined minerals 2007 tax receipts (2006 tax year):  
\$34,419,384

|            |              |
|------------|--------------|
| Gas:       | \$17,857,545 |
| Oil:       | 1,825,923    |
| Limestone: | 358,064      |
| Clay:      | 7,877        |
| Coal:      | 14,369,975   |

## Division of Collections

- During the last two fiscal years ending June 30, 2007, the Division of Collections collected a total of \$326,375,740; compared to a total of \$258,918,355 for the preceding two fiscal years.
- The Division of Collections collected Child Support for the Cabinet for Health & Family Services. For the last two fiscal years ending June 30, 2007, a total of \$18,677,804 was collected; compared to a total of \$2,684,763 for the preceding two fiscal years.
- The Division of Collections collects debts on behalf of other state and local government agencies under the authority of KRS 45.237(4) and KRS 45.241(6). This process began as small manual pilot programs under which nearly \$224,000 was collected. A Web-based process for other agencies to submit debt was recently implemented. The Kentucky Board of Nursing, KHEAA, and KCTCS are submitting debt for collection through this system.
- The Division of Collections has began a data match process whereby financial institutions are required to match lists of their account holders to lists of DOR debtors and provide the matched account information to DOR for possible levy sources. This authority is granted under KRS 131.670 through KRS 131.676. To date, 349 agreements have been signed with financial institutions. Nearly \$200,000 has been collected thus far under this project.

# Accomplishments

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- An automated system for entering delinquent personal property tax has been implemented. Using this system, county government employees or DOR employees may enter personal property tax debt into the receivables system to facilitate collection through refund offsets or enforced collection by DOR staff, when appropriate. The system includes a distribution piece for allocating collected funds back to appropriate tax jurisdictions.
- The Internet Listings of Delinquent Debtors was automated early in 2007. More than 40,000 debtors are posted with a combined posted liability exceeding \$460 million. The Web sites have resulted in 33,385 hits since their inception. Estimated revenue based on the number of hits exceeds \$500,000.

## Division of Operations

Over 50 percent of individual income tax returns were electronically filed. There were 1,014,498 returns filed electronically, an increase of 10 percent for the year. In addition, 224,477 2D barcode returns and 547,366 paper returns for a total of 1,786,341 returns were filed for tax year 2006.

Processed 1,309,442 timely and correctly filed individual income tax returns by June 15, 2007.

Issued 435,758 direct deposit refunds for individual income tax returns.

Processed 1,238,975 returns through electronic media representing an increase of 8.9 percent over the previous processing cycle.

# 2007 General Assembly



## A Review of Tax Law Changes Enacted by the 2007 General Assembly



**NOTE:** This 2007 legislative summary only presents 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 at [www.lrc.ky.gov](http://www.lrc.ky.gov).

The 2007 Kentucky General Assembly created, amended or repealed numerous statutes. A total of 795 bills were introduced. In the end, 120 bills became law, an enactment rate of 15 percent. No bills were vetoed by Gov. Ernie Fletcher. Fourteen bills had substantive tax implications, with some affecting more than one tax. This review describes the tax portion of each bill impacting taxes or programs administered by the DOR.

### GENERAL

**Business Entities (Effective June 26, 2007)**—Amends and defines business entities and updates KRS Chapter 271B to reflect the provisions of the Model Business Corporation Act. The provisions will provide for more consistency among business corporations, nonprofit corporations, cooperatives, associations, partnerships, limited partnerships, limited liability companies and business trusts. **(HB 334)**

**Electronic Levy of Delinquent Taxes (Effective June 26, 2007)**—Requires that the financial institution match system implemented by the DOR for the seizing of financial assets of delinquent taxpayers and debtors not be implemented unless and until the department is prepared to implement the system in 90 percent of all financial institutions within a period of no longer than 18 months from the effective date of this act. The bill also provides that financial institutions may implement a data match sooner. The bill amends KRS 131.990 to apply fines for failure to comply within 90 days of notification by the DOR and to require the financial

institution to forfeit its license to do business in the commonwealth for failure or refusal to comply within 120 days of notification by the DOR. The bill also amends KRS 205.990 to apply fines for failure to comply with KRS 205.772 and applicable administrative regulations if the financial institution has not complied within 90 days of the notification by the Cabinet for Families and Children. **(HB 443)**

### PROVIDER TAX

**Payment of Health Care Provider Tax by Hospitals (Effective June 26, 2007)**—Amends KRS 142.303 to provide that, beginning in fiscal year 2008-09 and continuing each year after, the tax imposed on providers of hospital services will be assessed on gross revenues received by providers during state fiscal year 2005-06. Payments of hospital provider taxes due are to be made in 12 equal installments with the DOR to send a notice to providers at least 30 days prior to the beginning of the fiscal year. The tax is to be applied according to the hospital's fiscal year 2005-06 revenues regardless of any subsequent change in ownership. The bill also requires that \$26,268,000 from hospital provider tax collections during fiscal year 2008-09, and continuing each year, is to be matched by federal funds and used solely for enhancements implemented during fiscal years 2006 and 2007. **(HB 244)**



# 2007 General Assembly

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## CORPORATION AND INDIVIDUAL INCOME TAX

**Internal Revenue Code Reference Date (Effective for tax years beginning on or after January 1, 2007)**—Amends KRS 141.010(3) to update the Internal Revenue Code (IRC) reference date for state individual and corporation income tax purposes to Dec. 31, 2006. The bill also amended KRS 67.750 to update the reference date for the IRC for local governments to Dec. 31, 2006. The depreciation and section 179 expense deductions for property placed in service after September 10, 2001 will still be computed under the IRC in effect on December 31, 2001. In addition, the bill amended KRS 141.010(13) to disallow any dividend-paid deduction of a captive real estate investment trust when computing the taxable net income of a corporation. **(HB 258)**

**Withdrawal of Commonwealth's Consent to Suits (Effective March 19, 2007)**—Withdraws the commonwealth's consent to suits attempting to recover alleged tax overpayments generated by the use of *unitary* corporate income tax returns. The bill also prohibits withdrawals from the State Treasury to pay these claims. The purpose of the legislation is to end litigation and the commonwealth's exposure resulting from a 1994 court decision that created a tax loophole for certain corporations. **(HB 316)**

## PROPERTY TAX

**Private Purchases of Delinquent Property Taxes (Effective June 26, 2007)**—Retroactively establishes limitations on the additional amounts that can be collected by private purchasers of delinquent property taxes and requires private purchasers to include contact information in the notices that are sent to taxpayers relating to the certificate of delinquency. The bill also allows taxpayers to pay the county clerk to satisfy a certificate of delinquency held by a private purchaser if the taxpayer has difficulty locating the private purchaser. **(HB 321)**

**Remediation Protection for Purchasers (Effective June 26, 2007)**—Provides protection for innocent purchasers of property where certain environmental problems are found after such purchase, which derived from the activities of a previous owner, and where the innocent purchaser has taken all customary steps to

investigate the condition of the property prior to purchase. The bill broadens the incentive's eligibility to include most voluntary cleanups conducted under a remediation program administered by the Environmental and Public Protection Cabinet and makes it easier for a taxpayer to qualify for the credit. **(SB 82)**

## SALES AND USE TAX

**Streamlined Sales Tax Agreement (Effective July 1, 2007)**—Amends KRS Chapter 139 to make changes in conformity with the Streamlined Sales and Use Tax Agreement (SSUTA) plus updates to **utility gross receipts tax** and **telecommunications tax** statutes where Chapter 139 was previously referenced. These changes to KRS 139 address multiple points of use issues, telecommunications definitions, bundling definitions, CSP indemnification, and clarifications to sales price and prepared food definitions. The ongoing uniformity and streamlining efforts of the SSUTA project benefit the administration of sales and use tax. By removing barriers to compliance and establishing a national registration system, uniform exemption certificate and common return format, the project has generated new sales and use tax dollars into the commonwealth from remote vendors registering and becoming SSUTA vendors. **(HB 360)**

## ECONOMIC DEVELOPMENT INCENTIVE PROGRAMS

**Economic Development Project (Effective June 26, 2007)**—Amends KRS 154.22-010(10) and KRS 154.28-010(11) to expand and define *economic development project* to include certain leased facilities. Such economic development projects utilizing leased facilities will be eligible only for the aggregate assessments pursuant to KRS 154.22-070 or KRS 154.28-110 withheld by the approved company each year and will not be eligible for credit against Kentucky income tax and limited liability entity tax. **(HB 462)**

**Economic Development Project Adjoining Regional Postsecondary Education Center (Effective March 16, 2007)**—Expands the Kentucky Jobs Development Act by amending KRS 154.24-090(4) to provide that if an eligible company receives approval from the Kentucky Economic Development Finance Authority

# 2007 General Assembly

before July 1, 2008, and locates an economic development project on property that adjoins one of the five regional postsecondary education centers operated and occupied in cooperation with the Kentucky Community and Technical College System, the eligible company may alternatively satisfy the wage requirements. Ninety percent of the company's employees must receive base hourly wages and benefits equal to or greater than 200 percent of the federal minimum wage and the company must seek to provide meaningful employment opportunities for nontraditional students enrolled at a regional postsecondary education center. **(HB 468)**



**Economic Development Incentive Program-Cities Of The First Class (Effective March 23, 2007)**—Creates new sections of KRS Chapter 154 to establish an economic development incentive program that would provide tax credits and wage assessment fees to eligible companies. An *eligible company* means any corporation, limited liability company, partnership, limited partnership, sole partnership, business trust or any other entity designated by the United States Department of Commerce, United States Census Bureau North American Industry Classification System code 336211, 336111, 336112 or 336120 that is within the jurisdiction of a consolidated local government containing a city of the first class, employs a minimum of 1,000 full-time persons engaged in manufacturing, has been operating within the commonwealth on a continuous basis for at least five years preceding the request for approval by the Kentucky Economic Development Finance Authority of the project that meets the standards set forth in the act, and that has been previously approved for economic development incentives from the commonwealth related to one or more of its facilities. **(HB 536)**

**Tax Increment Financing and Urban Redevelopment (Effective March 23, 2007)**—Provides that any city or county government may establish a local development area to encourage reinvestment in and development and reuse of areas of the city or county as provided in the act. Any taxing authority may, in

addition to any other pledge permitted by law to secure its obligations, pledge up to 100 percent of the incremental local tax revenues (real property and occupational taxes) generated in the development area or local development area or from a project within the development area or local development area. In addition, any city, county or agency with bonding authority may issue increment bonds and may pledge incremental revenues to the payment of the incremental bonds. Certain projects within the development areas shall be eligible for participation by the commonwealth, if such projects meet the requirements for commonwealth participation.

The measure also creates a State Tax Increment Financing Commission that offers three tax increment participation programs: Participation Program for Real Property Ad Valorem Tax Revenues, Signature Project Program and Mixed-Use Redevelopment in Blighted Urban Areas. State tax revenues received from real property taxes, individual income taxes, corporate income taxes, limited liability entity taxes or sales taxes may be used as funding sources for the designated and approved projects provided such taxes were not previously committed to another development project within the same development area. The state tax revenues that can be committed are further limited by the requirements of the tax increment participation programs.

The bill establishes the Division of Tax Increment Financing within the DOR to analyze and assist in implementing proposed state tax increment financing projects and serve as the record keeping unit for all state tax increment financing projects. **(HB 549)**

**Economic Revitalization Project (Effective March 23, 2007)**—Amends KRS 154.26-010 and KRS 154.26-080 to include in the definition of an *economic revitalization project* a closed facility that resumes operations. Also amends the definition of *eligible company* to reduce the requirement on the number of tons of coal mined from an economic revitalization project facility from four million to three million tons. **(HB 69)**

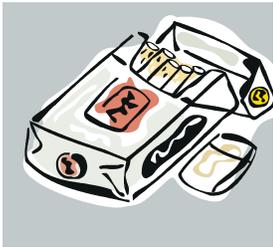


# 2007 General Assembly

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## CIGARETTES

**Fire-Safe Cigarettes (Effective April 1, 2008)**— Requires cigarettes sold and distributed in Kentucky to comply with fire-safe performance standards. The bill also defines terms and establishes the testing and approval processes to certify a cigarette is in compliance. It also addresses compliance issues and requires the DOR in its normal cigarette tax inspection process to verify compliance and notify the State Fire Marshal's Office when noncompliant cigarettes are located. **(SB 134)**



# Legal Issues

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## 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; interpreting and analyzing the commonwealth's tax laws and assisting with their implementation and administration; assisting with the preparation of DOR informational publications; handling or assisting with 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 that OLS handles frequently have a substantial fiscal impact or significant precedential value.

## Office of Legal Services for Revenue Legal Developments and Court Decisions

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 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.

### ***Department of Revenue v. Davis, 06-666, United States 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 United States Constitution's Commerce Clause. They also assert that this violates the United States 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 DOR's petition for a writ of certiorari to the United States Supreme Court was granted on May 21, 2007.

### ***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

# Legal Issues

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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. The parties have submitted briefs and are awaiting the scheduling of argument by the Court.

## ***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 and therefore could not be enforced against the taxpayer. 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 Mar. 9, 2005. On May 11, 2005 the Supreme Court granted the taxpayer's cross motion for discretionary review of that facet of the Court of Appeals' opinion adverse to it. The Supreme Court has reversed the decision of the Court of Appeals. The Court agreed with the Court of Appeals that the assessment letter had been timely issued or mailed. Disagreeing with the Court of Appeals, the Supreme Court held that the assessment letter constituted sufficient notice for purposes of KRS 139.620(1) and that accordingly, DOR's assessment was timely under that statutory provision. The Supreme Court's disposition of

# Legal Issues

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this question made it unnecessary for the Court to consider the other issues that had been addressed by the Court of Appeals.

The Supreme Court's decision is not yet final. The taxpayer's petition for rehearing is pending.

## ***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 (House Bill 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 after Dec. 22, 1994 seeking refunds under the unitary business concept.

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 the taxpayers the equal protection of the laws under the Kentucky and United States Constitutions. The Court did agree with the taxpayers that the 2000 amendment (H.B. 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 H.B. 541 is so lengthy as to constitute a due process violation."

This decision is not yet final. The DOR's motion for discretionary review has been granted by the Kentucky Supreme Court.

## ***DirecTV, Inc. v. Treesh, 487 F.3d 471 (6<sup>th</sup> Cir. 2007)***

On May 31, 2007 the United States Court of Appeals for the Sixth Circuit rejected a constitutional challenge to a provision of the gross revenue and excise tax law (KRS 136.660) enacted in 2005 that forbade the imposition of franchise fees or taxes by local governments upon multichannel video programming service. The plaintiffs in this case were satellite television companies who asserted that this law discriminated against interstate commerce. Specifically, the satellite companies asserted that this law only benefited cable television companies, which they characterized as intrastate by virtue of their alleged in-state infrastructure, because only cable television companies were subject to local franchise fees or taxes before the 2005 law's enactment. The satellite companies had not been subject to such franchise fees and taxes by virtue of a federal law, §602(a) of the Telecommunications Act of 1996.

The Court of Appeals held that the new gross revenue and excise tax structure simply substituted a uniform state taxation scheme for what had existed before and did not discriminate against interstate commerce. The Court noted that the Commerce Clause does not protect a particular method of operation in a retail market. The law in question, the Court held, did not alter the competitive balance between in-state and out-of-state competitors. Any differential tax treatment between cable television companies and satellite television companies resulted from differences between the nature of their businesses and not from the location of their activities. Kentucky's law did not amount to a protective tariff forbidden by the Commerce Clause, or the functional equivalent of such a tariff, by benefiting in-state economic interests at the expense of out-of-state interests.

Accordingly, the Court of Appeals affirmed a decision in DOR's favor by the United States District Court for the Eastern District of Kentucky.

On Sept. 18, 2007 the Court of Appeals denied the satellite companies' petition for rehearing. The Court of Appeals' decision in this case is not yet final, however, because the satellite companies have the option of seeking review by the United States Supreme Court.

# DOR Administration

| Department of Revenue                    |                      |                     |                     |                         |                      |
|--|----------------------|---------------------|---------------------|-------------------------|----------------------|
| Expenditures for FY2007 - All Funds      |                      |                     |                     |                         |                      |
| (Excluding PVAs)                         |                      |                     |                     |                         |                      |
| Expenditure Category                     | General Fund         | Road Fund           | Agency Fund         | Tobacco Settlement Fund | Total                |
| Regular Salaries & Wages                 | 31,629,268.23        | 1,102,324.38        | 1,488,048.24        | -                       | 34,219,640.85        |
| Other Salaries & Wages                   | 844,500.44           |                     | 16,223.55           | -                       | 860,723.99           |
| Employer FICA                            | 2,339,721.75         | 74,796.74           | 74,102.74           |                         | 2,488,621.23         |
| Employer Retirement                      | 2,535,515.54         | 71,467.72           | 78,144.57           |                         | 2,685,127.83         |
| Health Insurance                         | 4,404,338.42         | 126,129.98          | 125,370.33          |                         | 4,655,838.73         |
| Life Insurance                           | 17,995.03            | 491.04              | 526.69              |                         | 19,012.76            |
| <i>Subtotal Salaries &amp; Fringe</i>    | <i>41,771,339.41</i> | <i>1,375,209.86</i> | <i>1,782,416.12</i> | <i>-</i>                | <i>44,928,965.39</i> |
| Worker's Compensation                    | 137,895.00           |                     |                     |                         | 137,895.00           |
| Other Personnel Costs                    | 220,112.39           |                     | 131.60              |                         | 220,243.99           |
| Auditing Services                        | 229,302.00           |                     |                     |                         | 229,302.00           |
| Other Professional Services Contracts    | 3,012,217.17         | 11,033.00           |                     |                         | 3,023,250.17         |
| <b>Total Personnel Costs</b>             | <b>45,370,865.97</b> | <b>1,386,242.86</b> | <b>1,782,547.72</b> | <b>-</b>                | <b>48,539,656.55</b> |
| Utilities & Heating Fuels                | 324,288.71           | 5,732.00            |                     |                         | 330,020.71           |
| Facilities and Support Services Charges  | 37,532.64            |                     |                     |                         | 37,532.64            |
| Other Rentals                            | 2,905,892.09         | 52,895.42           | 25,468.37           |                         | 2,984,255.88         |
| Maintenance and Repairs                  | 932,501.13           |                     | 3,097.50            |                         | 935,598.63           |
| Postage & Related Services               | 3,544,622.28         | 172.20              | 153,145.92          |                         | 3,697,940.40         |
| Miscellaneous Services                   | 1,613,594.88         | 162.00              | 6,901.02            | 174,740.00              | 1,795,397.90         |
| Telecommunications                       | 85,183.63            | 24.96               | 2.66                |                         | 85,211.25            |
| Computer Services                        | 15,924,043.24        | 470,000.00          | 1,031,196.71        |                         | 17,425,239.95        |
| Items for Resale                         | 450.00               |                     |                     |                         | 450.00               |
| Supplies                                 | 266,664.19           |                     | 11,727.54           |                         | 278,391.73           |
| Commodities                              | 203,731.17           | 32,685.65           | 53,178.79           |                         | 289,595.61           |
| Travel                                   | 692,502.66           | 4,485.46            | 148,589.86          |                         | 845,577.98           |
| Miscellaneous Commodities                | 6,325.41             | 47,599.45           | 339,384.81          | 260.00                  | 393,569.67           |
| <b>Total Operating Expenses</b>          | <b>26,537,332.03</b> | <b>613,757.14</b>   | <b>1,772,693.18</b> | <b>175,000.00</b>       | <b>29,098,782.35</b> |
| Financial Assistance-Non-State Employees | -                    |                     | 148.10              |                         | 148.10               |
| <b>Total Grants/Loans/Benefits</b>       | <b>-</b>             | <b>-</b>            | <b>148.10</b>       | <b>-</b>                | <b>148.10</b>        |
| Motor Vehicles                           |                      |                     | 12,016.00           |                         | 12,016.00            |
| <b>Total Capital Outlay</b>              | <b>-</b>             | <b>-</b>            | <b>12,016.00</b>    | <b>-</b>                | <b>12,016.00</b>     |
| <b>Total Expenditures</b>                | <b>71,908,198.00</b> | <b>2,000,000.00</b> | <b>3,567,405.00</b> | <b>175,000.00</b>       | <b>77,650,603.00</b> |

# DOR Administration

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## DOR Offices, Divisions and Their Duties

### Office of Processing & 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.

### Division of Minerals Taxation and GIS Services

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; Minerals Severance Tax; 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, verifying and preparing refunds and discovery of non-filer populations.
- The **Division of Miscellaneous Taxes** is responsible for administering the following taxes: affordable housing trust fund fee, alcoholic beverage taxes; cigarette enforcement fee, cigarette papers tax, license, excise tax and surtax; other tobacco products and snuff taxes; gasoline tax; liquefied petroleum gas; special fuels taxes; petroleum storage tank environmental assurance fee; health care provider tax; inheritance and estate tax; insurance premiums and insurance surcharge taxes; bank franchise tax; legal process; marijuana and controlled substance; motor vehicle tire fee; motor vehicle usage taxes; loaner-rental program; PSC annual assessment; pari-mutuel excise, racing license and admissions taxes; RECC and RTCC; transient room tax; and utility gross receipts license tax. It consists of two branches: Road Fund Branch and Miscellaneous Tax Branch.

# DOR Administration

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## Office of Income Taxation

The Office of Income Taxation was established pursuant to KRS 131.020(1)(g). The Office is responsible for administering all matters related to the individual income, withholding, corporation income, corporation license, and limited liability entity taxes, including but not limited to technical tax research, compliance, taxpayer assistance, tax specific training, public announcements, publications, creating and updating forms, analyzing legislation, drafting legislation, and drafting regulations. The Office is comprised of the Division of Individual Income Tax, the Division of Corporation Income Tax and the Executive Director's Office.

- The **Division of Individual Income Tax** is comprised of the individual income tax branch, withholding tax branch, and the director's office. The division has the primary responsibility of providing taxpayer assistance for individual income and individual income withholding taxes, including handling taxpayer inquiries received over the phone, by written correspondence, via e-mail and via live chat. The Division is also responsible for compliance programs for individual income and individual withholding taxes and assisting the Office of Processing and Enforcement in the processing of returns.
- The **Division of Corporation Tax** is responsible for the administration of corporation income and license taxes, limited liability entity tax, pass-through entity withholding, economic development income tax credits, and other types of income tax incentives. The Division is divided into two branches, the Corporate Income & License Tax Branch and the Pass-through Entity Branch. The two branches

perform the same basic functions—taxpayer assistance and compliance, albeit on different types of corporation and pass-through entity tax returns.

## 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.

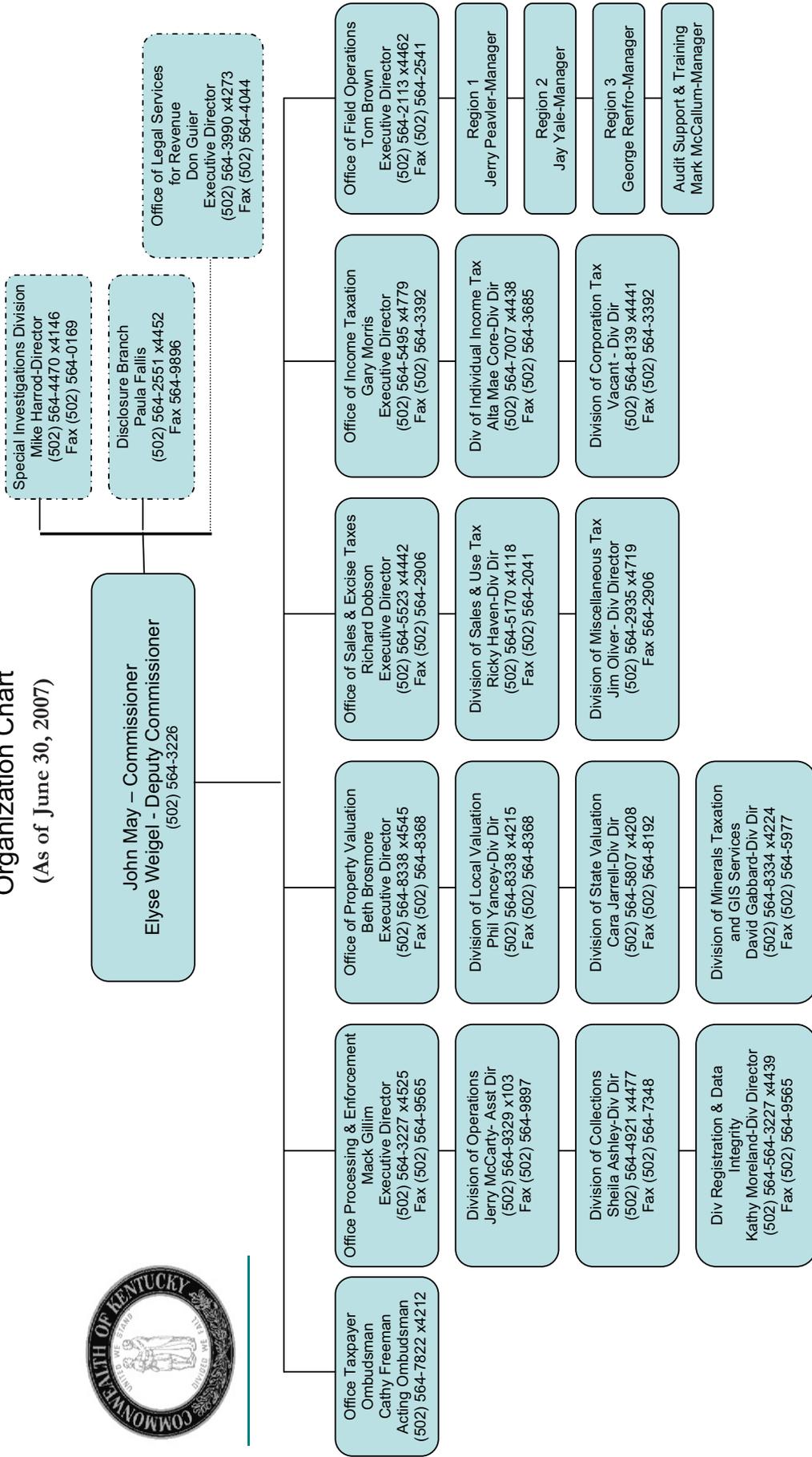
## PVA Offices (Accounting)

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.

# FINANCE & ADMINISTRATION CABINET KENTUCKY DEPARTMENT OF REVENUE

## Organization Chart

(As of June 30, 2007)



# Taxes Administered

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**Affordable Housing Trust Fund Fee (KRS 64.012) – Effective Aug. 1, 2006**—Collected by agreement between DOR and the Kentucky Housing Corporation, \$6 of each \$12 fee imposed on the recording with the county clerk of a (1) Deed of trust or assignment for the benefit of creditors; (2) Deed; (3) Real estate mortgage; (4) Deed of assignment; (5) Real estate option; (6) Power of attorney; (7) Revocation of power of attorney; (8) Lease which is recordable by law; (9) Deed of release of a mortgage or lien under KRS 382.360; (10) United States lien; (11) Release of a United States lien; (12) Release of any recorded encumbrance other than state liens; (13) Lis pendens notice concerning proceedings in bankruptcy; (14) Lis pendens notice; (15) Mechanic's and artisan's lien under KRS Changer 376; (16) Assumed name; (17) Notice of lien issued by the Internal Revenue Service; (18) Notice of lien discharge issued by the Internal Revenue Service; (19) Original, assignment, amendment, or continuation financing statement; (20) Making a record for the establishment of a city, recording the plan or plat thereof, and all other service incident; (21) Survey of a city, or any part thereof, or any addition to or extensions of the boundary of a city; (22) Recording with statutory authority for which no specific fee is set, except a military discharge; and (23) Filing with statutory authority for which no specific fee is set shall be paid to the affordable housing trust fund established in KRS 198A.710 and shall be remitted by the county clerk.

## Agricultural Products

- In Hands of Producer or Agent (**KRS 132.020(1)(e), 132.200(6)**)—1.5 cents (per \$100 of assessment). State rate only.
- Tobacco Not at Manufacturer's Plant (Storage)—(**KRS 132.020(1)(d), 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)(e), 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(1)(p), 132.200(18)**)—1.5 cents (per \$100 of assessment). Local option.
- For Hire Non-Public Service Company (**KRS 132.020(1)(r)**)—45 cents (per \$100 of assessment). Subject to full local rates.
- Public Service Company Aircraft (**KRS 136.120, KRS 136.180(3)**)—Subject to annual adjustment. Multiplier applied to local rates and subject to annual adjustment.

**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.

# Taxes Administered

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**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.

**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 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.

**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 exemptions from the tax may apply to newly permitted production from thin seam.

**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.

For tax years beginning on or after Jan. 1, 2007 all pass-through entities will be treated the same for Kentucky income tax purposes as they are treated for federal income tax purposes, except for differences between Kentucky law and federal law. The AMC was repealed and a new limited liability entity tax (LLET) is imposed on every corporation and limited liability pass-through entity doing business in Kentucky. "Corporation means "corporation" as defined in Section 7701(a)(3) of the Internal Revenue Code.

The (LLET) is the lesser of \$0.095 per \$100 of a corporation's or pass-through entity's Kentucky gross

# Taxes Administered

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receipts, or \$0.75 per \$100 of a corporation's or pass-through entity's Kentucky gross profits.

For tax years beginning on or after Jan. 1, 2007, if gross receipts or gross profits from all sources are \$3 million or less, a \$175 minimum payment is due. Also, marginal LLET tax relief is provided if gross receipts or gross profits from all sources are in excess of \$3 million, but less than \$6 million.

An individual that is a partner, member or shareholder of a limited liability pass-through entity is allowed an LLET credit against the income imposed by KRS 141.020 equal to the individual's proportionate share of LLET computed on the gross receipts or gross profits of the limited liability pass-through entity as provided by KRS 141.0401(2), after the LLET is reduced by the minimum tax of \$175 and by any other credits for which the limited liability pass-through entity may be allowed.

The credit allowed a corporation or individual that is a partner, member or shareholder in a limited liability pass-through entity shall be applied only to the income tax assessed on the corporation's or individual's proportionate share of distributive income from the limited liability pass-through entity as provided by KRS 141.0401(3)(a) and KRS 141.0401(3)(b), respectively. Any remaining credit shall be disallowed and shall not be carried forward to the next year.

A corporation that is a partner or member of a limited liability pass-through entity is allowed a LLET credit against the income tax imposed by KRS 141.040 equal to the LLET computed on its gross receipts or gross profits as provided by KRS 141.0401(2)(c), after the LLET is reduced by the minimum tax of \$175 and by any other credits for which the corporation may be allowed. Corporation income tax rates: first \$50,000 of net income—4 percent; next \$50,000—5 percent; and all over \$100,000—6 percent.

**Distilled Spirits (KRS 132.020(1)(n), 132.097, 132.099, 132.180 and 132.200(4))**—Except for inventories qualifying for goods in transit to an out-of-state destination within six months and certain products in course of manufacture, subject to 5 cents (per \$100 of assessment) state rate and full local rates.

**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.

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

**Farm Machinery Used in Farming (KRS 132.020(1)(f))**—.1 cent (per \$100 of assessment). State rate only.

**Goods Held for Sale in the Regular Course of Business (KRS 132.020(1)(n))**—5 cents (per \$100 of assessment). Subject to local rates.

**Health Care Provider Tax (KRS 142.301 to 142.359)—Effective July 1, 2006**—2.5 percent of gross receipts for hospital services for facilities not in operation during FY06, for facilities in operation during FY06, the monthly tax is one-twelfth of the total paid during FY06; 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

# Taxes Administered

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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: 2006—\$1,970 and 2007—\$2,050.

## **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, 304.49220)**—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.

**Leasehold Interest (KRS 132.020(1)(b), 132.200(2))**—Privately owned leasehold interest in industrial buildings. 1.5 cents (per \$100 of assessment). State rate only.

**Livestock and Poultry (KRS 132.020(1)(g))**—.1 cent (per \$100 of assessment). State rate only.

**Legal Process Taxes (KRS 142.010 et seq.)—Effective Jan. 1, 2007**—Conveyances of real property (deeds)—**\$4.00**; mortgages, financial statements and security agreements—**\$4.00**; marriage licenses\*—**\$4.50**; powers of attorney to convey real or personal property—**\$4.00**; lien or conveyance of coal, oil, gas or other mineral right or privilege—**\$4.00**. 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.

**Loaner-Rental Tax (KRS 138.460 & KRS 138.4605)**—Loaner-Rental tax is paid by a dealer who is regularly engaged in the servicing or repair of motor vehicles and loans or rents a motor vehicle to a retail customer while the customer's motor vehicle is at the dealership for repair or service. Dealers must make application to be in the program. Upon acceptance into the program, the dealer will be required to file a monthly return and remit \$25 per vehicle for as long as the vehicle is used as a Loaner-Rental. A vehicle log must be maintained by the dealer; loan/rental dates, mileage in and out, customer names and description of repairs completed for the customer.

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

**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

# Taxes Administered

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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.

**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.

**Pollution Control Facilities (KRS 132.020(1)(k), 132.200(8))**—15 cents (per \$100 of assessment). State rate only.

**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 Warehouses**—Goods held for sale except goods in transit. **(KRS 132.020(1)(n))**—5 cents (per \$100 of assessment). Subject to local rates.

Goods in Transit to an out-of-state destination within six months. **(KRS 132.097, 132.099)**

Exempt from state, county, school and city tax. Special taxing districts only may levy a rate.

# Taxes Administered

## 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            |

### Race Track 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.

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

**Railroads—Interstate (KRS 136.120, 136.180(4))**—Subject to annual adjustment. Multiplier applied to local rates and subject to annual adjustment.

**Raw Materials and Products in Course of Manufacture (KRS 132.020(1)(n), 132.200(4))**—5 cents (per \$100 of assessment). State rate only.

**Real Estate Not elsewhere Specified (KRS 132.020(1)(a))**—Adjusted annually (by July 1) per KRS 132.020(4). The state real estate rate was 13.3 cents (per \$100 assessment) for 2003, 13.1 cents for 2004 and 2005, 12.8 cents for 2006 and 12.4 cents for 2007. Full local rates.

**Recreational Vehicles (KRS 132.485(1)(b), 132.730. 132.751)**—Classification depends on permanency of location. 45 cents (per \$100 of assessment). Full local rates.

**Recycling Machinery (KRS 132.020(1)(r), 132.200(15))**—45 cents (per \$100 of assessment). State rate only.

# Taxes Administered

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**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)

Vendor's compensation is allowed up to \$1,500 per timely filed and paid return.

There are statutory exemptions.

**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.

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

**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 timely filed and paid return for the excise tax portion of the telecommunications tax 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.

**Trucks and Tractors-Interstate (KRS 136.188, 132.487, 132.760)**—Subject to annual ad valorem fee as of Jan. 1, 2007. Fee subject to annual adjustment. State and local fees are collected by Department of Transportation and distributed by DOR. Buses and nonapportioned KY registered vehicles are subject to KRS 132.487. Semi-trailers of interstate motor carriers are exempt.

**Unmined Coal, etc. same as for real estate.**

**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 12.4 cents for 2007, 12.8 cents for 2006, 13.1 cents for 2005, 13.1 cents for 2004 (per \$100 assessments). Full local rates.

**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.

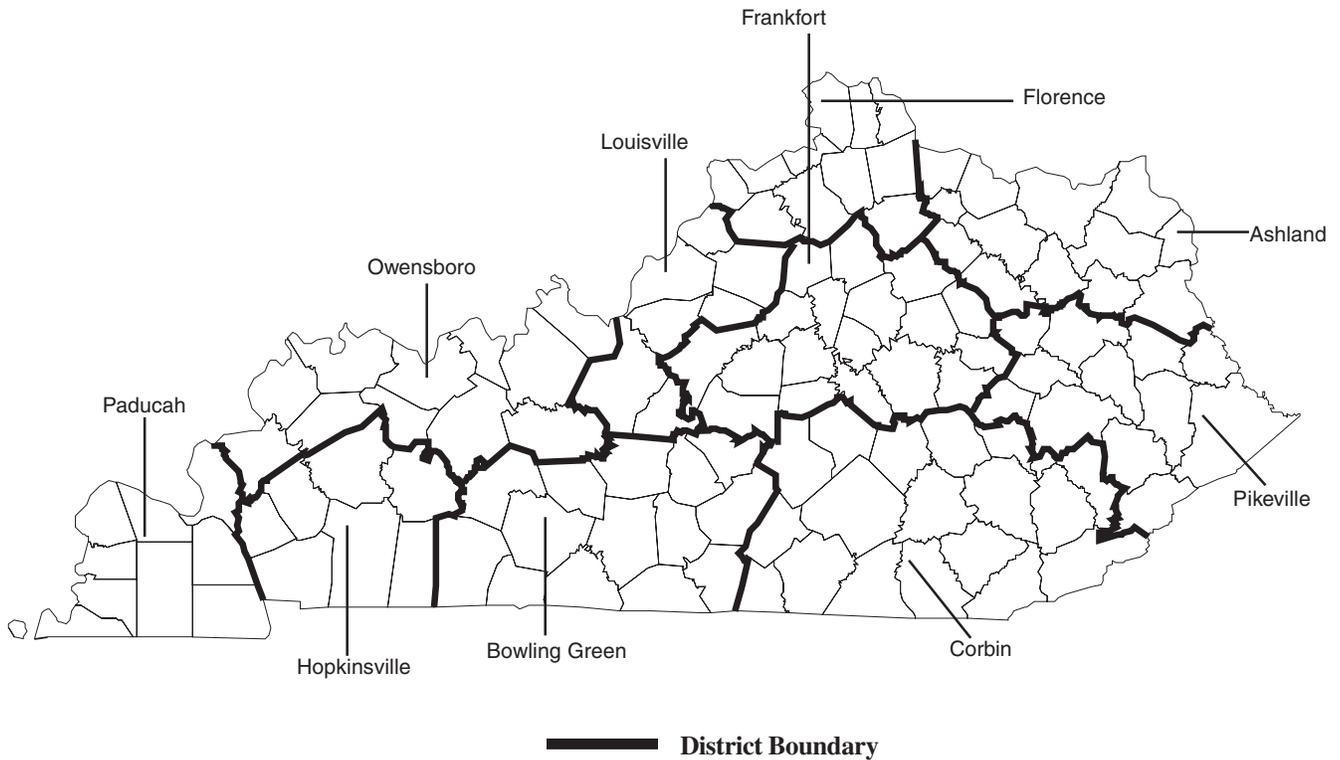
# Taxes Administered

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## Watercraft

- Commercial (**KRS 136.120 and 136.181**)—45 cents (per \$100 of assessment). Full local rates.
- Individual (**KRS 132.020(1)(r), 132.488**)—45 cents (per \$100 of assessment). Full local rates.
- Federally Documented (**KRS 132.020(1)(q), 132.200(19)**)—1.5 cents (per \$100 of assessment). Local option.

# 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**

501 High Street, Tenth 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**

501 High Street, Sixth 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

**Northern Kentucky**

Turfway Ridge Office Park  
7310 Turfway Rd., Suite 190  
Florence, 41042-4871  
Telephone: (859) 371-9049  
Fax: (859) 371-9154

**Owensboro, 42301-0734**

311 West Second Street  
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Fax: (270) 687-7244

**Paducah, 42001-4024**

2928 Park Avenue  
Clark Business Complex, Suite G  
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Fax: (270) 575-7027

**Pikeville, 41501-1275**

126 Trivette Drive  
Uniplex Center, Suite 203  
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