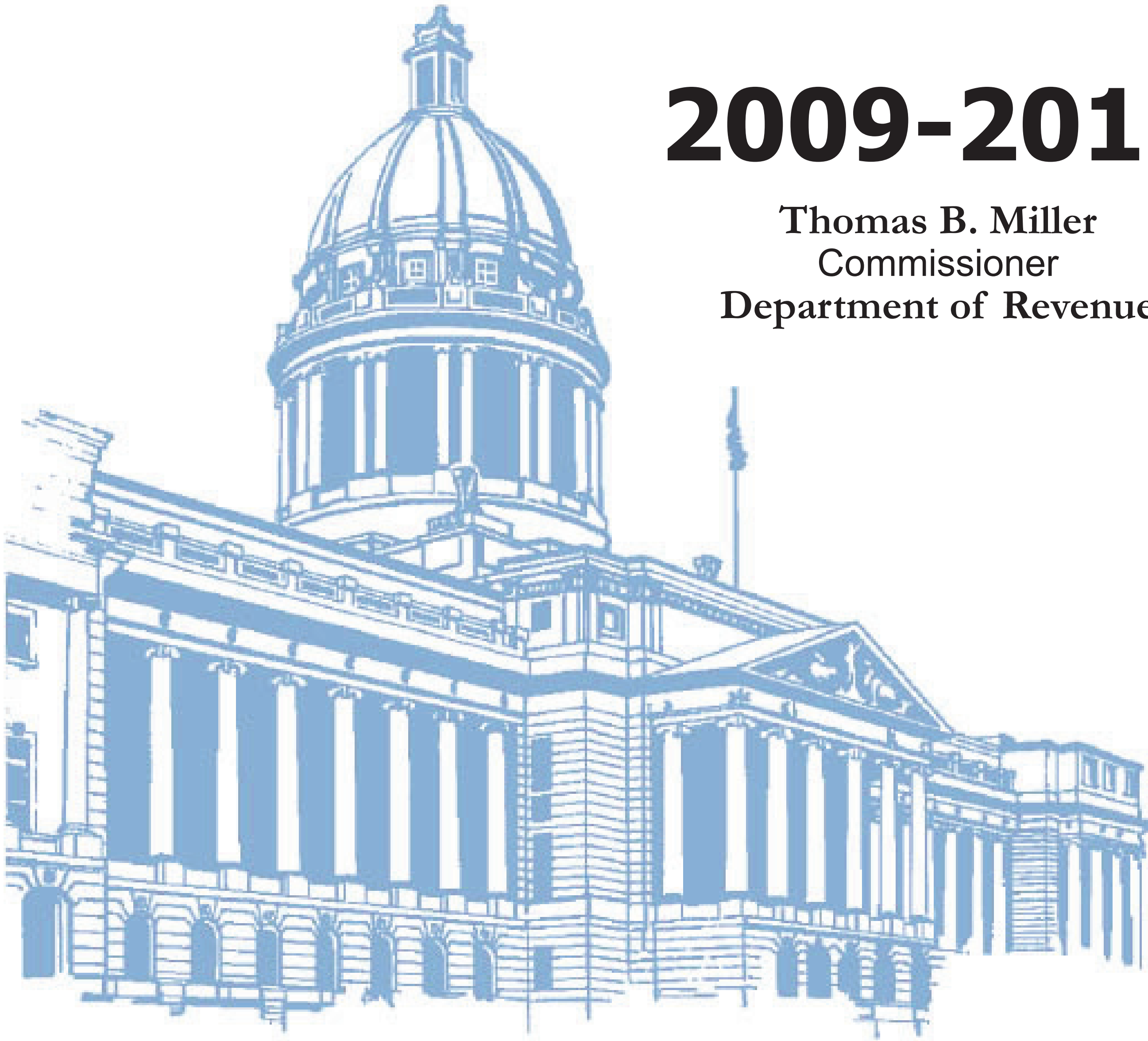
Annual Report

2009-2010



Thomas B. Miller
Commissioner
Department of Revenue

Steven L. Beshear
Governor
Commonwealth of Kentucky

Jonathan Miller
Secretary
Finance and Administration Cabinet

Kentucky
UNBRIDLED SPIRIT

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.

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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.

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

Steven L. Beshear
Governor

FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE

501 HIGH STREET
FRANKFORT, KENTUCKY 40620
Phone (502) 564-3226
Fax (502) 564-3875
www.revenue.ky.gov

Jonathan Miller
Secretary

Thomas B. Miller
Commissioner

December 1, 2010

The Honorable Steven L. Beshear
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 Ending (FYE) June 30, 2010. This report reflects the dedicated work of the many fine professionals who comprise the Department of Revenue workforce.

The Department assisted or took the lead in the implementation of several new incentive programs that became effective during the FYE June 30, 2010. Some of the new tax incentives we helped implement were the new home tax credit, new vehicle trade-in allowance, and the Kentucky Business Investment Program.

In the last month of the fiscal year we began immediate implementation of the Expedited Protest Resolution Program that was signed into law by you on June 4, 2010. We had already placed a greater emphasis on settling as many unresolved protest cases as possible to be fairer to the impacted taxpayers and to expedite the receipt of revenues.

The Department also placed a greater emphasis on training its employees during the FYE June 30, 2010. The training emphasis was greatly needed to ensure the most productive return on the investment the Commonwealth made in granting additional compliance positions to the Department and to help compensate for the loss of key experienced employees via the retirement window that ended in 2008.

Electronic filing continued to grow during FYE June 30, 2010. Over 65 percent of individual income tax returns were electronically filed. There were 1,204,565 electronically filed individual income tax returns, an increase of 2.17 percent for the year.

Thank you for your support of the Department of Revenue and its employees.

Very truly yours,

Thomas B. Miller

Thomas B. Miller
Commissioner

Contents

Revenue Receipts

Reprinted from the Governor's Office for Economic Analysis

Quarterly Economic & Revenue Report
Fourth Quarter 2010
Fourth Quarter, FY 2010

General Fund

General Fund receipts in the fourth quarter of FY10 totaled $2.219 billion compared to $2.209 billion in the fourth quarter of FY09, an increase of 0.4 percent. The fourth quarter increase stemmed a tide of five consecutive quarterly declines.

General Fund receipts started to show some positive signs in the fourth quarter of FY10 reflecting some of the underlying recovery in the national economy after the negative performances in each of the first three fiscal quarters of FY10. These changes will be discussed below in the appropriate category.

The sales and use tax receipts increased by 4.2 percent in the fourth quarter of FY10 following declines in each of the first three quarters. The rate of decline mitigated throughout the fiscal year, culminating in actual growth in the fourth quarter.

Individual income tax receipts fell 4.0 percent in the fourth quarter of FY10 compared to collections in the fourth quarter of FY09. Receipts of $925.1 million were $38.6 million less than were collected in the fourth quarter of the previous fiscal year.

Corporation income taxes posted an increase of 41.1 percent during the fourth quarter of FY10. Receipts totaled $108.7 million and were $31.7 million more than collected a year earlier. Corporation income tax receipts were down 11.2 percent for the year due to lower profits and other factors.

The LLET had collections of $52.4 million in the forth quarter of the fiscal year, a decrease of 1.3 percent. LLET receipts were up 20.0 percent for the year.

The coal severance tax receipts increased 3.6 percent in the fourth quarter following sizable declines in each of the first three quarters. Receipts of $77.3 million compare to $74.7 million collected in the fourth quarter of FY09.

Cigarette taxes decreased in the fourth quarter. Receipts of $72.9 million were 11.9 percent less than collected in the fourth quarter of FY09.

Property tax collections fell by 13.1 percent in the fourth quarter of FY10. Collections of $47.1 million compare to $54.2 million received in the final quarter of the prior fiscal year. Weakness in the other property tax receipts, a category which includes watercraft and distributions to local governments, contributed to the overall decline in property taxes.

Lottery receipts increased 6.7 percent, or $3.5 million, in the fourth quarter of FY10 with revenues of $55.5 million.

The *Other* category represents the remaining accounts in the General Fund, and combined for $152.1 million in receipts, a decline of 0.8 percent from FY09.

Road Fund

Road Fund receipts increased 4.6 percent in the fourth quarter of FY10 due to strong growth in motor fuels tax receipt and timing of receipts. Receipts totaled $331.2 million compared to the $316.6 million received in the fourth quarter of FY09.

Motor fuels tax receipts increased 9.5 percent during the fourth quarter of FY10. Receipts were $176.2 million and compare to $160.9 million collected during the fourth quarter last year. The increase was partially a result of the statutory formula which triggered increases in statutory wholesale price due to increased actual wholesale prices observed in the marketplace.

Motor vehicle usage tax receipts increased by 4.3 percent during the fourth quarter. This rebound was after a very tough stretch over the past two years. Receipts were $88.5 million compared to $84.9 million collected during the same period last year.

Weight distance tax receipts totaled $17.3 million, an increase of 2.4 percent from the fourth quarter of last year.

Motor vehicle license tax receipts declined by 8.2 percent during the fourth quarter of FY10. Receipts of $35.0 million compare to $38.1 million received during the fourth quarter of FY09.

Investment income was down in the fourth quarter of FY10, yielding $0.8 million.

The remainder of the accounts in the Road Fund combined for an increase of 8.5 percent. Receipts for the *Other* category totaled $9.4 million during the fourth quarter, compared to $8.7 million in the fourth quarter of FY09.

Motor fuels taxes and motor vehicle usage taxes comprised 80.0 percent of Road Fund revenues in the fourth quarter. The next-largest source of revenue was the motor vehicle license tax with 11.0 percent, followed by weight distance taxes with 5.0 percent. The *Other* category accounted for 3.0 percent, while motor vehicle operators accounted for 1 percent and investment income under 1 percent.

Revenue Receipts

Revenue Receipts

GENERAL FUND TOTAL RECEIPTS

Fiscal Year	Receipts	Percent Change
2009-10	$8,225,127,620	-2.4
2008-09	8,426,351,594	-2.7
2007-08	8,664,336,663	1.1
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

ALCOHOLIC BEVERAGE TAXES—Distilled Spirits

Fiscal Year	Receipts	Percent Change
2009-10	$38,689,977	0.1
2008-09	38,670,484	4.2
2007-08	37,110,587	5.0
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

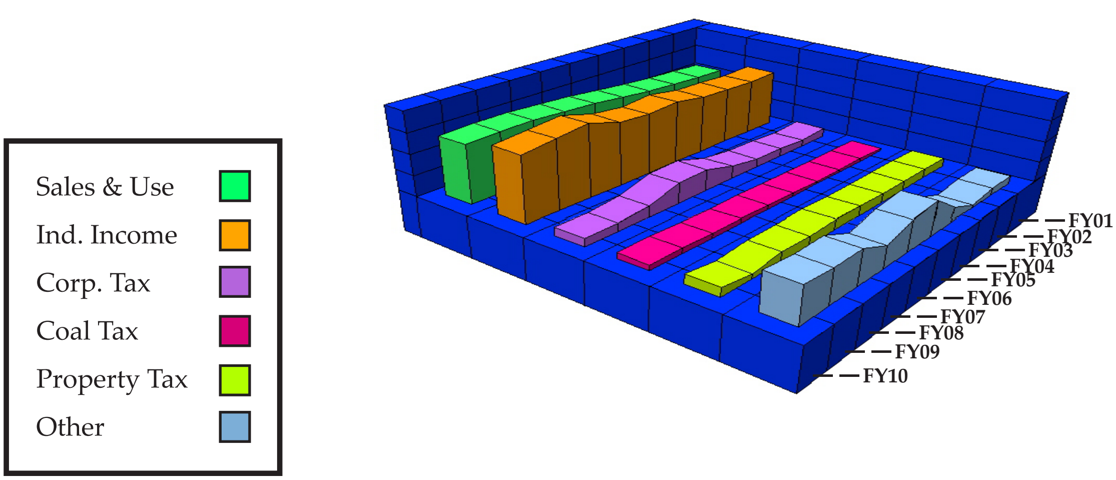
ALCOHOLIC BEVERAGE TAXES—Malt Beverage

Fiscal Year	Receipts	Percent Change
2009-10	$57,761,760	-1.0
2008-09	58,175,089	3.8
2007-08	56,066,611	5.5
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

ALCOHOLIC BEVERAGE TAXES—Wine

Fiscal Year	Receipts	Percent Change
2009-10	$14,524,249	-1.0
2008-09	14,748,769	2.9
2007-08	14,330,732	4.5
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

General Fund Receipts by Major Sources
Millions of Dollars



Revenue Receipts

CIGARETTE TAX

Fiscal Year	Receipts	Percent Change
2009-10	$278,159,743	48.9
2008-09	186,756,010	10.1
2007-08	169,547,927	0.5
2006-07	168,778,213	-2.0
2005-06	172,069,493[1]	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

[1] *Rate increase $0.27 surtax.*

COAL SEVERANCE TAX

Fiscal Year	Receipts	Percent Change
2009-10	$271,943,100	-7.1
2008-09	292,591,094	25.6
2007-08	232,977,827	5.0
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

CORPORATION INCOME TAX

Fiscal Year	Receipts	Percent Change
2009-10	$237,867,392	-11.2
2008-09	267,984,858	-38.4
2007-08	435,222,566	-56.0
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

CORPORATION LICENSE TAX

Fiscal Year	Receipts	Percent Change
2009-10	$5,470,951	-40.2
2008-09	9,154,338	224.4
2007-08	2,822,279	-75.9
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

INDIVIDUAL INCOME TAX

Fiscal Year	Receipts	Percent Change
2009-10	$3,154,488,000	-4.9
2008-09	3,315,368,217	-4.8
2007-08	3,483,137,317	14.5
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

LIMITED LIABILITY ENTITY TAX (LLET)

Fiscal Year	Receipts	Percent Change
2009-10	$145,948,432	20.0
2008-09	121,650,092	23.6
2007-08	98,407,313	N/A

Revenue Receipts

INHERITANCE AND ESTATE TAX

Fiscal Year	Receipts	Percent Change
2009-10	$37,201,611	-9.8
2008-09	41,234,240	-19.2
2007-08	51,001,299	17.0
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[1]	-0.1
2000-01	83,461,499	12.0

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

OIL PRODUCTION TAX

Fiscal Year	Receipts	Percent Change
2009-10	$7,564,121	-10.3
2008-09	8,430,228	-17.4
2007-08	10,201,113	64.6
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

LOTTERY RECEIPTS

Fiscal Year	Receipts	Percent Change
2009-10	$200,000,000	3.4
2008-09	193,500,000	3.2
2007-08	187,461,591	0.4
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

PARI-MUTUEL TAX

Fiscal Year	Receipts	Percent Change
2009-10	($82,480)	-----
2008-09	4,387,515	-17.6
2007-08	5,327,540	-3.0
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

MINERALS AND NATURAL GAS TAX

Fiscal Year	Receipts	Percent Change
2009-10	$37,639,344	-31.5
2008-09	54,963,206	9.6
2007-08	50,155,157	6.3
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

PROPERTY TAXES—REAL ESTATE

Fiscal Year	Receipts	Percent Change
2009-10	$248,756,857	3.2
2008-09	241,008,338	1.6
2007-08	237,153,330	3.9
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

Revenue Receipts

PROPERTY TAXES—TANGIBLE

Fiscal Year	Receipts	Percent Change
2009-10	$193,234,982	-5.2
2008-09	203,783,916	-1.0
2007-08	205,763,426	7.0
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

PROPERTY TAXES—INTANGIBLE

Fiscal Year	Receipts	Percent Change
2009-10	-----	-----
2008-09	-----	-----
2007-08	-----	-----
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

SALES AND USE TAX

Fiscal Year	Receipts	Percent Change
2009-10	$2,794,057,329	-2.2
2008-09	2,857,665,168	-0.7
2007-08	2,877,814,014	2.1
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

BANK FRANCHISE TAX

Fiscal Year	Receipts	Percent Change
2009-10	$69,085,922	-5.8
2008-09	73,339,144	1.9
2007-08	71,976,055	12.6
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

ROAD FUND TOTAL RECEIPTS

Fiscal Year	Receipts	Percent Change
2009-10	$1,206,622,639	1.2
2008-09	1,191,982,894	-5.6
2007-08	1,262,798,750	3.0
2006-07	1,225,943,515	5.2
2005-06	1,165,409,505	3.4
2004-05	1,126,554,402	0.9
2003-04	1,116,734,272	-0.6
2002-03	1,123,103,133	0.4
2001-02	1,119,005,317	5.2
2000-01	1,064,181,565	-2.4

MOTOR FUELS TAXES—Motor Fuels Normal

Fiscal Year	Receipts	Percent Change
2009-10	$616,967,780	5.3
2008-09	585,871,307 [2]	2.4
2007-08	571,983,920 [1, 2]	6.1
2006-07	539,147,756 [1, 2]	7.3
2005-06	502,494,550 [1, 2]	7.0
2004-05	469,621,779 [1, 2]	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

[1] *Figures reflect annual rate increase capped at 10% of average wholesale prices.*
[2] *Reflects correction in reporting method.*

Revenue Receipts

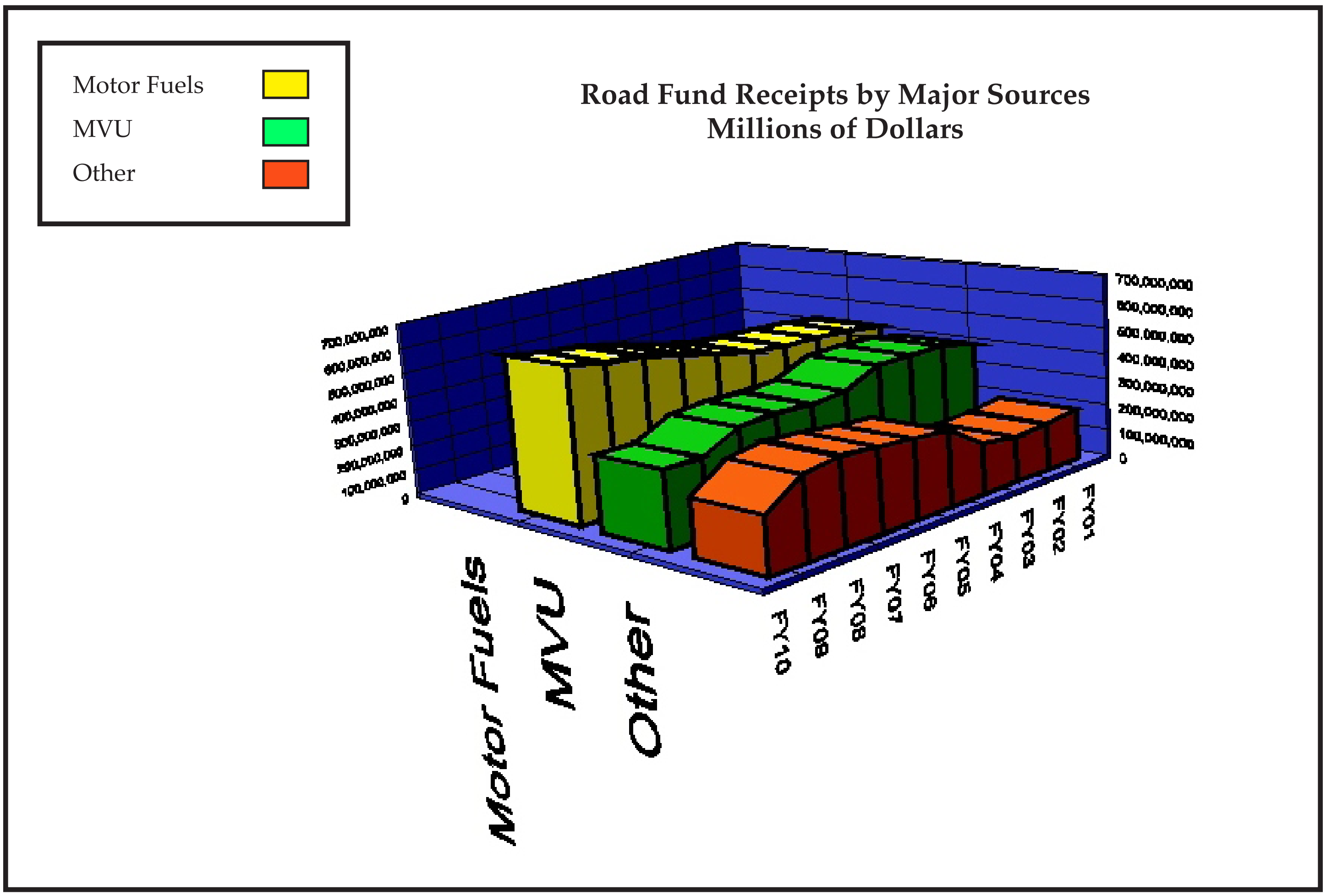
MOTOR VEHICLE OPERATOR'S LICENSE FEE

Fiscal Year	Receipts	Percent Change
2009-10	$15,941,488	2.7
2008-09	15,521,191	1.0
2007-08	15,372,618	-2.8
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

MOTOR VEHICLE USAGE TAX

Fiscal Year	Receipts	Percent Change
2009-10	$295,190,610	-1.0
2008-09	296,062,866[1]	-18.2
2007-08	361,723,956[1]	-2.5
2006-07	370,943,429[1]	1.9
2005-06	363,976,577[1]	-2.4
2004-05	373,034,898[1]	-4.6
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

[1] *Reflects correction in reporting method.*



MAJOR ACCOMPLISHMENTS IN FISCAL YEAR 2009-2010

OFFICE OF THE COMMISSIONER

The Commissioner's Office placed a greater emphasis on training the Department's employees during the FYE June 30, 2010. As a result, the Department conducted 58 formal training classes for its employees during the fiscal year.

The Commissioner's Office participated in the review and approval of 106 protest settlements resulting in $72 million in additional receipts.

The Division of Special Investigations had 22 indictments resolved by guilty plea or guilty verdict, and had 47 new cases indicted during the year. The Division brought in $332,849 in restitution paid to the Department and saved another $330,448 in fraudulent income tax refunds that were identified and halted, for a total of $663,297. During the fiscal year the courts ordered defendants to pay $844,063 in restitution to the Department over time.

OFFICE OF PROCESSING AND ENFORCEMENT

Division of Operations

o Approximately 65 percent of individual income tax returns were electronically filed. There were 1,204,565 electronically filed returns, an increase of 2.17 percent for the year.

o Total requested direct deposits were 581,348. This equals approximately 65 percent of the refunds requested on electronically filed returns (890,524).

o In addition, 243,700 2D barcode returns and 314,142 paper returns, for a total of 1,762,407 returns, were filed for FY10.

o The Division of Operations also processed over 60,000 prior year and amended individual income tax returns during FY10.

o The Division of Operations and the Commonwealth Office of Technology are working to update the electronic filing system, adapting to the changes made by the Internal Revenue Service. This new system will be implemented in April 2011 and will allow the Department of Revenue to incorporate other types of individual returns not in this system, including non-resident and part-year resident returns as well as amended and prior-year returns. These changes, along with the practitioner mandate passed in this last legislative session, will result in approximately 80 percent of all individual returns being electronically filed within the next few years.

o Received and processed 85,708 electronically filed sales and use tax returns, approximately a 13 percent increase over FY09.

o Received and processed 17,331 electronically filed returns for utility gross receipts license (UGRL) tax; an increase of approximately 6.9 percent over FY 09.

o Received and processed 13,728 electronically filed motor fuels tax returns.

o Received and processed 3,699 electronically filed Telecom tax returns.

Division of Collections

o During the last two fiscal years ending June 30, 2010 the Division of Collections collected a total of $365,787,600; compared to a total of $330,317,554 for the preceding two fiscal years.

o The Division of Collections continues to collect child support for the Cabinet for Health and Family Services. For the last two fiscal years ending June 30, 2010 a total of $38,926,775 was collected; compared to a total of $29,837,728 for the preceding two fiscal years.

o On behalf of other state and local government agencies under the authority of KRS 45.237(4) and KRS 45.241(6), the Division of Collections continues to collect for what is referred to as the Enterprise Collections program. For FY10 a total of $5,707,131 was collected through this program. Since inception, this program has distributed $6.7 million back to the referring agencies. There are currently eight agencies participating in this program and an additional seven agencies have expressed an interest in participating.

o The data match process continues to be utilized by the Division of Collections 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 131.676. For FY10, a total of $9,634,320 has been collected through this process. To date, 743 agreements have been signed with financial institutions.

o The Department of Revenue collected $45.2 million as part of the Governor's 2009 Legislative Revenue Enhancement Initiative approved by the General Assembly. The original estimate was $18.5 million for fiscal year 2010.

o The Protest Resolution Branch resolved cases totaling $74 million. The branch enacted the Expedited Protest Resolution (EPR) program, which provided taxpayers an opportunity to pay bills under protest without penalty. The program period began June 4, 2010 and ended July 31, 2010. In addition, the Protest Resolution Branch has implemented an aggressive training program in conjunction with field auditor staff, to improve the uniformity of audits being conducted across the Commonwealth and the United States. Proper training for audit and protest resolution staff speeds up the protest process, since protest resolution staff will be in agreement with audit terms.

Accomplishments

Division of Registration and Data Integrity

- o Answered 34,716 taxpayer assistance calls relating to registration inquiries and made 20,824 telephone calls requesting additional information.
- o Completed 29,011 Kentucky tax registration applications and 5,893 additional correspondence requests from taxpayers.
- o Completed 46,664 maintenances for existing registration accounts.
- o Reviewed approximately 51,000 possible noncompliant taxpayer cases and contacted over 23,500 new businesses for possible registrations.

Office of Sales and Excise Taxes

- o The Revenue Enhancement Initiative and Tobacco Compliance employees hired in the fiscal year yielded compliance activities of $4,951,702.
- o Filled two Training Branch positions, resulting in two training courses offered and several others in planning stages.

Division of Sales & Use Taxes

- o Answered 80,352 phone calls and 7,004 e-mails relating to sales and use tax inquiries.
- o Participated in training at the county clerks annual conference.
- o Made 12 distributions of the telecommunications tax totaling $36,407,882 to over 1,300 local political subdivisions.
- o Verified and transferred $11,845,351 to the Kentucky Horse Racing Authority from the sales tax on equine breeding fees.
- o Transferred $8,891,471 to the Road Fund from motor vehicle supplementary schedules.
- o Collected $2,568,051 in county clerk's use tax transfers, including compliance of affidavits forwarded by the clerks.
- o Verified and issued 24 refunds totaling $2,167,350 in response to requests relating to completed Kentucky Enterprise Initiative Act (KEIA) projects.
- o Verified and issued ten approved tourism project refunds totaling $5,405,626.
- o Involved in activities and meetings with third party computer contractors, Commonwealth Office of Technology (COT) staff and departmental staff to prepare for the new Comprehensive Tax System (CTS).
- o Participated in the Streamlined Sales and Use Tax Agreement (SSUTA) continues to yield benefits. For fiscal year end June 2010, there were 523 newly registered SST filers who remitted $8,319,336 to Kentucky. The total paid by all SST filers for the fiscal year was $14,273,393.
- o Prepared and mailed three newsletters during the year, the *Kentucky Sales Tax Facts*, with sales and use tax returns. Information included legislative updates, updates on business-specific issues and filing tips. The newsletters are also archived on the DOR Web site for future reference.

Division of Miscellaneous Tax

- o Administered the utility gross receipts license (UGRL) tax and distributed $215,183,617 to 158 local school districts throughout the Commonwealth. This represents a 1.4 percent increase over the previous fiscal year.
- o Successfully implemented the motor vehicle usage tax trade-in credit with an effective date of Sept. 1, 2009. Programming changes were made in AVIS and training sessions were conducted throughout the state for county clerks. Daily updates on trade-in credit totals claimed were posted to the Department Web site.
- o Answered 43,290 phone calls relating to miscellaneous tax inquiries.
- o Performed 721 retail cigarette inspections for compliance with the Master Settlement Agreement.

Office of Income Taxation

- o Responded to 1,910 Live Chat conversations and 9,448 Webmaster inquiries from individuals requesting individual income tax assistance.
- o Completed the implementation of electronic capture of all filed 2008 corporation income tax returns for the purpose of compliance and taxpayer assistance programs.
- o Completed the review of 5,756 requests for letters of good standing submitted by entities needing reinstatement with the Secretary of State.
- o Continued the partnership with the University of Kentucky and the IRS in presenting up-to-date income tax information for Kentucky tax practitioners, CPAs, attorneys, insurance adjusters, realtors and other interested parties.
- o 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, CPAs, attorneys and other interested parties.
- o Received 145,731 telephone inquiries for individual income tax and 54,081 telephone inquiries for withholding tax for a total of 199,812 telephone inquiries received by the Division of Individual Income Tax. The Division of Corporation Tax received 35,077 telephone inquiries.
- o Created the application and developed the Web site for the New Home Tax Credit. Processed over 1,200 applications for the credit.
- o Billed $70.2 million in compliance initiatives due to technological advances in electronic processing and data capture of corporate return information. The comparable amount from FY 2009 was $34.7 million.

Accomplishments

Office of Property Valuation

Local Valuation Branch

- With the passage of House Bill 262 by the 2009 General Assembly, major changes were made to the procedures followed by local officials with regard to delinquent property tax bills. The annual sheriff's sale was eliminated and the county clerk assumed the responsibility of advertising the delinquent tax bills and following specific guidelines developed so that all third party purchasers had an equal opportunity to acquire delinquent property tax bills. Consumer protections were also added that help ensure the affected property owners are able to contact the third party purchasers and understand the notices they receive.

State Valuation Branch

- Locally assessed tangible personal property assessments for calendar year 2009 totaled $56.8 billion. These assessments yielded an estimated $85.2 million in state taxes.
- Omitted personal property tax assessments totaled $8.3 billion and approximately $34.7 million in state and local property taxes were collected on these omitted assessments.
- Combined state and local motor vehicle property tax collections for FY10 were $105.3 million and 196.7 million, respectively.
- Public Service company assessments for 2009 were set at $26.4 billion and are expected to yield approximately $63.4 million in state tax revenues.
- Freddie Freeroader Program

  On Jan. 1, 2010 the Motax section had an offer from the University of Kentucky (UK) Transportation Center to participate in a grant concerning the Freeroader Program. This program has been active since 1997; however it has not been given full attention or updates since then. In the grant, Motax received new updated materials such as: posters, tri-fold brochures and small flyers issued for the Northern Kentucky counties (Kenton, Boone and Campbell). The Motax section delivered these materials to the County Clerk and PVA offices the middle of January for the offices to distribute to the taxpayers. As of July 1, 2010 the Motax section had received approximately 1,500 inquiries versus approximately 300 inquiries in 2009. Motax has billed for the vehicle assessments of $697,211, (Assessed Value of Bills $41, 836) from these counties. Motax has also worked with KYTC and recorded a PSA using a state trooper, county police officer and sheriff to hopefully broadcast on the Governor's weekly commentary. One of the most important factors during this project is that the Motax Section has made contact and resources with the Northern Kentucky police officers and are working together to enforce proper registration of these out of state plates that were given citations. Motax has proved to UK that the revitalization of this program has potential revenue.

Minerals Taxation and GIS Services Branch

Cartography/GIS Section

The Cartography Section helps counties that do not have GIS software update their parcel file with new changes counties have made on their paper maps, print new maps for the office and store their digital parcel files on our server for future use. This section also prints PVA maps for sale from scans, prints PVA maps from digital parcel files and prints large posters for all of the Department of Revenue as needed.

MAP SALES: Sale of PVA maps to the public and governmental agencies

Generates approximately $5,000 to $12,000 annually

80 percent of money received returns to county PVA

Assist PVA offices with data sales when needed—All monies go to PVA office

Total maps sale receipts for tax year 2009 = $6,570

The Cartography/GIS Branch personnel continued their training efforts with PVA offices in six computer mapping classes: GeoSync XG, Intro to GeoSync Version 3.2, Advanced GeoSync Version 3.2, Ky 60 Mapping (15 hrs), IAAO 600 Mapping (30hrs), IAAO 400 Assessment Administration (30 hrs) and IAAO 601 Advanced Mapping (30 hrs).

Minerals Severance Section

Severance tax receipts for FY10 totaled $314,188,379. One half of these receipts are distributed back to counties with mining activity.

Coal:	$270,341,379
Gas:	23,056,125
Oil:	7,701,189
Minerals:	13,089,686

The coal severance tax has been selected as the first tax type to be integrated into the new Comprehensive Tax System (CTS).

The Coal Severance Tax system went live August 21, 2009. In the fall of 2010 the Coal Severance Tax is anticipating the Go-Live of the Web self-service portal which will allow the Coal Severance taxpayers to file and pay online.

Minerals Resource Valuation Branch

Total unmined minerals 2010 tax receipts (2009 tax year):

Total:	$44,149,978
Gas:	4,215,041
Oil:	---
Limestone:	512,046
Clay:	6,230
Coal:	16,903,420

2010 General Assembly

A Review of Tax Law Changes
Enacted by the 2010 General Assembly

2010 Legislation Affecting Kentucky Department of Revenue

NOTE: This 2010 legislative summary presents only general information concerning tax provisions enacted by the General Assembly during the 2010 Regular Session and does not represent a complete analysis of the law changes. The 2010 Regular Session and 2010 Extraordinary Session did not result in any major tax changes, but tax changes were made and most of the changes will be effective during 2010. Full text of the enacted bills is available on the legislative home page at *www.lrc.ky.gov*.

The 2010 General Assembly created, amended or repealed numerous statutes. A total of 826 bills were introduced, and 162 bills became law; an enactment rate of 19.61 percent. Eight bills had tax implications. This review summarizes the tax portion of each bill and its impact on taxes or programs administered by the Department of Revenue (DOR).

ELECTRONIC COMMERCE

Individual Income Tax Returns

Several law changes were enacted to mandate or permit an increase to the number of tax returns filed electronically. Tax return preparers that file more than 10 individual income tax returns will be required to file their clients' returns electronically. The mandate will first apply to 2010 individual income tax returns due on April 15, 2011 and follows a federal return mandate enacted by Congress in 2009.

Business Tax Returns for Non-Road Fund Taxes

Electronic returns and corresponding electronic payment of tax due may be mandated for various business taxes via the promulgation of Administrative Regulations. Any new business tax electronic filing mandate beyond specific tax guidelines included in this legislation will not be imposed on taxpayers or tax return preparers until an administrative regulation approved by the General Assembly promulgates the rules for complying with the mandate.

Road Fund Taxes

For tax periods beginning on or after Aug. 1, 2010, motor fuel transporters required to file a monthly return under the provisions of Kentucky Revised Statute (KRS) 138.260 are required to file the return electronically. KRS 138.464 was amended to close 120 bank accounts established in statute for the County Clerks to use in the collection of motor vehicle usage tax. Eliminating these designated bank accounts will simplify the clerks' daily deposit and reconciliation processes. (HB 319)

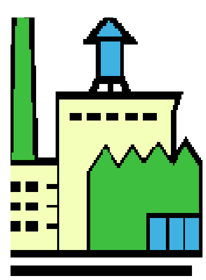
ENERGY RELATED TAX INCENTIVES

Energy Efficient Homes and Energy Efficient Products Income Tax Credits

KRS 141.435, 141.436, 141.437 and 141.0205 were repealed and re-enacted to ensure that the language passed in 2008 Regular Session House Bill 2 was properly enacted in the Kentucky Revised Statutes. Several other nontax related statutes were repealed and re-enacted for the same purpose. The energy efficient homes credit (KRS 141.437) and energy efficient products credit (KRS 141.436) remain effective for taxable years beginning after Dec. 31, 2008 and before Jan.1, 2016. (HB 240)

Incentives for Energy Independence

KRS 154.27 and KRS 143.024 were amended to allow an expansion of the provisions of the Incentives for Energy Independence to apply to an energy-efficient alternative fuel facility newly constructed on or after Aug. 30, 2010, or an existing facility located in Kentucky that is retrofitted or upgraded on or after Aug. 30, 2010. The new construction, retrofit or upgrade must produce energy-efficient alternative fuels. Energy-efficient alternative fuels are homogeneous fuels that are produced from processes designed to densify feedstock coal, waste coal, or biomass resources. The energy-efficient alternative fuels must have an energy content that is greater than the feedstock used in their production. An approved company under these incentives may qualify for sales and use tax, coal severance tax, income tax, limited liability entity tax or wage assessment fee incentives. (HB 552)



KRS 152.715 and 154.27 were amended and a new section of KRS Chapter 143A was created to expand the provisions of the Incentives for Energy Independence Act to include facilities newly constructed or retrofitted on or after Aug. 1, 2010 that produce alternative transportation fuels using natural gas or natural gas liquids as the primary feedstock, and in which a minimum capital investment of $1 million is made. An approved company under these incentives may qualify for sales and use tax, natural gas severance tax, income tax, limited liability entity tax or wage assessment fee incentives. (HB 589)

KENTUCKY RURAL ECONOMIC DEVELOPMENT ACT (KREDA) INCENTIVES

Effective July 14, 2010, KRS 154.22-050 was amended to allow approved companies under the KREDA incentive program to apply to the Kentucky Economic Development Financing Authority (KEDFA) to extend the length of the project agreement term from 15 years up to 25 years. If an extension is granted, KEDFA cannot increase the maximum amount of incentives established by the existing tax incentive agreement. To qualify for the extension, the approved company has to meet the following requirements:

- Agrees to an additional investment or the creation of additional jobs;
- Consolidates operations, facilities or services currently located in another state to the Kentucky facility; and
- Has used less than 60 percent of the inducements awarded under the tax incentive agreement at the time the extension is granted.

The KREDA tax incentives are income tax credits, limited liability entity tax credits and wage assessment fees. (HB 287)

SALE OF DELINQUENT PROPERTY TAX BILLS

Various property tax statutes were amended to clarify and expand upon the provisions enacted in 2009 Regular Session HB 262 which permits the sale of delinquent property tax bills to third parties. The changes made include the following:

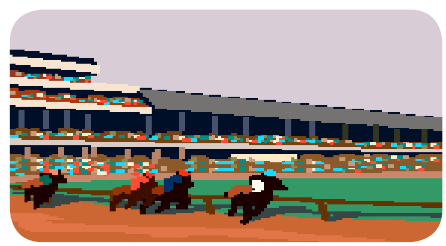
- Adds the sale of delinquent oil and gas and unmined coal property tax bills to the types of delinquent property tax bills that may be sold to third parties;
- Provides procedures to prevent the sale of a certificate of delinquency that is involved in bankruptcy or some other litigation initiated by the county attorney;
- Provides the proper steps to issue a refund to a third party, if necessary;
- Clarifies the base for the calculation of interest on certificates of delinquency; and
- Allows third party purchasers to enter into payment plans with taxpayers.

These legislative changes will apply to sales of delinquent property tax bills occurring in 2010. (HB 298)

PARI-MUTUEL TAX

Various sections of the pari-mutuel tax statutes were amended to accomplish the following:

- Effective July 14, 2010, creates a new section of KRS Chapter 230 to create the Kentucky quarter horse, appaloosa and Arabian development fund; and
- Requires the sponsor of an international horse racing event held in the Commonwealth in 2010 to contract on a date specific to conduct that same event in Kentucky in 2011 or 2012 in order for wagers associated with the 2010 event to qualify for a pari-mutuel tax exemption. The additional contractual agreement must be in place by Nov. 4, 2010. (HB 347)



ADMINISTRATIVE REGULATIONS

Effective July 14, 2010, KRS 131.130 was amended to allow DOR to include examples as part of an administrative regulation, and to allow those examples to include demonstrative, non-exclusive lists. (SB 158)

2010 SPECIAL SESSION ENACTS TAX LAW CHANGES IN HOUSE BILL 2

A 2010 Special Session of the Kentucky General Assembly enacted several tax law changes in House Bill 2 as follows:

Expedited Protest Resolution

An expedited protest resolution program was signed into law by Gov. Beshear on June 4, 2010. Any notice of tax due (tax bill) that as of Jan. 19, 2010 has been properly protested under Kentucky Revised Statute (KRS) 131.110, not been the subject of a final ruling letter and not been the subject of collections action is eligible. A taxpayer may pay 100 percent of the tax due on eligible bills and be absolved from owing penalty and interest on those bills. Payment of 100 percent of the tax due on eligible bills must be made by the close of business on July 30, 2010 in order to qualify. The DOR has sent a letter to taxpayers with bills that have been identified as being eligible under this program. This program should not be confused with previous tax amnesty programs. This is not a tax amnesty program, but rather a program to expedite resolution of the Jan. 19, 2010 inventory of tax bill protests.

Individual Income Tax New Home Tax Credit

The new home tax credit provided by KRS 141.388 has been extended to Dec. 31, 2010. The credit cap has been lowered from $25 million to $15 million. *Qualified buyer* is now defined as "a resident who purchases a qualified principal residence." Qualified buyers who purchased a qualified principal residence between Nov. 7, 2009 and June 4, 2010 have until July 6, 2010 to fax an application for approval. Homeowners who purchased a home between these dates may qualify for this credit even if they also qualified for the federal homebuyer credit. Qualified buyers that purchase a qualified principal residence outside of the above referenced dates are still required to fax the application for approval within seven (7) calendar days from the date of purchase. The fax number is (502) 564-3706. Additional questions regarding the changes to the credit may be answered by calling the Individual Income Taxpayer Assistance Section at (502) 564-4581 or using the Live Help service available on the main page of our Web site at *revenue.ky.gov*.

Individual and Corporation Income Tax–Domestic Production Activities Deduction

For taxable years beginning on or after Jan. 1, 2010, the amount of the domestic production activities deduction (DPAD) for Kentucky income tax returns will be 6 percent as allowed in Section 199(a)(2) of the Internal Revenue Code (IRC) for taxable years beginning before Jan. 1, 2010. **Thus,** Kentucky does not recognize the 9 percent DPAD calculation rate allowed for federal income tax returns filed for taxable years beginning on or after Jan. 1, 2010.

Individual and Corporation Income Tax Pass-through Entity Withholding Estimated Payments

Effective for taxable years beginning after Dec. 31, 2011, every pass-through entity required to withhold Kentucky income tax from nonresident individual partners, members or shareholders and corporate partners or members doing business in Kentucky only through its ownership interest in a pass-through entity, must make estimated payments. The estimated payments are due under the same estimated payment installment rules provided for individuals under the provisions of KRS 141.305 and for corporations under KRS 141.044.

Motor Vehicle Usage Tax

The new car trade-in allowance was extended to June 30, 2011. The cap for the trade-in allowance remained at $25 million. The cap was reached on August 16, 2010 and the credit is no longer available.

Income and Limited Liability Entity Taxes–Film Industry Tax Credit

The film industry tax incentives provided in KRS 141.383 and 148.542 to 148.546 were amended to establish a cap of $5 million for the fiscal year 2010-2011, and $7.5 million for the fiscal year 2011-2012. The cap was codified in KRS 148.546(3)(b).

Income and Limited Liability Entity Taxes– Kentucky Reinvestment Act Credit

The Kentucky Reinvestment Act credit, provided by KRS 154.34-120, was amended for any approved company which receives preliminary approval on or after Feb. 1, 2010 to limit the amount of incentives allowed in any year to not exceed the lesser of the tax liability of the approved company related to the reinvestment project for that taxable year or 20 percent of the total amount of the approved costs.

Income and Limited Liability Entity Taxes–Small Business Development Credit Program

The Small Business Development Credit Program authorized by KRS 154.60-020 and KRS 141.384 was amended to allow the credit to apply to taxable years beginning after Dec. 31, 2010 instead of taxable years beginning after Dec. 31, 2011. The definition of *base year* for purposes of the credit computation was changed to the first full year of operation that begins on or after Jan. 1, 2009 and before Jan. 1, 2010.

Income and Limited Liability Entity Taxes–Endow Kentucky Tax Credit

Effective for taxable years beginning on or after Jan. 1, 2011, the Endow Kentucky Tax Credit was created to encourage donations to community foundations across the Commonwealth. KRS 141.438

was created to allow a nonrefundable income tax and limited liability entity tax credit of 20 percent of the value of the endowment gift, not to exceed $10,000. Unused credit may be carried forward for use in a subsequent taxable year, for a period not to exceed five years. The total amount of credit that may be awarded by the DOR in each fiscal year is $500,000. An application for preliminary authorization for the credit must be submitted to the DOR. The new application form is currently under development. If preliminary approval is received from the department, the taxpayer must make an endowment gift within 30 days of preliminary approval to a qualified community foundation, county-specific component fund, or affiliate community foundation which has been certified by the Endow Kentucky Commission created by KRS Chapter 147A. The taxpayer has ten days after making the gift to provide the department with proof of the gift. If the proof is then approved, the department will issue a final tax credit letter to the taxpayer.

Income, Limited Liability Entity and Insurance Premiums Taxes–New Markets Development Program Tax Credit

The New Markets Development Program Tax Credit (NMDPTC) was created in KRS 141.432 to 141.434 to encourage taxpayer investment in low-income communities. A taxpayer that makes a qualified equity investment in a qualified community development entity may be eligible for a credit that may be taken against the corporation income tax, individual income tax, insurance premiums taxes and limited liability entity tax. The qualified community development entity must first submit an application to the DOR and once approved, the qualified community development entity may issue a long-term debt security or receive an equity investment that will result in eligible credit. The person or entity actually making the loan or making the equity investment will be able to claim a credit, subject to a $5 million credit cap each fiscal year. The total credit computation is 39 percent of the purchase price or loan amount, broken down as follows for each of the next seven years beginning with the date on which the equity investment is initially made:

- 0 percent of the purchase price or loan amount may be taken in the first two years including the year in which the investment is initially made;
- 7 percent of the purchase price or loan amount may be taken in the third year including the year in which the investment is initially made; and,
- 8 percent of the purchase price or loan amount may be taken for fourth through seventh years including the year in which the investment is initially made.

Any unused approved credit may be carried forward for use in any subsequent tax year. The qualified community development entity must utilize at least 85 percent of the funds received via a qualified equity investment to invest in qualified active low-income community businesses located in the Commonwealth of Kentucky within 24 months after the issuance of the investment. The maximum investment in any individual qualified active low-income community business is $10 million. A *qualified active low-income community business* is defined by Section 45D of the IRC. The DOR is currently developing a regulation to provide guidance on the credit application and approval process for the NMDPTC. The regulation should be filed by Sept. 15, 2010. Additional information regarding this new credit program will be provided via our Web site at *revenue.ky.gov*.

Income and Limited Liability Entity Taxes– Environmental Stewardship Tax Credit Changes

Effective for taxable years ending on or after June 4, 2010, the baseline year portion of the Kentucky Environmental Stewardship Credit calculation shall be multiplied by 50 percent.

Legal Issues

Office of Legal Services for Revenue (OLS)

The Office of Legal Services for Revenue (OLS) represents DOR in judicial actions and in administrative proceedings before such tribunals as the Kentucky Board of Tax Appeals (KTBA) 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; providing advice and assistance on 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 (OLS) 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.

Miller v. Johnson Controls, Inc., 296 S.W.3d 392 (Ky. 2009), cert. den., 130 S.Ct. 3324 (2010).

At issue in this corporation income tax case was 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). (These statutory provisions were later recodified at KRS 141.010(16) and (17).) The taxpayers challenging these provisions in this case had filed amended corporation income tax returns after Dec. 22, 1994, seeking refunds under the unitary business concept based upon the Kentucky Supreme Court's decision in *GTE and Subsidiaries v. Revenue Cabinet*, 889 S.W.2d 788 (Ky. 1994).

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

The Supreme Court granted both DOR's motion for discretionary review and the taxpayers' cross motion for discretionary review of the Court of Appeals' opinion. On Aug. 27, 2009, the Supreme Court rendered an opinion that reversed the Court of Appeals on the due process issue. The Court recognized that a tax statute is not unconstitutional merely because it is retroactive. To pass constitutional muster, a retroactive statute need only be rationally related to a legitimate legislative purpose, and in this case, the challenged statutory provisions satisfied this standard, as they were designed to prevent a significant and unanticipated revenue loss. The Supreme Court also held that the statutory provisions in question did not violate any of the other state and federal constitutional provisions invoked by the taxpayers.

The taxpayers' petition for rehearing was denied on Nov. 25, 2009. On Feb. 2, 2010, the taxpayers filed a petition for a writ of certiorari with the United States Supreme Court seeking that court's review of the Kentucky Supreme Court's decision. On May 24, 2010, this petition was denied.

John Bradford Freeman, Jessamine County Property Valuation Administrator v. St. Andrew Orthodox Church, Inc., 294 S.W.3d 425 (Ky. 2009)

At issue in this case was whether two houses on five-acre tracts owned by a church and rented to private tenants were exempt from ad valorem taxation under Ky. Const. § 170 as real property owned and occupied by a religious institution. The KBTA found that the real property in question was not occupied by the church in question, rejecting the church's arguments that its occasional uses of the property (including the storage of personal property in one of the houses) and its annual picnic on the property, all with the tenants' permission or acquiescence, constituted the necessary occupancy. The Jessamine Circuit Court agreed with the KBTA as to the houses and their curtilages, but not as to the balance of the property.

In an opinion rendered on Aug. 10, 2007, the Court of Appeals held that both properties were exempt in their entirety. The Court reasoned that as "there was no evidence that [the church] intended to use the property for investment purposes or to construct anything other than a church," the property should have been granted the exemption.

The motion for discretionary review of the Court of Appeals' opinion filed by OLS was granted by the Kentucky Supreme Court. On May 21, 2009, the Supreme Court rendered an opinion that reversed the Court of Appeals in part and affirmed it in part and reinstated the circuit court's decision. The Court agreed with the position advocated by OLS that real property must in fact be both owned and occupied by a religious institution to be exempt from taxation. It rejected the position expressed in an Attorney General opinion (OAG 91-216), relied upon by the church in this case, that the exemption could apply to property owned by a church, but intended for "future occupation." The Court further expressed concern that the exemption not be granted "to property owned by the church and rented as commercial real estate, including shopping centers and other commercial enterprises" or that the exemption be construed to "allow churches to compete in commercial land speculation."

Agreeing with the circuit court, the Court found the houses and their curtilages to be "occupied by tenants who pay rent to the church" and thus were not exempt. The Court ruled that the remaining property was exempt because it had been subjected to some use by the church. The Court found that while the church's use of the property was not regular or continuous, it nevertheless used the property "like a park, although not on either a daily or weekly basis," and "with the same frequency as many, if not most, churches use outdoor land that adjoins their main sanctuaries."

The church's petition for rehearing or modification of the Supreme Court's decision was denied on Oct. 29, 2009.

Monumental Life Insurance Co. v. Department of Revenue, 294 S.W.3d 10 (Ky. App. 2008), cert. den., 130 S.Ct. 2062 (2009).

In this case, the taxpayer was a domestic life insurance company subject to ad valorem taxation under KRS 136.320 by the Commonwealth of Kentucky, Jefferson County and the City of Louisville. The tax suffered from a similar constitutional infirmity addressed in *St. Ledger v. Revenue Cabinet,* 912 S.W.2d 34 (Ky. 1995), vacated and remanded, 517 U.S. 1206, on remand, 942 S.W.2d 893 (Ky. 1997), cert. dism'd, 521 U.S. 1146 (1997). Specifically, shares of stock owned by the taxpayer were included in its taxable capital under KRS 136.320 and its shares of stock in corporations paying at ad valorem taxes on at least 75 percent of their property were then exempted under the statutory computation in accordance with KRS 136.030, the statute held unconstitutional in *St. Ledger.*

Finding that the principle upheld in *St. Ledger* also applied to KRS 136.320, DOR allowed the taxpayer a refund of $1,470,357. The taxpayer disagreed with DOR's action; it argued that its refund should instead be $8,107,668 based upon its theory that its shares of stock should be excluded from taxable capital altogether.

DOR also determined that the taxpayer had improperly failed to report as taxable under KRS 136.320 an account entitled "separate accounts." This determination resulted in an increase in the taxpayer's liability for 1998 from $48,672 to $3,061,280 and in assessments totaling $2,895,878 for the tax years 1995 through 1998.

The KBTA upheld DOR's assessments and its denial of the taxpayer's refund claims. The Franklin Circuit Court affirmed the KBTA's decision.

In an opinion rendered on June 27, 2008, the Court of Appeals affirmed the circuit court's ruling. The Court rejected the taxpayer's reading of *St. Ledger* as declaring all stock nontaxable and requiring the exclusion theory it advocated. The Court found this to be "an excessively extravagant extension of *St. Ledger.*" The Court held that DOR's calculation of the refunds legitimately due the taxpayer was correct. The taxpayer's method of computing the refunds resulted in a "manifestly illogical result."

The Court of Appeals also agreed that the separate accounts were properly subjected to taxation. These accounts constituted taxable capital owned by the taxpayer for which no exemption was provided by statute. The accounts were properly assessed as omitted property because the taxpayer failed to disclose in its filings those accounts' taxable nature. The Court further rejected a variety of arguments based upon the doctrine of contemporaneous construction, accord and satisfaction, ERISA and unlawful discrimination under Ky. Const. § 171, because of their lack of merit or the taxpayer's failure to preserve them for appellate review.

Finally, the Court rejected the taxpayer's claim that interest on the assessments should be abated under KRS 131.081(8) of the Kentucky

Taxpayers' Bill of Rights. The taxpayer could not point to any written advice from DOR that it relied upon in failing to report its separate accounts.

The taxpayer's motion for discretionary review of the Court of Appeals' opinion was denied by the Kentucky Supreme Court on Oct. 21, 2009. On Jan. 19, 2010, the taxpayer filed a petition for a writ of certiorari with the United States Supreme Court seeking that court's review of the Court of Appeals' opinion. On Mar. 29, 2010, that petition was denied.

Revenue Cabinet v. Asworth Corporation, 2009-SC-816, Kentucky Supreme Court.

In this case, the taxpayers were corporations that had no property or payroll in Kentucky during the years in question, but did own interests in partnerships that did business in Kentucky. At issue was whether these corporations' distributive shares of the income from the partnerships were subject to Kentucky income tax under KRS 141.206 and if so, whether this taxation violated the U.S. Constitution's Commerce and Due Process Clauses because the corporations lacked a Kentucky physical presence.

On Nov. 20, 2009, the Court of Appeals ruled in DOR's favor, holding that the corporations' distributive shares were indeed subject to tax under KRS 141.206 and that the Commerce Clause did not impose a physical presence requirement in the income tax context. The Court also held that the apportionment of the income was governed by KRS 141.206 and not KRS 141.120, as the taxpayers in this case had contended. Finally, the Court ruled that House Bill 704 (2008) and House Bill 216 (2009) relating to interest on tax refunds (which delayed the accrual of interest and set the rate of interest at "prime minus 2 percent") were constitutional and did not violate the Due Process, Equal protection, and Takings Clauses of the U.S. and Kentucky Constitutions and Ky. Const. §§ 51 and 59.

On Aug. 18, 2010, the taxpayers' motion for discretionary review of the Court of Appeals' decision was denied by the Kentucky Supreme Court.

Department of Revenue v. Rohm and Haas Company, 2009-SC-00142, Kentucky Supreme Court

At issue in this case was the sales and use tax energy exemption provided for in KRS 139.480(3). Under this exemption, a taxpayer's purchases of energy or energy-producing fuels used in the course of manufacturing, processing, mining, or refining and any related distribution, transmission and transportation services are exempt from tax to the extent that the cost of this energy or fuels bill to the user exceed 3 percent of the cost of production. The cost of production is to be computed on the basis of plant facilities which shall mean all permanent structures affixed to real property at one location.

The taxpayer in this case produced three types of items at its plant. One item - - distilled methyl methacrylate or MMA - - was used in the production of the other two. The taxpayer did not include in its cost of production of the other two items the cost of its acquisition and distillation of the crude MMA. This in turn increased the taxpayer's energy exemption. DOR challenged the taxpayer's refund claims based upon this increase.

The taxpayer contended that the production of the distilled MMA was separate and distinct from its production of the other two items at its plant and relied upon the Supreme Court's prior decision of *Revenue Cabinet v. James B. Beam Distilling Co.,* 798 S.W.2d 134 (Ky. 1990). The Court of Appeals agreed with the taxpayer in an opinion rendered on Feb. 6, 2009. It found that the production of the other two items was not dependent upon the distilled MMA produced by the taxpayer because that material could be purchased from third parties. Therefore, the cost of the acquisition and distillation of the MMA did not have to be included by the taxpayer in the cost of production of the other two items.

On Jan. 13, 2010, the Supreme Court denied DOR's motion for discretionary review of the Court of Appeals' opinion.

Directv, Inc. v. Treesh, 290 S.W.3d 638 (Ky. 2009), cert. den., 130 S.Ct. 1053 (2010).

In this case, providers of direct satellite broadcast and wireless cable service (DBS providers) challenged the imposition of the school utility gross receipts license tax upon them. The Franklin Circuit Court ruled that this taxation, pursuant to KRS 160.614, was pre-empted by § 602(a) of the federal Telecommunications Act of 1996. This federal law exempts DBS providers from fees or taxes imposed by local taxing jurisdictions.

In an opinion rendered on Sept. 7, 2007, the Court of Appeals reversed the circuit court's judgment and held that the tax was not pre-empted by the federal law. The Court held that Kentucky's law fell within the preservation of state authority set forth in § 602(c) of the Telecommunications Act, which provides that a tax imposed and collected by a state and distributed to local jurisdictions was not pre-empted.

The DBS providers' motion for discretionary review of the Court of Appeals' opinion was granted by the Kentucky Supreme Court. On June 25, 2009, the Supreme Court rendered an opinion reversing the Court of Appeals. The Court held that the school tax was a local tax and not a state one. Accordingly, it ruled that this tax was pre-empted by Section 602(a) of the Telecommunications Act of 1996 and thus unconstitutional under the United States Constitution's Supremacy Clause (Art. VI, cl. 2).

DOR filed a petition for certiorari with the United States Supreme Court seeking that court's review of the Kentucky Supreme Court's decision. The United States Supreme Court denied this petition on Jan. 11, 2010, making the Kentucky Supreme Court's decision final.

Commonwealth ex rel. Department of Revenue v. North Atlantic Operating Co., 2009-SC-00234, Kentucky Supreme Court

In this case, the Court of Appeals on Mar. 27, 2009 affirmed a Franklin Circuit Court ruling that the cigarette paper tax enacted in 2006 (House Bill 380, 2006 Ky. Acts, ch. 252, part XXXIII) was unconstitutional under Ky. Const. § 51, which states that "[n]o law enacted by the General Assembly shall relate to more than one subject, and that shall be expressed in the title, and no law shall be revised, amended, or the provisions thereof extended or conferred by reference to its title only, but so much thereof as is revised, amended, extended or conferred, shall be reenacted and published at length." The Court of Appeals held that the title of House Bill 380 ("AN ACT relating to appropriations and revenue measures providing financing and conditions for the operations, maintenance, support, and functioning of the government of the Commonwealth of Kentucky and its various officers, cabinets, departments, boards, commissions, institutions, subdivisions, agencies, and other state-supported activities") violated the single subject requirement of Ky. Const. § 51.

On Aug. 18, 2010, DOR's motion for discretionary review of the Court of Appeals' opinion was denied by the Kentucky Supreme Court.

DOR Administration

DOR Offices, Divisions and Their Duties

Office of the Commissioner

The Office of the Commissioner is responsible for the overall management of the Department of Revenue including administering the Taxpayer Bill of Rights, the Department's budget and legislative initiatives. The Office of the Commissioner consists of a Commissioner, Deputy Commissioner and support staff. This Office also has a **Division of Special Investigations** that is responsible for investigating alleged violations of the tax laws and recommending criminal prosecution of the laws as warranted. The Office of the Commissioner also has a **Security and Disclosure Branch** responsible for oversight of the Department's physical security, data security, and exchange of information agreements.

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.

The Office of Property Valuation

The Office of Property Valuation supervises and assists Kentucky's 120 Property Valuation Administrators in the valuation of real and personal property throughout the Commonwealth, values the property of public service companies, values unmined coal and other mineral resources, values motor vehicles and supervises the collection of delinquent taxes. It consists of three branches:

1. **Local Valuation,** which oversees the real property tax assessment and collection process throughout the state in each county's property valuation administrator's and sheriff's office.

2. **State Valuation,** which administers all state–assessed taxes, including public service property tax, motor vehicle property tax and the tangible and intangible tax program; and

3. The **Minerals Taxation and GIS Services Branch** 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 sections: Mineral Resource Valuation; Minerals Severance Tax; and Cartography/GIS.

4. The **PVA Administrative Support Branch (PVA Offices Accounting)** oversees budget, fiscal, personnel and payroll, and (KHRIS) timekeeping administration for PVAs in all 120 counties and more than 700 deputies throughout the Commonwealth. It also coordinates open enrollments for Health and Life insurances and teaches property tax educational KY-Courses. The Branch conducts workshops and roundtable discussions during summer and fall PVA conferences and meetings. It provides and receives administered services to and from Division of Local Government Services, Governor's Office of Local Development and the Auditor's of Public Accounts.

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 Division of Sales and Use Tax, Division of Miscellaneous Taxes and the office of the executive director.

- 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 and refund incentive programs, initiating compliance activities, assisting taxpayers, verifying and preparing refunds and discovery of nonfiler 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.

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. Those responsibilities include but are not limited to: technical tax research, compliance, taxpayer assistance, tax specific training, public announcements, publications, creating and updating forms, analyzing legislation and drafting legislation and regulations. The Office is comprised of the Division of Individual Income Tax, the Division of Corporation Income Tax and the office of the executive director.

- 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 and License Tax Branch and the Pass-through Entity Branch. The two branches perform the same basic functions for taxpayer assistance and compliance but for different types of corporation and pass-through entity tax returns.

Office of Field Operations

The Office of Field Operations supports the Department of Revenue in administering tax laws, collecting revenue and providing services in a fair, courteous and efficient manner for the benefit of the Commonwealth and its citizens.

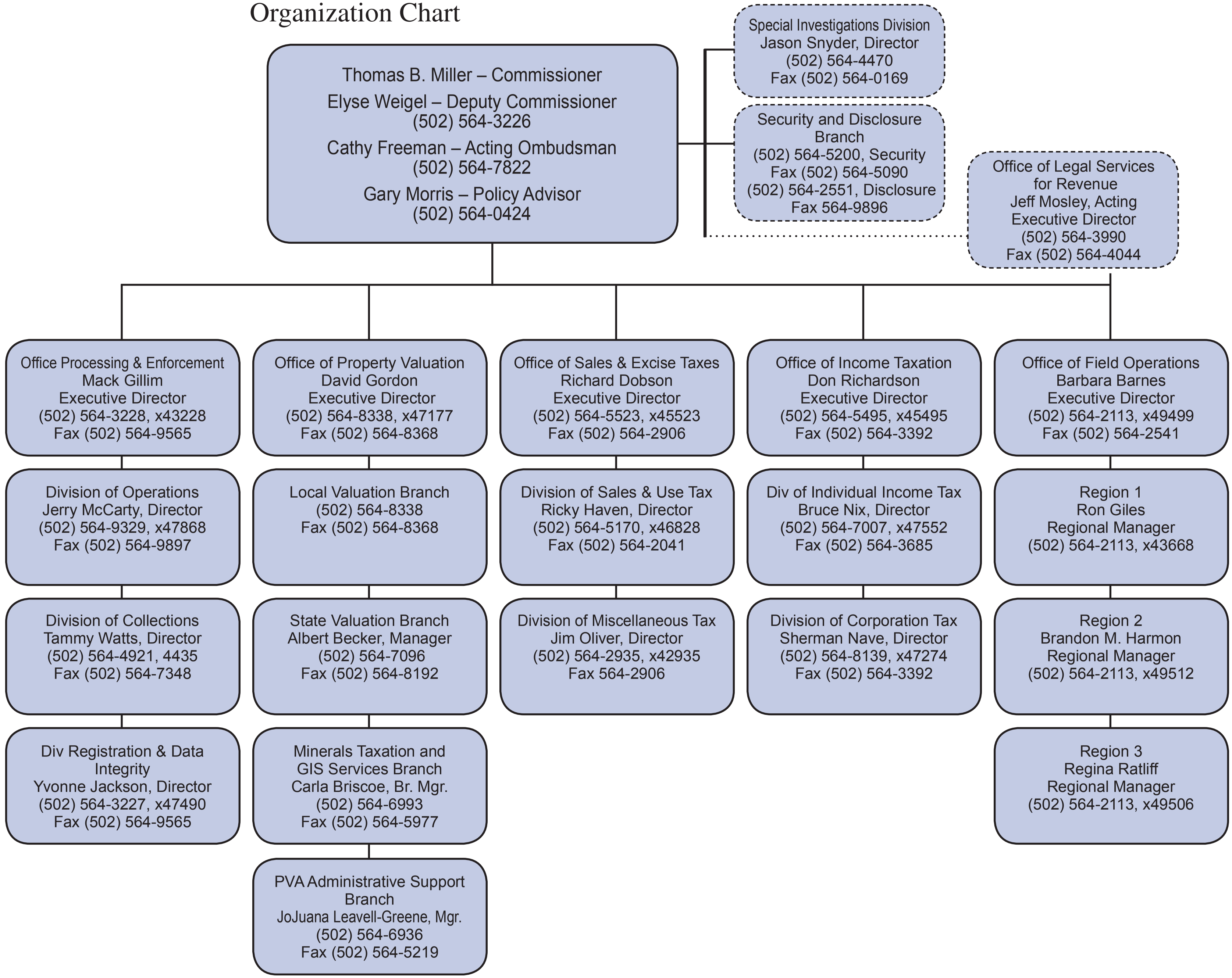
The Office of Field Operations consists of approximately 200 employees located at ten Taxpayer Service Centers across the Commonwealth. These service centers are a link between taxpayers and the Department of Revenue employees located in Frankfort. Multiple issues involving various taxes can be resolved in these service centers. In essence, these service centers are mini–Departments of Revenue that provide one–stop shopping for taxpayers.

The Field Compliance Program consists of assistance and taxpayer education. Services include: filing individual income tax returns for taxpayers; contacting new sales tax permit holders to improve education in sales and use tax law and filing procedures; issuing temporary permits for transient vendors selling in the Commonwealth of Kentucky.

The Audit Program is a necessary part of the Department of Revenue's compliance efforts. This program ensures fair and equitable tax treatment to all businesses operating in the Commonwealth. Audits are performed in the areas of sales and use tax, corporation income and license tax and property tax, to name a few. Audits are conducted in all 120 counties of Kentucky and across the United States from California to Rhode Island as appropriate.

Department of Revenue Expenditures for FY2010 - All Funds (Excluding PVAs)					
Expenditure Category	**General Fund**	**Road Fund**	**Agency Fund**	**Tobacco Settlement Fund**	**Total**
Regular Salaries & Wages	31,903,752.25	1,495,144.43	2,123,189.03		35,522,085.71
Other Salaries & Wages	458,317.76	59.41	24.88		458,402.05
Employer FICA	2,296,692.28	101,400.51	162,044.77		2,560,137.56
Employer Retirement	3,821,202.13	164,297.85	265,968.07		4,251,468.05
Health Insurance	5,384,830.43	243,901.09	425,627.14		6,054,358.66
Life Insurance	14,630.54	673.24	1,058.56		16,362.34
Subtotal Salaries & Fringe	*43,879,425.39*	*2,005,476.53*	*2,977,912.45*	-	*48,862,814.37*
Worker's Compensation	154,741.18				154,741.18
Other Personnel Costs	3,165,855.76		265,167.09		3,431,022.85
Auditing Services	182,300.00		182,300.00		364,600.00
Other Professional Services Contracts	231,924.23	-	1,418.30		233,342.53
Total Personnel Costs	**47,614,246.56**	**2,005,476.53**	**3,426,797.84**	**-**	**53,046,520.93**
Utilities & Heating Fuels	876,676.86				876,676.86
Facilities and Support Services Charges	2,073,385.62				2,073,385.62
Other Rentals	908,576.62		54,906.09		963,482.71
Maintenance and Repairs	1,183,791.94		28,006.02		1,211,797.96
Postage & Related Services	4,102,819.94				4,102,819.94
Miscellaneous Services	1,252,107.97	26,257.50	698.25	275,000.00	1,554,063.72
Telecommunications	75,486.15		80,544.57		156,030.72
Computer Services	12,012,855.99	287,962.96	1,179,277.51		13,480,096.46
Supplies	218,982.16		31,662.84		250,645.00
Commodities	724,949.07		1,516,241.65		2,241,190.72
Travel	495,742.37	2,448.42	31,508.83		529,699.62
Miscellaneous Commodities	105,444.54		450,593.33		556,037.87
Total Operating Expenses	**24,030,819.23**	**316,668.88**	**3,373,439.09**	**275,000.00**	**27,995,927.20**
Furniture			186,701.08		186,701.08
Server Hardware			89,425.53		89,425.53
Motor Vehicles			35,800.00		35,800.00
Total Capital Outlay	**-**	**-**	**311,926.61**	**-**	**311,926.61**
Total Expenditures	**71,645,065.79**	**2,322,145.41**	**7,112,163.54**	**275,000.00**	**81,354,374.74**

FINANCE & ADMINISTRATION CABINET
KENTUCKY DEPARTMENT OF REVENUE
Organization Chart



Taxes Administered

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 IRS; 18) Notice of lien discharge issued by the IRS; 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 Nonpublic 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 to provide for the expenses of the DOR in administering the cigarette tax law.

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) —$0.30 per 20 cigarettes. A one-time surtax on cigarette inventory on hand at 11:59 p.m. on March 31, 2009.

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)—$0.57 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 greater of $175 or the lesser of $0.095 per $100 of a corporation's or pass-through entity's Kentucky gross 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.

For tax years beginning on or after Jan. 1, 2007 a pass-through entity is required to withhold tax on the distributive share income of nonresident individuals and on the distributive share of corporate partners doing business in Kentucky only through their ownership interest in a pass-through entity. Withholding is at the maximum rate as provided in KRS 141.020 or KRS 141.040.

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 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-$10.60 per nonMedicare patient bed day for nursing facilities services.

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

Individual Income Tax (KRS 141.010 et seq.)—First $3,000—2 percent; Next $1,000—3 percent; Next $1,000—4 percent; Next $3,000—5 percent; next $67,000—5.8 percent. In excess of $75,000—6 percent.

Graduated tax upon an individual's taxable income. Residents must pay on their entire taxable income. Nonresidents must pay on that portion of their income attributable to Kentucky sources. Fiduciaries must pay on that portion of income of an estate or trust not distributed or distributable to beneficiaries.

Tax base is the federal adjusted gross income adjusted for differences in Kentucky and federal laws, including U.S. government bond interest, limited pension/retirement income exclusion, Social Security benefits and Railroad Retirement Board benefits and deductions for long-term care and health insurance premiums. Taxable income is computed by using the standard deduction or Kentucky itemized deductions. Tax credits include personal credits of $20, child and dependent care, family size and various business credits. Standard deduction: 2009—$2,190 and 2010—$2,210.

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— Beginning in 2005, the state death tax credit was replaced by a deduction for state death taxes paid until the repeal of the federal estate tax in 2010. Therefore, the Kentucky estate tax is effectively repealed for the estates of decedents who die after Dec. 31, 2004.

Insurance Premium Surcharge (KRS 136.392)—Beginning April 1, 2010 the surcharge is 1.8 percent of premiums collected. The rate remains 1.5 percent for premiums collected prior to April 1, 2010. 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; mortgages, financial statements and security agreements - $4; marriage licenses* - $4.50; powers of attorney to convey real or personal property - $4; lien or conveyance of coal, oil, gas or other mineral right or privilege - $4. 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 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 that 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 16.1 cents per gallon. Rate is determined quarterly. A 5 cent per gallon Supplemental Highway User Motor Fuel Tax also applies. It is 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 April 1, 2009)*—15 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.)—1.583 mills (subject to change annually up to 2 mills). Maximum assessment—2 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.

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 December 31 each year for the race year ended November 30.

Taxes Administered

Admission Tax (KRS 138.480 et seq., 139.100(2)(c))—Tracks under jurisdiction of the Kentucky Horse Racing Authority (KHRA)—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 KHRA 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 KHRA 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 12.8 cents (per $100 assessment) for 2006, 12.4 cents for 2007, 12.2 cents for 2008, 2009 and 2010. 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.

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 and digital property or taxable services within Kentucky. (KRS 139.200)

Use tax is imposed on the use, storage or other consumption in the state of tangible personal property and digital 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. Deduct 1.75 percent of the first $1,000 and 1 percent of the amount in excess of $1,000.

There are statutory exemptions.

Snuff Tax—(KRS 138.140(5))—Effective April 1, 2009, $0.19 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 multi-channel 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 multi-channel 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. Deduct 1.75 percent of the first $1,000 and 1 percent of the amount in excess of $1,000.

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 Kentucky registered vehicles are subject to KRS 132.487. Semi-trailers of interstate motor carriers are exempt.

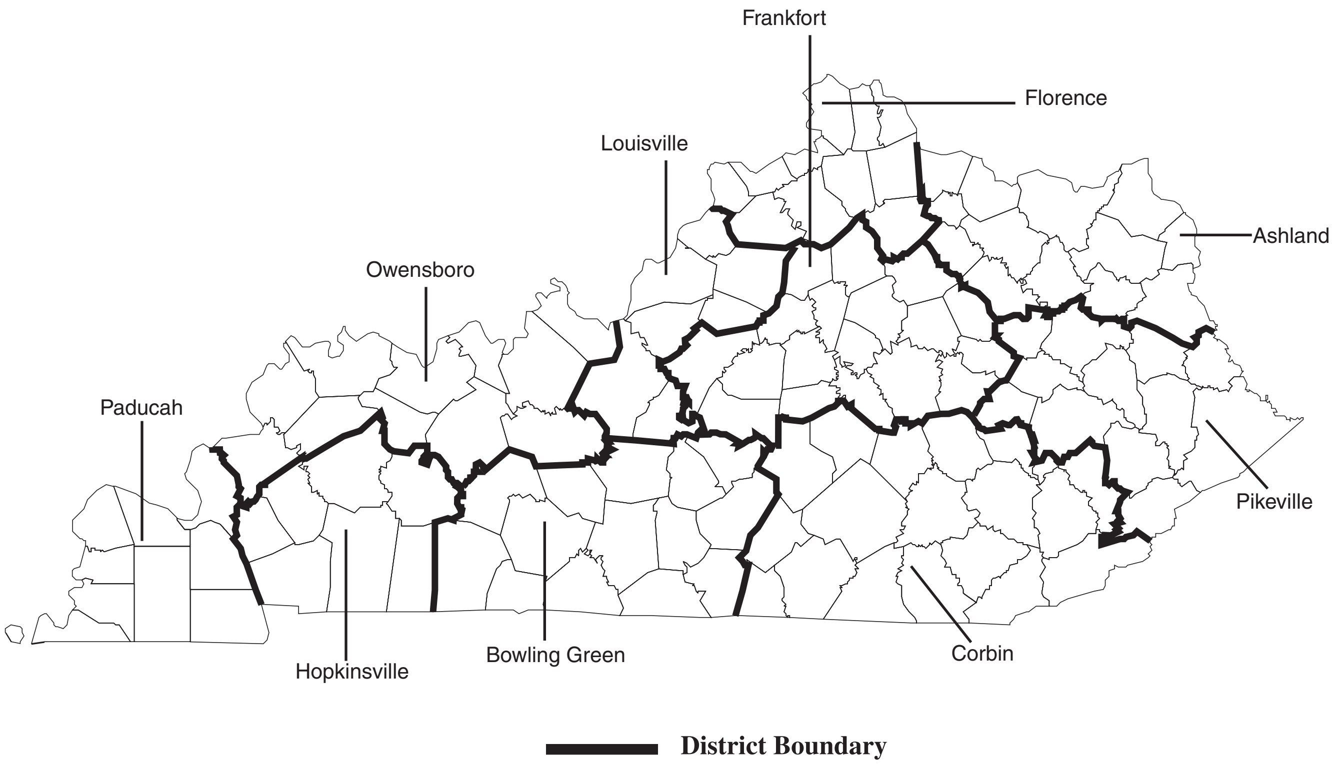
Unmined Coal, Oil and Gas Reserves and Other Mineral or Energy Resources held separately from Surface Real Property (KRS 132.820)—Same tax rates as shown for real estate.

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.

Watercraft

- Commercial **(KRS 138.1801–136.1806)—**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, 40601
Telephone: (502) 564-5930
Fax: (502) 564-8946

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

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

Louisville, 40202–2310
600 West Cedar Street
2nd Floor WEST
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, 42301–6295
Corporate Center
401 Frederica Street
Building C, Suite 201
Telephone: (270) 687-7301
Fax: (270) 687-7244

Paducah, 42001–4024
2928 Park Avenue
Clark Business Complex, Suite G
Telephone: (270) 575-7148
Fax: (270) 575-7027

Pikeville, 41501–1275
126 Trivette Drive
Uniplex Center, Suite 203
Telephone: (606) 433-7675
Fax: (606) 433-7679