



KENTUCKY DEPARTMENT OF REVENUE

Daniel P. Bork, Commissioner

ANNUAL REPORT 2017-2018



MATTHEW G. BEVIN, GOVERNOR
Commonwealth of Kentucky

WILLIAM M. LANDRUM III, SECRETARY
Finance and Administration Cabinet



KENTUCKY DEPARTMENT OF **REVENUE**

Putting People **FIRST**

Fairness

We are committed to the unbiased administration of tax laws.

Integrity

We conduct ourselves in a manner that promotes public confidence and safeguards taxpayer information.

Respect

Our goal is to treat every taxpayer interaction with the highest regard for civility.

Service

Serving taxpayers with expertise, pride, professionalism, and enthusiasm is our highest priority.

Teamwork

We pledge to work hand in hand with taxpayers and community partners. We are “One Department, One Team.”

Mission Statement

The Kentucky Department of Revenue serves the citizens of our Commonwealth through the fair administration of tax laws; adherence to the Taxpayer Bill of Rights; and collection of revenues used to fund public services, programs, and the protection of natural resources. We perform our duties in a manner that is professional, efficient, and merits the utmost in public confidence while demonstrating the highest level of integrity.



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William M. Landrum III
Cabinet Secretary

Daniel P. Bork
Commissioner

December 1, 2018

The Honorable Matthew G. Bevin
Commonwealth of Kentucky
The State Capitol
Frankfort, KY 40601

Dear Governor Bevin:

We are proud to serve alongside the employees of the Kentucky Department of Revenue (DOR) and are pleased to present the Annual Report for the fiscal year July 1, 2017 through June 30, 2018. DOR is charged with the task of consistently and objectively administering tax laws while providing quality customer service to the taxpayers and tax professionals living and working in Kentucky. We balance our resources in order to efficiently and thoroughly complete this undertaking.

This report reflects the hard work and dedication of the many professionals who constitute the workforce of DOR. Amongst many other things, we are pleased to report that in Fiscal Year 2017-18 DOR:

- Collected in excess of \$10.5 billion of taxes and related payments into the General Fund
- Collected over \$1.15 billion of taxes and related payments into the Road Fund
- Received and responded to more than 850,000 phone calls, over 95,000 letters, and more than 30,000 electronic communications from taxpayers and tax professionals
- Stopped in excess of \$23.7 million of fraudulent tax refund requests (calendar year 2018)
- Repealed six administrative regulations and amended an additional 24
- Received budget approval and issued a request for proposal for an integrated tax system to replace more than 60 antiquated tax systems
- Began implementation of House Bill 487, the most significant sales tax change in over a decade

More detail about the work we conduct and the accomplishments we are proud to report are included in the body of the Annual Report. We appreciate all of the support we receive and are honored to serve the Commonwealth.

With kind regards,

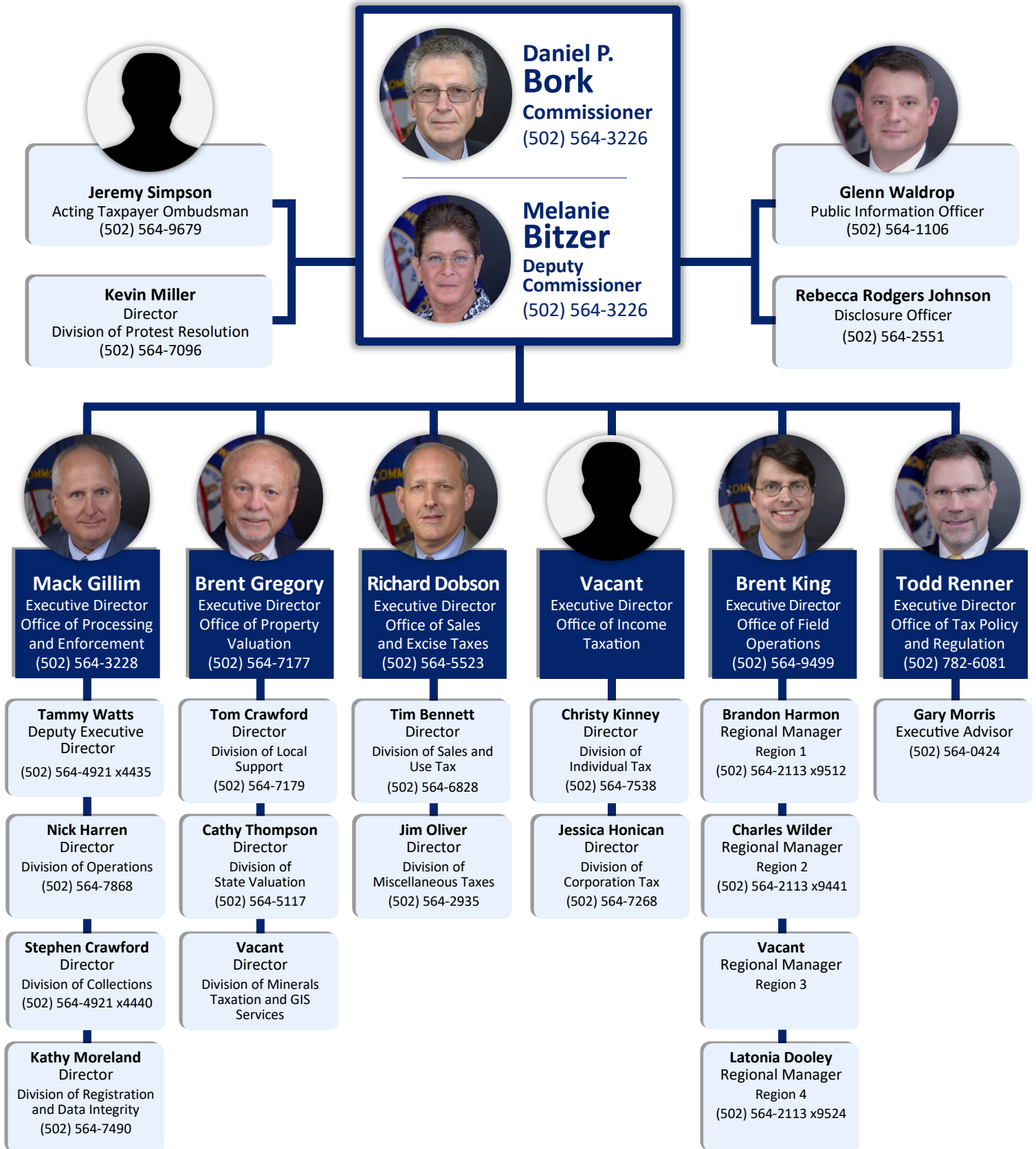
Daniel P. Bork
Commissioner

Approved by:

William M. Landrum III
Finance and Administration Cabinet Secretary



KENTUCKY DEPARTMENT OF REVENUE





EXECUTIVE SUMMARY

Office of Processing and Enforcement

- Deposited receipts in excess of \$8.3 billion electronically
- Processed more than 2 million individual income tax returns in calendar year 2018
- Processed over \$570 million of individual income tax refunds to taxpayers in calendar year 2018
- Processed more than 64,700 business tax registration applications
- Collected in excess of \$200 million of unpaid tax obligations
- Collected more than \$26.7 million of debt on behalf of enterprise agencies

Office of Property Valuation

- Collected over \$30.1 million of state and local omitted personal property tax payments
- Collected in excess of \$418 million of state and local motor vehicle property taxes
- Determined assessment values of over \$38 billion related to public service and centrally assessed companies
- Certified to local government partners assessment values of approximately \$68 billion related to bank franchise deposits
- Assessed the valuation of more than \$73 billion worth of tangible personal property through the PVA offices
- Collected in excess of \$123.7 million in severance tax receipts
- Assessed more than \$1.072 billion of unmined mineral taxes in calendar year 2017

Office of Sales and Excise Taxes

- Collected in excess of \$44.13 million through tax compliance programs and refund request reductions
- Collected more than \$36.5 million in sales and use tax through the national Streamlined Sales Tax Registration System
- Collected and distributed over \$223.61 million of Utility Gross Receipts License Tax (UGRLT)
- Conducted 217 retail cigarette inspections

Office of Income Taxation

- Assessed over \$51.4 million of individual income tax through compliance measures
- Assessed more than \$124.3 million of corporate income tax through compliance measures
- 88% of individual income tax returns electronically filed in calendar year 2018
- 37% of corporate income tax returns electronically filed in calendar year 2018

Office of Field Operations

- Assessed more than \$58 million of tax due as a result of the 950 audits conducted
- Assessed over \$4.3 million of tax due as a result of compliance measures
- Collected in excess of \$15 million in payments through taxpayer assistance programs
- Received and responded to over 29,000 in-person inquiries from taxpayers who visited Taxpayer Service Centers
- Prepared approximately 2,240 individual income tax returns for qualified taxpayers

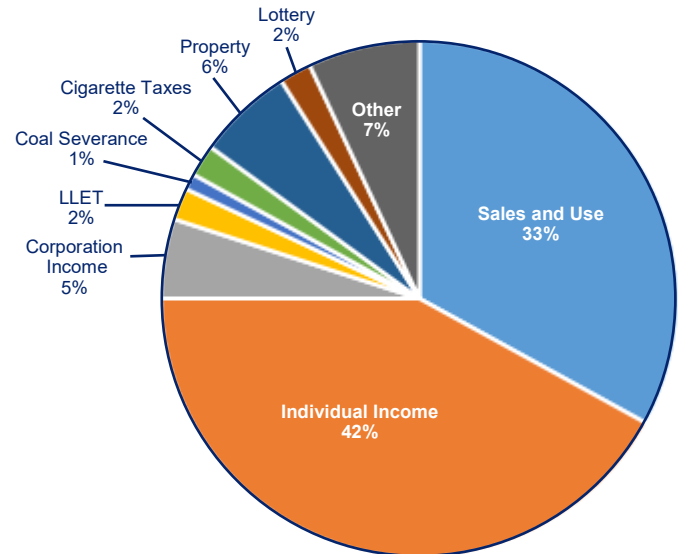


REVENUE RECEIPTS

General Fund

General Fund Revenue Compared To Last Year (\$ Millions)

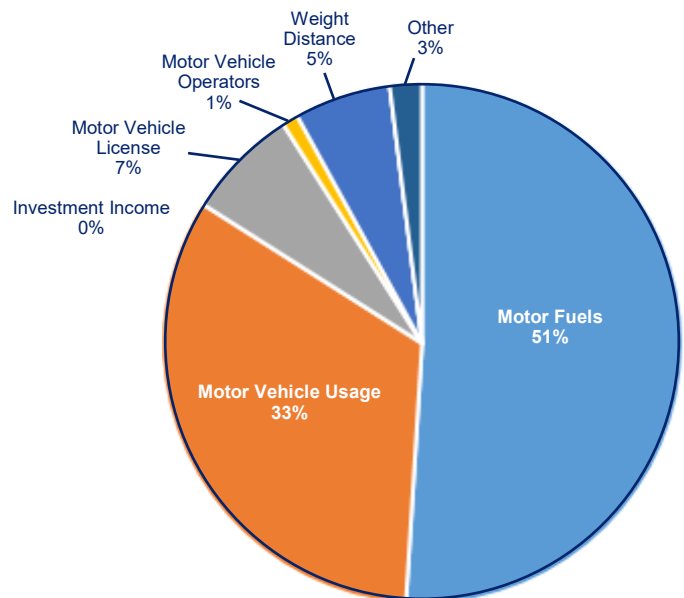
	Full Year		Growth Rate
	FY 18	FY 17	FY 18
Individual Income	4,603.6	4,393.9	4.8
Sales and Use	3,605.7	3,485.2	3.5
Property	621.3	602.1	3.2
Corporation Income	511.4	497.5	2.8
LLET	238.1	245.6	-3.0
Cigarette Taxes	211.8	221.4	-4.3
Lottery	253.0	241.6	4.7
Coal Severance	89.6	100.5	-10.8
Other	703.7	690.1	2.0
Total	10,838.2	10,477.8	3.4



Road Fund

Road Fund Revenue* Compared To Last Year (\$ Millions)

	Full Year		Growth Rate
	FY 18	FY 17	FY 18
Motor Fuels	764.9	760.5	0.6
Motor Vehicle Usage	493.1	499.8	-1.3
Motor Vehicle License	112.9	111.9	0.8
Motor Vehicle Operators	16.8	16.1	4.2
Weight Distance	81.7	82.9	-1.4
Investment Income	2.8	1.6	79.4
Other	38.7	35.1	10.2
Total	1,511.0	1,508.0	0.2



*includes revenue collected and deposited by DOR and other agencies



PUBLIC OUTREACH AND STAFF DEVELOPMENT

Public Outreach

The Kentucky Department of Revenue is committed to using multiple communications platforms to better inform and educate taxpayers. Our goal is to make it easier to do business with the Commonwealth of Kentucky and we use a variety of methods to achieve this goal. DOR personnel, along with staff from the Finance and Administration Cabinet, formed a communications team to design a cohesive and comprehensive plan to foster better communications between staff and taxpayers.

The team created a dedicated website (taxanswers.ky.gov) to assist in the implementation of a new sales tax initiative associated with the passing of HB 487 in the 2018 legislative session. DOR also participated in many other public outreach appearances, including:

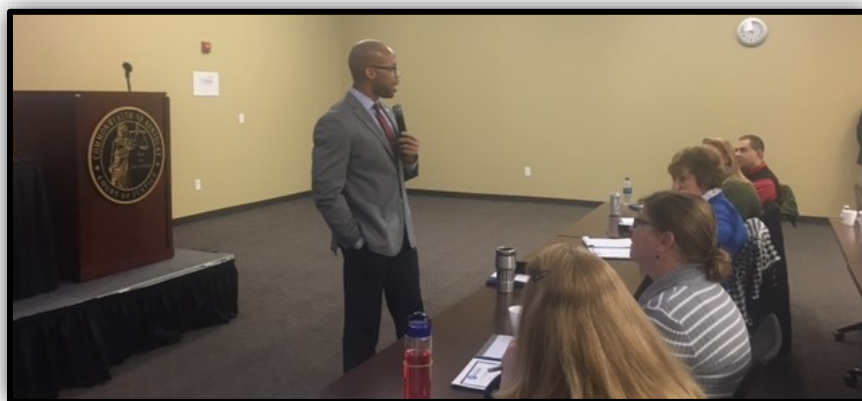
- Co-produced a live call-in show on KET
- Conducted multiple radio, television, and print media interviews
- Staffed a booth at the Kentucky State Fair
- Presented at the Public Protection Cabinet's Senior Scam Jam



Staff Development

DOR operates training efforts from a centralized unit in order to provide training consistently for all of our staff. The training team focuses on trainings that are universal to all staff and coordinates tax specific trainings across DOR.

- 10 DOR employees were enrolled in the Certificate of Supervisory Essentials program
- Two DOR employees accepted into the Governor's Minority Management Training Program
- Coordinated video, online, and in-person training and education courses for DOR employees
- Coordinated DOR presentations for many events, including the annual University of Kentucky Income Tax Seminar Program, the KyCPA Kentucky State Tax Conference, and the Kentucky Digital Government Summit





TAXPAYER SERVICE CENTERS

The Department of Revenue supports 10 Taxpayer Service Centers (TSCs) throughout the Commonwealth. DOR employees at these TSCs assist taxpayers with a range of tax matters involving all tax types.

1 Paducah Taxpayer Service Center
Clark Business Complex, Suite G
2928 Park Avenue
Paducah, KY 42001
(270) 575-7148

2 Hopkinsville Taxpayer Service Center
181 Hammond Drive
Hopkinsville, KY 42240
(270) 889-6521

3 Owensboro Taxpayer Service Center
401 Frederica St, Bldg C, Suite 201
Owensboro, KY 42301
(270) 687-7301

4 Bowling Green Taxpayer Service Center
201 West Professional Park Court
Bowling Green, KY 42104
(270) 746-7470

5 Louisville Taxpayer Service Center
600 West Cedar Street
2nd Floor West
Louisville, KY 40202
(502) 595-4512

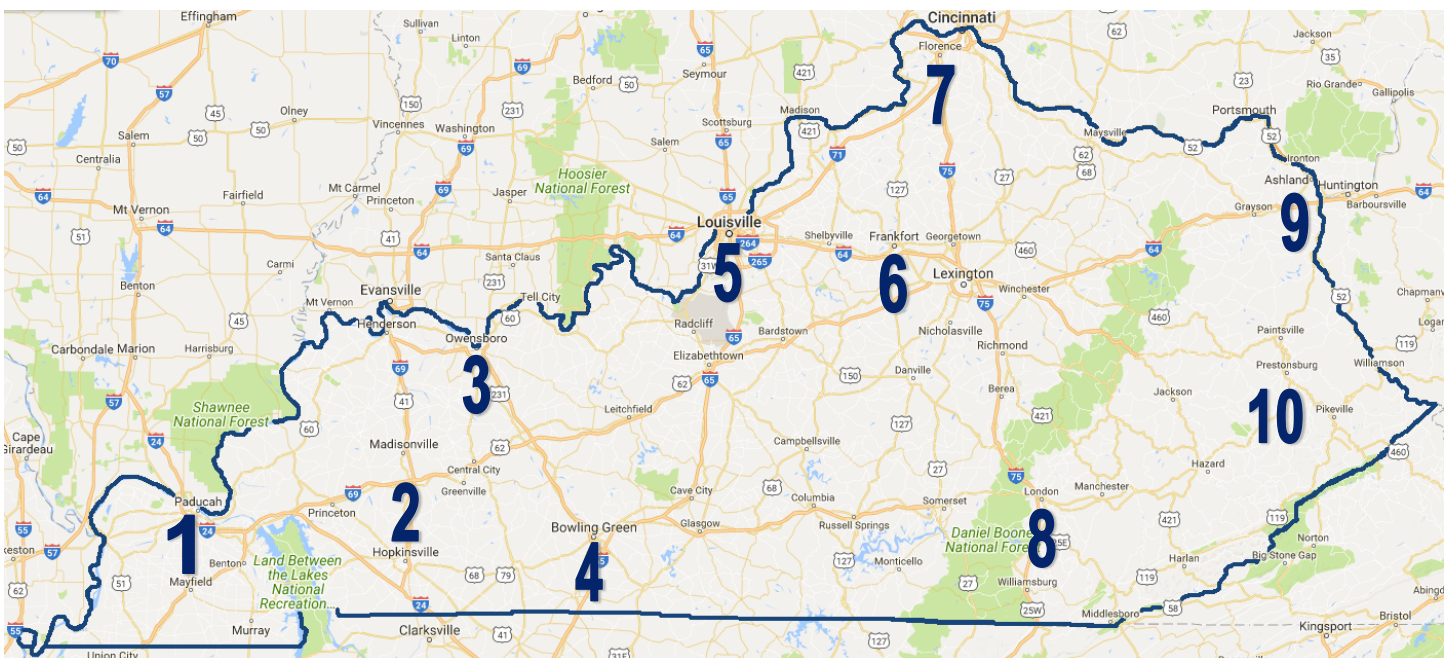
6 Frankfort Taxpayer Service Center
501 High Street
Station 38
Frankfort, KY 40601
(502) 564-5930

7 Northern Kentucky Taxpayer Service Center
7310 Turfway Rd, Ste 190
Florence, KY 41042
(859) 371-9049

8 Corbin Taxpayer Service Center
15100 North US 25E, Ste 2
Corbin, KY 40701
(606) 528-3322

9 Ashland Taxpayer Service Center
1539 Greenup Avenue
Ashland, KY 41101
(606) 920-2037

10 Pikeville Taxpayer Service Center
Uniplex Center
126 Trivette Drive, Suite 203
Pikeville, KY 41501
(606) 433-7675





OFFICE OF THE COMMISSIONER

DIVISION OF PROTEST RESOLUTION DIVISION OF TAXPAYER OMBUDSMAN DISCLOSURE BRANCH

The Office of the Commissioner of the Kentucky Department of Revenue includes Commissioner Daniel P. Bork, the Deputy Commissioner, the Public Information Officer, the Division of Protest Resolution, the Division of the Taxpayer Ombudsman, and the Disclosure Branch. The Office of the Commissioner is responsible for the overall management of DOR.

The **Division of Protest Resolution** is responsible for managing all formal protests filed with DOR (except residential real estate protests). The Division of Protest Resolution independently reviews each case before attempting to resolve the matter directly with the taxpayer. Protests can encompass all tax types and typically involve a taxpayer disagreement as to a position, legal interpretation, and/or action taken by DOR. Tax protests frequently relate to assessments, denials of full and partial tax refund requests, and tax exemption denials.

- Received 507 new tax protest cases amounting to more than \$102.8 million in protested taxes
- Resolved 540 tax protest cases and collected in excess of \$13.8 million as a result
- Reduced average time for protest resolution by two months
- Reduced outstanding inventory of tax protest cases by over \$115.5 million (*decrease of 46.6% compared to prior fiscal year*)

The **Division of the Taxpayer Ombudsman** receives thousands of telephone, written, and electronic inquiries from taxpayers, tax practitioners, and other government agencies, including the legislative constituent office. The Division of the Taxpayer Ombudsman also maintains the Practitioner Hotline which provides an avenue of communication between tax practitioners and DOR. The Division of the Taxpayer Ombudsman responds to inquiries encompassing all tax types and acts as a liaison between taxpayers and DOR to ensure protection of taxpayer rights. The Taxpayer Ombudsman provides essential services to citizens of the Commonwealth who need assistance with issues that are not resolved through regular channels.

- Responded to 3,681 total telephone inquiries received by the Taxpayer Ombudsman (*15% increase compared to prior fiscal year*)
- Responded to more than 680 telephone inquiries received by the Practitioner Hotline

The **Disclosure Branch** coordinates DOR's physical and electronic security internally and with other agencies and third parties. The Disclosure Branch also oversees exchange of information agreements and coordinates the flow of data between the Kentucky Department of Revenue and the Internal Revenue Service (IRS).

- Collected over \$87.8 million through exchange of information agreements (*11.67% increase compared to prior fiscal year*)



OFFICE OF PROCESSING AND ENFORCEMENT

DIVISION OF OPERATIONS
DIVISION OF REGISTRATION AND DATA INTEGRITY
DIVISION OF COLLECTIONS
DIVISION OF APPLICATION DEVELOPMENT AND SUPPORT

The Office of Processing and Enforcement is comprised of four divisions: (1) Operations, (2) Registration and Data Integrity, (3) Collections, and (4) Application Development and Support. The four divisions work closely with all DOR offices and tax types in addition to external agencies.

The **Division of Operations** is responsible for receiving documents (including tax returns), capturing and storing relevant data, receiving and depositing payments, and initial processing of tax returns for all tax types.

- Average processing time for individual income tax returns was 11.3 days in calendar year 2018
- Processed more than 2 million individual income tax returns in calendar year 2018
- Processed over \$540.2 million of individual income tax refunds to taxpayers in calendar year 2018 (*the average refund amount was \$412 per taxpayer*)
- Deposited receipts in excess of \$8.3 billion electronically
- Prevented the processing of more than \$23.7 million in fraudulent individual income tax refund requests

The **Division of Registration and Data Integrity** receives and processes all business tax applications, both those received on paper as well as those submitted electronically through Kentucky Business One Stop. The division also identifies businesses that need to register for business taxes through compliance programs.

- Processed more than 39,500 tax registration applications received on paper and reviewed over 25,200 tax registrations completed through Kentucky Business One Stop
- Administratively registered over 20,000 noncompliant businesses
- Answered more than 76,800 calls from taxpayers and preparers (*approximately 40% increase in calls answered*)
- Began implementation of HB 487, requiring the registration of many new businesses

The **Division of Collections** works with taxpayers to resolve their tax liabilities and debts. The division implements all administrative and legal actions available to enforce the collection of unpaid tax obligations owed to the Commonwealth. Additionally, the Division of Collections engages in collection efforts for external enterprise agencies as contractually agreed upon.

- Collected a total of over \$227 million
 - Collected more than \$26.7 million of debt on behalf of external enterprise agencies

The **Division of Application Development and Support** was formed during Fiscal Year 2017-18. This division is tasked with providing project management, planning, analysis, application development, implementation, security, support, and maintenance for new and legacy systems of DOR. Commonwealth Office of Technology staff familiar with DOR systems transferred into the new division, along with existing DOR subject matter experts.

- Fully supports 75 applications and provides business analysis for an additional 39 mainframe systems



OFFICE OF PROPERTY VALUATION

DIVISION OF LOCAL SUPPORT DIVISION OF MINERALS TAXATION AND GIS SERVICES DIVISION OF STATE VALUATION

The Office of Property Valuation is comprised of three divisions: (1) Local Support, (2) Minerals Taxation and GIS Services, and (3) State Valuation. All three divisions oversee and address different aspects of state and local property valuation and property tax matters.

The **Division of Local Support** supervises and assists the Property Valuation Administrators (PVAs), sheriffs, and county clerks in all 120 Kentucky counties with property tax assessment and collection duties. Further, the Division of Local Support provides guidance and establishes policies for all PVA offices involving budgets, payroll, accounting, and administrative support.

- Collected in excess of \$537 million in property tax receipts on behalf of the Commonwealth through sheriffs' offices (*3.7% increase compared to prior fiscal year*)
- Assisted county fiscal courts across the state with the receipt of more than \$326.6 million in property tax revenue (*3.4% increase compared to prior fiscal year*)
- Assisted school districts across the state with the receipt of over \$1.78 billion of property tax revenue (*10% increase compared to prior fiscal year*)
- Assisted local jurisdictions in all counties with the receipt of more than \$2.59 billion in property tax revenue (*4.6% increase compared to prior fiscal year*)
- Presented property tax training sessions for PVAs, county attorneys, sheriffs, and county clerks across the state

The **Division of Minerals Taxation and GIS Services** is responsible for administering the severance taxes and the unmined minerals property taxes. The division also coordinates cartography utilizing geographical information systems ("GIS") mapping efforts.

- Collected in excess of \$123.7 million in severance tax receipts, which includes over:
 - \$10.3 million of natural gas tax payments (*46% increase compared to prior fiscal year*)
 - \$89.4 million of coal severance tax
 - \$18.5 million of solid minerals severance tax
 - \$5.4 million of oil production tax
- Assessed more than \$1.072 billion of unmined mineral taxes in calendar year 2017, which includes over:
 - \$451 million of unmined coal tax
 - \$181.5 million of oil tax
 - \$381.5 million of natural gas tax
 - \$57.6 million of limestone tax
 - \$471,500 of clay tax



OFFICE OF PROPERTY VALUATION

The **Division of State Valuation** administers all state-assessed property taxes, including public service property tax and motor vehicle property tax, as well as tangible and intangible tax programs. The Division of State Valuation also plays a critical role in the valuation of property of public service companies, valuation of motor vehicle property tax, and the valuation of tangible and intangible property.

- Assessed the valuation of more than \$73 billion worth of tangible personal property through PVA offices
- Collected over \$30.1 million of combined state and local omitted personal property tax payments
- Collected in excess of \$418 million of combined state and local motor vehicle property taxes (*4.24% increase compared to prior fiscal year*)
- “Freddie Freeroader Program” assessed over \$59,000 of tax owed by residents fraudulently using out of state license plates on their vehicles
- Determined assessment values of over \$38 billion related to public service and centrally assessed companies (*1.6% increase compared to prior fiscal year*)
- Certified to local government partners assessment values of approximately \$68 billion related to bank franchise deposits (*4.62% increase compared to prior fiscal year*)
- Collected in excess of \$35.4 million of TVA in Lieu of Tax payments before distributing to local governments (*2.31% increase compared to prior fiscal year*)
- Collected and/or distributed \$53.2 million of local tax dollars on behalf of local government partners related to omitted personal property, motor vehicles, apportioned vehicles, commercial watercraft, and railroad carlines
- Developed a database that enables efficient electronic transmission of data between DOR and local government offices





OFFICE OF SALES AND EXCISE TAXES

DIVISION OF SALES AND USE TAX DIVISION OF MISCELLANEOUS TAXES

The Office of Sales and Excise Taxes (OSET) is comprised of two divisions: (1) Sales and Use Tax and (2) Miscellaneous Taxes. Both divisions carefully review tax returns; implement compliance measures; assist taxpayers and tax preparers with general and specific issues; coordinate efforts with other DOR offices and outside agencies; and develop sales, use, and miscellaneous tax publications. OSET participates in workgroups and related initiatives sponsored through the national Streamlined Sales Tax Governing Board and the Federation of Tax Administrators.

The **Division of Sales and Use Tax** is responsible for administering the sales and use tax, the telecommunications excise and gross revenues taxes, a number of economic development incentive programs involving tax exemption and tax refunds, and the CMRS 911 fee. The Division of Sales and Use Tax implements compliance measures, including office or “desk” audits; administers a number of tax exemption and tax refund incentive programs; receives and responds to taxpayer inquiries; and reviews and processes requests for tax refunds.

The **Division of Miscellaneous Taxes** administers over 40 taxes, conducts systematic audits, receives and responds to taxpayer inquiries, reviews and processes tax refund requests, and implements compliance measures. The Division of Miscellaneous Taxes administers both General Fund and Road Fund taxes, including:

- Affordable housing trust fund fee
- Alcoholic beverage taxes
- Cigarette enforcement fee
- Chewing tobacco tax
- Other tobacco products and snuff taxes
- Gasoline tax
- Liquefied petroleum gas tax
- Special fuels taxes
- Petroleum storage tank environmental assurance fee
- Health care provider tax
- Inheritance tax
- Insurance premiums and insurance surcharge taxes
- Bank franchise tax
- Legal process tax
- Marijuana and controlled substance tax
- Motor vehicle tire fee
- Motor vehicle usage tax
- Loaner-rental program tax
- Public Service Commission annual assessment
- Pari-mutuel excise tax
- Racing license and admissions tax
- Advanced deposit wagering tax
- Rural Electric Cooperative Corporation tax annual assessment
- Rural Telephone Cooperative Corporation tax annual assessment
- Transient room tax
- Utility gross receipts license tax (UGRLT)
- Spouse abuse shelter fund



OFFICE OF SALES AND EXCISE TAXES

- Collected in excess of \$44.13 million through tax compliance programs and refund request reductions
- Administered E-911 fee imposed on prepaid calling arrangements as required by HB 585 (effective January 1, 2017)
 - Registered 187 new E-911 fee accounts and collected over \$9.1 million for distribution to the 911 Services Board
- Collected more than \$36.5 million in sales and use tax through the national Streamlined Sales Tax Registration System (*20.3% increase compared to prior fiscal year*)
 - Over \$18.2 million collected from voluntary sellers
- Migrated taxpayers out of old electronic filing system into E-File and increased voluntary electronic filing for sales tax to 54%, transient room tax to 78%, and waste tire fee to 60%
- Distributed more than \$36.4 million of telecommunications payments to 1,359 local jurisdictions across the Commonwealth
- Verified and issued six sales tax TIF refunds totaling over \$13.74 million
- Verified and issued 17 tourism attraction project tax refunds totaling more than \$6.04 million
- Verified and issued 36 KEIA refunds totaling over \$6.48 million
- Received and responded to more than 91,600 phone calls and over 17,700 electronic inquiries from taxpayers and tax professionals
- Conducted 217 retail cigarette inspections to ensure compliance with the Tobacco Master Settlement Agreement
- Collected and distributed over \$223.61 million of UGRLT payments to school districts across the Commonwealth





OFFICE OF INCOME TAXATION

DIVISION OF INDIVIDUAL TAX DIVISION OF CORPORATION TAX

After DOR receives tax returns and inputs the information and images into its databases, the Office of Income Taxation assumes responsibility for the continued processing and careful review of individual, corporate, and withholding tax returns. In calendar year 2018, DOR received more than:

- 2 million individual income tax returns
- 199,000 corporate income and limited liability entity tax returns
- 845,000 withholding tax returns

The Office of Income Taxation is comprised of two divisions: (1) the Division of Individual Tax and (2) the Division of Corporation Tax. Although one is focused on individuals and the other on businesses, both divisions carefully review tax returns, implement compliance measures, assist thousands of taxpayers and preparers with general and specific issues, coordinate efforts with other DOR offices and government agencies, administer millions of dollars of tax credits, implement federal and state government cooperative compliance programs, and develop income and withholding tax forms and instruction booklets, amongst a number of other operational tasks.

Compliance Initiatives

- Assessed over \$51.4 million of individual income tax due and refund request reductions through compliance measures
- Assessed more than \$124.3 million of corporate income tax due and refund request reductions through compliance measures
- Assessed over \$47.8 million of withholding tax due through compliance measures

Taxpayer and Preparer Assistance

- Received and responded to approximately 9,450 webmaster inquiries from taxpayers
- Received and responded to over 88,400 other correspondence inquiries from taxpayers
- Received and responded to more than 219,600 phone calls involving individual and withholding tax inquiries from taxpayers and preparers
 - Two-minute average hold time for calls
 - More than 14,600 callers utilized the call-back assist feature
- Received and responded to approximately 25,950 calls involving corporate tax inquiries from taxpayers and preparers
- Processed over 6,500 corporate “Letter of Good Standing” requests

Electronic Filing of Income Tax Returns

- 88% of individual income tax returns were filed electronically in calendar year 2018
- 37% of corporate income tax returns were filed electronically in calendar year 2018



OFFICE OF INCOME TAXATION

Tax Credits

The Division of Corporation Tax administers many incentive tax credits for the Commonwealth. Some examples and the tax credit amounts claimed in Fiscal Year 2017-18 are listed below.

Examples of Economic Development Tax Credits Managed by DOR (FY 2017-18)

Kentucky Business Investment	\$25,056,806
Kentucky Industrial Development Act	\$10,113,419
Kentucky Industrial Revitalization Act	\$5,358,587
Kentucky Jobs Development Act	\$6,728,714
Kentucky Jobs Retention Act	\$53,731,210
Kentucky Reinvestment Act	\$5,952,508
Kentucky Rural Economic Development Act	\$21,121,584

Examples of Additional Tax Credits Managed by DOR (FY 2017-18)

Distilled Spirits Ad Valorem	\$2,198,035
Energy Efficiency	\$500
Film	\$1,711,339
Skills Training Investment	\$464,017





OFFICE OF TAX POLICY AND REGULATION

DOR's Office of Tax Policy and Regulation develops and implements tax policies and programs. It also reviews and provides guidance regarding proposed policies, regulations, legislation, and determinations. The Office of Tax Policy and Regulation also provides economic and policy analysis for tax policy decisions and acts as a liaison between DOR, the Finance and Administration Cabinet, and other agencies, especially the Kentucky Legislative Research Commission.

- Assisted the Commissioner and other DOR offices in the implementation of House Bill 487 (HB 487), which made multiple changes to several taxes
- Repealed six administrative regulations, amended an additional 24 regulations, and promulgated two new regulations during the fiscal year
- Reviewed and provided analysis on 112 pieces of proposed legislation

SUMMARY OF TAX LAW CHANGES ENACTED BY THE 2018 GENERAL ASSEMBLY

Sales Tax Base Expansion in HB 487

HB 487 amended KRS 139.200 to make the following items subject to sales tax effective July 1, 2018:

- Transient accommodations, including campsites, campgrounds, and recreational vehicle (RV) parks;
- Landscaping services;
- Janitorial services;
- Small animal veterinary services;
- Pet care services including but not limited to grooming and boarding services, pet sitting services, and obedience training services;
- Industrial laundry services including but not limited to industrial uniform supply services, protective apparel supply services, and industrial mat and rug supply services;
- Non-coin-operated laundry and dry cleaning services;
- Linen supply services;
- Indoor tanning services;
- Non-medical diet and weight reducing services;
- Limousine services, if a driver is provided;
- Extended warranty services sold on or after July 1, 2018 for tangible personal property or

digital property that is taxable at the point of sale to the warranty holder;

- Taxable admissions expanded to include the privilege of using facilities or participating in an event or activity, including but not limited to: bowling centers; skating rinks; health spas; swimming pools; tennis courts; weight training facilities; fitness and recreational sports centers; and golf courses, both public and private; and
- Gross receipts subject to sales tax will include installation / repair labor associated with the sale of taxable tangible personal property, digital property, or services.

Other sales and use tax changes in HB 487 that are effective July 1, 2018:

- An expansion for the economic presence of remote retailers was added to the sales and use tax nexus rules;
- The pollution control exemption for sales and use tax was eliminated; and
- The motion picture refund credit is unavailable until July 1, 2022.

Income Tax Changes in HB 487

A flat tax rate of 5% was enacted for both individuals and corporations, effective for taxable years beginning on or after January 1, 2018.



2018 GENERAL ASSEMBLY

Additional individual income tax adjustments in HB 487 include the following adjustments effective for taxable years beginning on or after January 1, 2018:

- Elimination of the adjustment for premiums paid for health insurance coverage;
- Elimination of the adjustment for Master Tobacco Settlement payments;
- Elimination of value of property leasehold interests donated and used for homeless shelters;
- Elimination of the itemized deductions for investment interest, taxes paid, casualty or theft losses, medical care expenses, moving expenses, and other miscellaneous deductions;
- Elimination of the dollar limit cap for itemized deductions; and
- Elimination of the \$10 personal tax credits for taxpayers and dependents, except for taxpayers over age 65, blind, or members of the Kentucky National Guard.

Additional Corporation Income Tax Changes in HB 487

Effective January 1, 2018, the apportionment factor for assigning multi-state income to Kentucky changed from a three-factor apportionment formula based on sales, property, and payroll to a single-factor formula based on sales. However, a three-factor apportionment method is still allowed for corporations in the business of providing:

- Communications service;
- Cable service; or
- Internet access.

Effective for taxable years beginning on or after January 1, 2019, Unitary Combined Group filing is required for corporations unless the group elects a ninety-six month same-as-federal consolidated group filing. If a corporation does not meet the definition of a “combined group” or “unitary business” under the new provisions, then a separate entity return is required.

The nexus consolidated group filing requirement and fifty percent net operating loss limitation rule are

eliminated for taxable years beginning on or after January 1, 2019.

Income Tax Incentive Changes in HB 487

- HB 487 created a nonrefundable and nontransferable credit against income and limited liability entity taxes for personal property tax **timely** paid on inventory on or after January 1, 2018. The credit is phased in: 25% in 2018, 50% in 2019, 75% in 2020, and 100% in 2021 and thereafter.
- HB 487 changed the income tax refundable film tax credit to be nonrefundable and nontransferable for applications approved on or after April 27, 2018.

Tax Administration Law Changes Applicable to Multiple Taxes

HB 487 made several changes to statutes that will make navigating the protest and appeals process more efficient:

- The time to protest a tax assessment or reduced refund was increased from 45 to 60 days for notices issued on or after July 1, 2018.
- The Taxpayer Bill of Rights was amended to prohibit DOR from entering into a contingent fee contract for audits, collections, or legal services if the service performed is contingent upon the amount of tax, interest, fee, or penalty assessed against or collected from the taxpayer.

Excise Tax Changes

- HB 487 enacted a 50 cents per pack cigarette tax increase and a 50-cent cigarette inventory floor stocks tax, both effective July 1, 2018.
- Effective July 1, 2018 the waste tire fee imposed on each new motor vehicle tire sold in Kentucky increases from \$1 to \$2.
- House Bill 400 amended the alcoholic beverage statutes to allow small farm wineries to ship product and monthly club membership orders directly to consumers.
- House Bill 136 requires microbrewers to report and pay state excise taxes directly to DOR.

This summary is intended to provide a general overview of important tax matters addressed during the 2018 legislative session. It does not represent a full and complete list, nor does it provide a complete and thorough analysis of all tax matters addressed during the 2018 legislative session. Additional information, including proposed legislation and full text of enacted bills is available at www.legislature.ky.gov.



OFFICE OF FIELD OPERATIONS

4 REGIONAL DIVISIONS
10 TAXPAYER SERVICE CENTERS

The Office of Field Operations (OFO) consists of ten Taxpayer Service Centers (TSCs) strategically located throughout the Commonwealth of Kentucky. Through its TSCs, OFO serves two critical functions: (1) to provide direct assistance to taxpayers in close physical proximity to the localities where they live and work and (2) to implement DOR compliance measures, primarily in the form of field audits and “desk” audits.

Services available to taxpayers at the TSCs include: receiving assistance to help understand and resolve tax bills or outstanding collection matters, receiving answers related to filing or amending returns, registering a tax account for a new business, receiving temporary permits for transient vendors engaging in sales within the Commonwealth, and having a local DOR liaison with the Central Office on other tax matters. Also, OFO partners with the Internal Revenue Service (IRS) and each TSC serves as a Volunteer Income Tax Assistance (VITA) site that provides tax return preparation and filing assistance to eligible low-income individuals and families as well as employees of the Commonwealth.

The Office of Field Operations serves an essential role in DOR compliance initiatives and has developed audit and compliance functions that ensure fair and equitable tax treatment for taxpayers. OFO selects and conducts field audits in all 120 counties throughout Kentucky as well as in many other states.

- Assessed more than \$58 million of tax due as a result of the 950 audits conducted (*48.5% increase compared to prior fiscal year*)
- Assessed over \$4.3 million of tax due as a result of other compliance measures
- Collected over \$1.48 million from more than 7,000 out of state or unregistered transient vendors identified by OFO staff attending over 600 local events across the Commonwealth (*4.3% increase compared to prior fiscal year*)
- Collected in excess of \$15 million in payments through taxpayer assistance programs
- Received and responded to more than 53,000 phone calls from taxpayers and tax professionals
- Received and responded to over 29,000 in-person inquiries from taxpayers who visited TSCs
- Prepared approximately 2,240 individual income tax returns for low-income individuals and families as well as employees of the Commonwealth through OFO VITA sites

VITA
Volunteer Income Tax Assistance





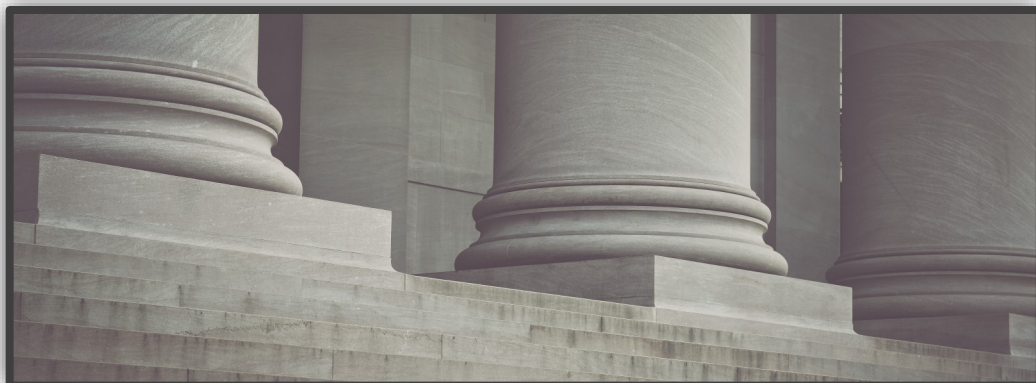
FAC DIVISION OF SPECIAL INVESTIGATIONS

The **Division of Special Investigations**, organized through the Finance and Administration Cabinet's Office of the Inspector General, investigates allegations of tax law violations (particularly tax evasion, tax preparer fraud, and tendering of cold checks for tax payment), recommends criminal prosecution when warranted, and works with prosecutors around the Commonwealth to take legal action against tax law violators. The Division of Special Investigations represents the legal interests of DOR in criminal tax cases and coordinates its efforts with law enforcement agencies and Commonwealth Attorneys to prosecute criminal activity around the state.

The Division of Special Investigations directly assisted with the receipt of 13 indictments of tax law violations, including 119 felony charges that were found and presented by Kentucky grand juries in Fiscal Year 2017-18. The division opened 27 new cases and investigated 724 tips received by mail, telephone tip line, and the Department of Revenue's website. In Fiscal Year 2017-18 the Division of Special Investigations collected nearly \$500,000, including restitution directly paid to DOR, income tax refund request denials associated with fraudulent income tax refund requests, and collections from assessments and bills generated.

In Fiscal Year 2017-18 the Division of Special Investigations was involved with many criminal tax cases including:

- In a case involving the filing of fraudulent Kentucky corporation income tax returns, the Federal District Court for the Western District of Kentucky sentenced an out of state resident taxpayer to 27 months in prison on one count of *mail fraud* and one count of *laundering monetary instruments*. The case was coordinated by multiple government agencies including the IRS, FBI, the state Attorney General's office, and the Office of the Inspector General of the United States Postal Service.
- A taxpayer pleaded guilty to eight Class D felony counts of *preparing a fraudulent Kentucky individual income tax return* in Jefferson Circuit Court.
- A Grand Jury in Franklin County presented an indictment of two Class C and two Class D felony counts of *theft by failure to make required disposition of property* against a taxpayer who committed sales and withholding tax fraud and evasion.
- A Grand Jury in Shelby County presented an indictment of four Class D felony counts of *filing a false Kentucky individual income tax return* against two taxpayers who filed a joint return, one count each for the years 2013 through 2016.





FAC OFFICE OF LEGAL SERVICES FOR REVENUE

The Office of Legal Services for Revenue (OLS), organized through the Finance and Administration Cabinet General Counsel's Office, represents DOR in administrative proceedings before the Kentucky Claims Commission (formerly Kentucky Board of Tax Appeals) and judicial actions at all levels of the state and federal court systems.

OLS performs a wide range of services and functions, which include: representing the legal interests of DOR in judicial actions and before administrative bodies; rendering legal advice on a wide range of matters involving and affecting DOR; providing legal review of tax information and guidance issued by DOR in the form of Technical Advice Memorandums (TAMs), Private Letter Rulings (PLRs), and General Information Letters (GILs); issuing legal opinions to and on behalf of DOR; conducting thorough analysis and preparation of language for policies, legislation, statutes, and regulations; providing advice and assistance in connection with open records requests and other disclosure matters that involve DOR. Legal cases handled by OLS address Kentucky state tax issues and have resulted in precedents of significant importance and interest to taxpayers and the Commonwealth. Cases of particular significance are highlighted below.

Commonwealth of Kentucky, Finance and Administration Cabinet, Department of Revenue, v. Interstate Gas Supply, Inc., et al., 554 S.W.3d 831 (2018).

In March 2018 the Kentucky Supreme Court ruled in favor of DOR and established new precedent when it overturned a Court of Appeals ruling holding that: 1) Section 170 of the Kentucky Constitution applied only to ad valorem property taxes; and 2) the Kentucky use tax is an excise tax, not a property tax, and therefore, not subject to the exemptions created by Section 170. The Court's opinion expressly overruled *Commonwealth ex rel. Lockett v. City of Elizabethtown*, 435 S.W.2d 78 (Ky. 1968) which held that an excise tax is sufficiently similar to a property tax to qualify for the exemption.

The defendant taxpayer, Tri-State Healthcare Laundry, Inc. ("Tri-State"), is a joint-cooperative laundry association located in Kenton County. Tri-State was formed by, is owned by, and serves the laundry needs of three charitable hospitals. However, the defendant was not a registered 501(c)(3) non-profit corporation, did not qualify for a charitable exemption from income tax, and did not qualify for an exemption from state sales and use tax. By and through its natural gas supplier, Interstate Gas Supply ("IGS"), the defendant sought a refund of use tax paid in connection with natural gas purchases over a four-year period. The amount

in controversy exceeded \$99,000, plus interest.

The issue in the case was whether Ky. Const. Section 170 exempted a charitable institution from the use tax. DOR argued that the exemption was solely one from direct property taxation (ad valorem tax) and had no application to use tax (an excise tax), a position supported by *Children's Psychiatric Hosp. of Northern Kentucky, Inc. v. Revenue Cabinet, Commonwealth of Ky.*, 989 S.W.2d 583 (Ky. 1999). The defense argued that prior precedent limiting the application of Ky. Const. Section 170 to ad valorem taxes should be overruled, or, in the alternative, that the use tax was so akin to a property tax as to make the constitutional exemption for charities applicable, even if limited to property taxes. DOR's counterargument was that the use tax was not separate from, but rather complimentary to, the sales tax.

In the unanimous decision authored by Deputy Chief Justice Hughes, the Kentucky Supreme Court ruled that "Ky. Const. § 170 does not exempt a 'public charity' institution from the use tax imposed by KRS 139.310."

The Court first analyzed the Kentucky use tax in the context of the integrated sales and use tax system, finding that "[s]ales and use taxes generally are classified as excise taxes because they are 'not a burden laid directly upon persons or property' but



FAC OFFICE OF LEGAL SERVICES FOR REVENUE

rather charges imposed on the sale and/or use of goods to raise revenue.” (citing *State Tax Comm’n v. Hughes Drug Co.*, 293 S.W. 944, 945 (Ky. 1927)).

Writing for the Court, Justice Hughes noted that, although “[g]eneralized sales taxes, such as this, with their complementary use taxes, first became widespread in the 1930s,” Kentucky’s general sales and use tax regime was not enacted until 1960, having been previously tried and abandoned between 1934 and 1936.

Next, the Court examined the history of Section 170, noting that the section, “on its face, is replete with references to property, both real and personal, including residences, places of burial and crops.” They further observed that Sections 171-175 all deal solely with ad valorem property taxes. “Through the years, this Court and its predecessor have recognized that §170 and other sections in that ‘run’ of constitutional provisions address only property (ad valorem) taxes.”

The Court addressed the defendant’s argument that use taxes are sufficiently similar to property taxes for the exemption in Section 170 to apply. The Court examined the two *Elizabethtown* cases (*Thomas v. City of Elizabethtown*, 403 S.W.2d 269 (Ky. 1966) and *Commonwealth ex rel. Lockett v. City of Elizabethtown*, 435 S.W.2d 78 (Ky. 1968)) and agreed with DOR’s assertion that its predecessor Court had “misconstrued” Section 170 in these decisions, and thereby, “expanded...the § 170 ‘public property’ exemption by skirting that exemption’s constitutional role as strictly a property tax exemption, and by paying insufficient heed to the use tax’s statutory role as a component of the unified sales and use tax scheme.”

Examining several prior decisions from Kentucky, Oklahoma, and the U.S. Supreme Court, the Court ultimately held that use tax is an excise tax, and not a property tax, and that the characterization of the use tax as, simultaneously, an excise tax and a property tax in the *City of Elizabethtown* cases “is largely unprecedented and unsupported anywhere else in the country.” The Court concluded: “[t]o the extent *City of Elizabethtown* holds that the use tax is

sufficiently like a property tax to allow a taxpayer (public entity or ‘institution of purely public charity’) to claim exemption from it under § 170, the case is hereby overruled.”

***Department of Revenue, Finance and Administration Cabinet v. Sommer, et al.*, 2017-SC-000071.**

In this Open Records Act case taxpayer plaintiffs sought copies of final rulings that had been issued by DOR pursuant to KRS 131.110. Specifically at issue were final rulings issued, but not appealed, to the Kentucky Board of Tax Appeals pursuant to KRS 131.340 (now numbered KRS 49.220). (The Kentucky Board of Tax Appeals was abolished and replaced with the Kentucky Claims Commission by Executive Order No. 2016-576 on August 8, 2016, which was ratified by HB 453 and signed into law on March 21, 2017.)

DOR took the position that these unappealed final rulings constituted confidential information that DOR was forbidden from disclosing by KRS 131.190(1) (a). See also KRS 131.081(15); 131.990(2); 61.878(1)(k) and (l); *Maysville Transit Co. v. Ort*, 296 Ky. 524, 177 S.W.2d 369 (1943). The law provides exceptions to this prohibition and final rulings *that are appealed* are made matters of public record by law. KRS 131.355(1) (now numbered KRS 49.230(1)). Thus, some final rulings would fall within an exception to this prohibition. However, final rulings that are not appealed would not fall within this exception and would remain confidential and not subject to disclosure. KRS 131.190(1).

In an opinion designated “To Be Published,” the Court of Appeals ruled that the final rulings should nevertheless be divulged by DOR, provided that suitable redactions are made. One judge of the three-judge panel dissented from this decision.

DOR filed a motion for discretionary review of the Court of Appeals’ opinion with the Kentucky Supreme Court on February 13, 2017, which was granted. The case was briefed and a hearing before the Kentucky Supreme Court was held on March 15, 2018. This case remains pending at the time of this publication.



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