2014-2015

Annual Report

Thomas B. Miller, Commissioner
Department of Revenue

Steven L. Beshear
Governor
Commonwealth of Kentucky

Lori Hudson Flanery
Secretary
Finance and Administration Cabinet

Kentucky UNBRIDLED SPIRIT
DEPARTMENT OF REVENUE

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, age, religion, disability, sexual orientation, gender identity, veteran status, genetic information or ancestry 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 40601
Phone (502) 564-3226
Fax (502) 564-3875
www.revenue.ky.gov

Lori Hudson Flanery
Secretary

Thomas B. Miller
Commissioner

December 1, 2015

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, 2015. This report reflects the dedicated work of the many fine professionals who comprise the Department of Revenue workforce.

The DOR completed work on an upgraded version of its award winning automated collection system. The new system is the result of a collaborative effort between CGI Group, Inc (CGI), the Department of Revenue (DOR), and the Commonwealth Office of Technology (COT). This upgrade project included an Early Wins component wherein new technology was used in conjunction with the existing collection system to achieve some automation of collections processes. Nearly $40 million was collected in the first two fiscal years as a result of this initiative with an additional $19 million in this fiscal year.

In January 2015, Modernized Electronic Filing (MeF) was enhanced to accept electronic payments of estimated tax at the time the taxpayer electronically files their individual income tax return, the filing of 40A102, Application for Extension of Time to File Individual, General Partnership, and Fiduciary Income Tax Returns and LLET Return and supporting schedules and forms. In April 2015, the Form 765, Kentucky Partnerships Income and LLET Return and supporting schedules and forms was added to MeF.

Electronic filing continued to grow during FYE June 30, 2015, representing 86.5 percent of individual income tax returns filed. There were 1,657,335 electronically filed individual income tax returns, an increase of 3.9 percent over the previous year.

The Department continues to place a greater emphasis on training its employees during the FYE June 30, 2015. The training emphasis is greatly needed to ensure the most productive return on the investment the Commonwealth made in granting additional compliance positions to the Department.

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, FY2015

General Fund

General Fund receipts in the fourth quarter of FY15 totaled $2,809.4 million compared to $2,586.7 million in the fourth quarter of FY14, an increase of 8.6 percent.

Among the major accounts, sales and use, individual income, corporation income and LLET taxes posted the largest increases. On the other hand, the largest declines occurred in the coal severance, property, lottery and other taxes, which were $6.6 million, $3.4 million, $6.4 million and $11.0 million below FY14 levels, respectively.

The sales and use tax posted an increase of 5.2 percent in the fourth quarter of FY15. Receipts of $854.5 million compare to the $812.6 million collected in the fourth quarter of FY14. Positive growth in the fourth quarter marks the eighth consecutive quarter of growth in the sales tax. In FY13 the sales tax fell in three of the four fiscal quarters.

Individual income tax receipts rose 11.5 percent in the fourth quarter of FY15 compared to collections in the fourth quarter of FY14. Receipts of $1,253.4 million were $129.1 million more than collected in the fourth quarter of the previous fiscal year.

Property tax collections decreased 5.4 percent in the fourth quarter of FY15. Collections of $58.7 million compare to $62.1 million received in the fourth quarter of the prior fiscal year. In general, property taxes have been very slow in recovering losses from the 2007 recession as the valuations on all types of property plummeted.

Corporation income collections rose 26.9 percent in the fourth quarter of FY15. Receipts totaled $232.6 million and were $49.2 million more than collected a year earlier.

Coal severance tax receipts continue to decrease in the fourth quarter as receipts fell 13.5 percent. Receipts of $42.1 million compare to $48.7 million collected in the fourth quarter of FY14. Kentucky severed tons have likely settled around 20 million tons per quarter having fallen from their peak of 34 million tons in FY10.

Cigarette taxes decreased in the fourth quarter. Receipts of $59.0 million were 0.1 percent less than collected in the fourth quarter of FY14. Year-to-date, cigarette tax receipts have fallen 3.1 percent due to a continued decline in the number of packs sold.

The LLET receipts increased 43.2 percent, or $29.8 million in the fourth quarter of FY15 with revenues of $98.7 million compared to $68.9 million. Collections rebounded sharply during the last two quarters of the fiscal year.

Lottery receipts decreased 10.1 percent, or $6.4 million, in the fourth quarter of FY15 with revenues of $56.5 million.

The "Other" category represents the remaining accounts in the General Fund which declined by 6.7 percent from FY14. Fourth quarter receipts for FY15 were $153.9 million and compare to $164.9 million in FY14.

Individual income tax and the sales tax comprised 75 percent of General Fund revenues. The next-largest source of revenue was the corporation income category at 8 percent followed by the "Other" accounted for 5 percent. The largest components in this category include the insurance premium tax, the bank franchise tax, the telecommunications tax and the beer wholesale tax.

The LLET accounted for 4 percent of the General Fund receipts. Finally property, cigarette, lottery and coal severance taxes accounted for 2 percent.

Road Fund

Road Fund receipts fell 8.7 percent in the fourth quarter of FY15. Receipts totaled $363.6 million compared to the $398.3 million received in the fourth quarter of FY14. Collections for this quarter are notable for the fact that both motor fuels and motor vehicle usage tax receipts declined.

Motor fuels tax receipts decreased 13.3 percent during the fourth quarter of FY15. Receipts were $188.3 million and compare to $217.3 million collected during the fourth quarter last year. House Bill 299, passed during the 2015 Regular Session of the General Legislative Session, set the motor fuels tax floor at 26.0 cents per gallon. This measure helped preserve $19.8 million in motor fuels revenue during the quarter.

Motor vehicle usage tax receipts declined 6.6 percent during the fourth quarter of FY15. Receipts of $109.5 million compared to $117.3 million received during the same period last year. The fiscal impact of the House Bill 440, which allows for a trade-in credit in new vehicle purchases, and House Bill 378, which exempts from taxation purchases made from Kentucky auto dealers by military service members assigned to duty in Kentucky, have played a role in the reduction in the revenue collected from this tax.

Motor vehicle license tax receipts increased 1.6 percent during the fourth quarter of FY15. Receipts of $32.3 million compare to $31.8 million received during the fourth quarter of FY14.

Motor vehicle operator's license fees totaled $4.0 million, a 1.6 percent decrease from the level observed a year ago.

Weight distance tax receipts totaled $18.9 million, a decrease of 1.5 percent from the fourth quarter of last year.

Investment income was down in the fourth quarter of FY15, yielding $0.3 million. The remainder of the accounts in the Road Fund combined for an increase of 50.0 percent. Receipts for the "Other" category totaled $10.2 million during the fourth quarter, compared to $6.8 million in the fourth quarter of FY14.

Revenue Receipts

GENERAL FUND TOTAL RECEIPTS

Fiscal Year	Receipts	Percent Change
2014-15	$9,966,630,897	5.3
2013-14	9,462,035,017	1.2
2012-13	9,348,326,000	2.8
2011-12	9,090,954,645	3.8
2010-11	8,759,442,646	6.5
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

ALCOHOLIC BEVERAGE TAXES—Distilled Spirits

Fiscal Year	Receipts	Percent Change
2014-15	$48,940,106	6.0
2013-14	45,790,472	6.0
2012-13	43,874,351	9.4
2011-12	41,050,705	9.5
2010-11	38,885,318	1.0
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

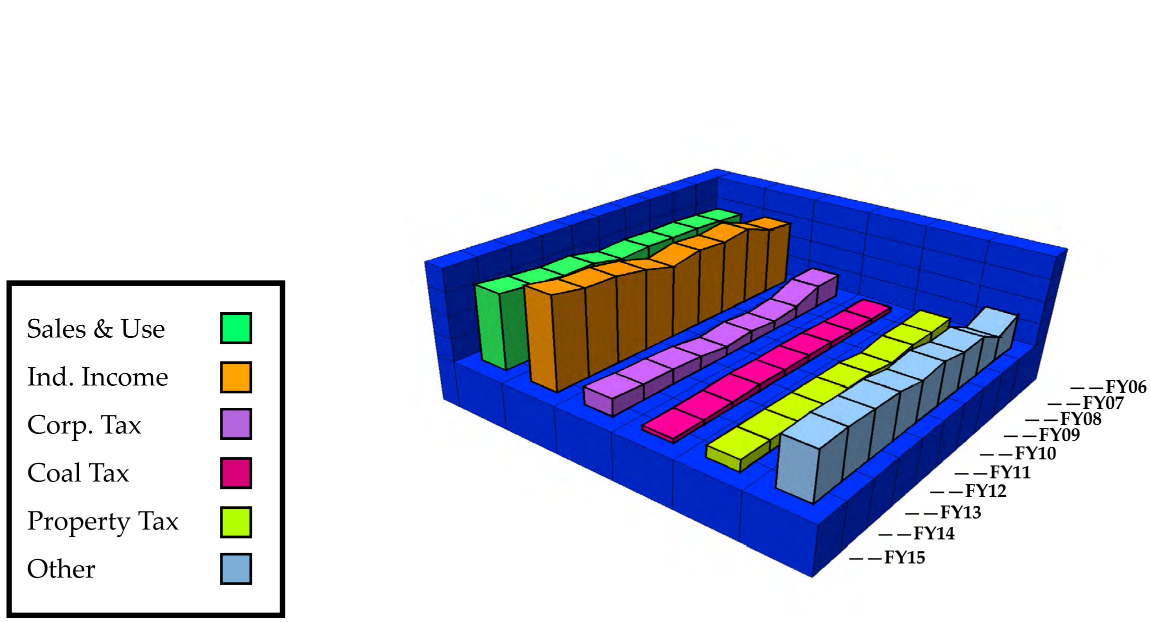
ALCOHOLIC BEVERAGE TAXES—Malt Beverage

Fiscal Year	Receipts	Percent Change
2014-15	$63,641,400	-0.9
2013-14	64,196,065	9.4
2012-13	59,940,130	-0.7
2011-12	60,265,153	9.7
2010-11	58,033,262	0.5
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

ALCOHOLIC BEVERAGE TAXES—Wine

Fiscal Year	Receipts	Percent Change
2014-15	$19,236,442	2.9
2013-14	18,417,146	9.7
2012-13	17,815,623	9.5
2011-12	16,819,928	9.8
2010-11	16,332,735	12.5
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

General Fund Receipts by Major Sources
Millions of Dollars



Revenue Receipts

CIGARETTE TAX

Fiscal Year	Receipts	Percent Change
2014-15	$220,902,529	-3.1
2013-14	228,076,834	-4.4
2012-13	238,669,895	-6.3
2011-12	254,798,018	-2.8
2010-11	262,220,720	-5.7
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

[1] *Rate increase $0.27 surtax.*

CORPORATION LICENSE TAX

Fiscal Year	Receipts	Percent Change
2014-15	$188,600	- -
2013-14	814,539	- -
2012-13	($294,874)	- -
2011-12	5,330,573	-50.0
2010-11	10,654,547	94.7
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

COAL SEVERANCE TAX

Fiscal Year	Receipts	Percent Change
2014-15	$180,283,352	-8.7
2013-14	197,525,899	-14.3
2012-13	230,540,150	-22.7
2011-12	298,263,637	0.8
2010-11	295,836,611	8.8
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

CORPORATION INCOME TAX

Fiscal Year	Receipts	Percent Change
2014-15	$528,118,737	11.2
2013-14	475,120,319	18.6
2012-13	400,752,175	7.0
2011-12	374,423,779	24.5
2010-11	300,782,364	26.4
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

INDIVIDUAL INCOME TAX

Fiscal Year	Receipts	Percent Change
2014-15	$4,069,500,570	8.5
2013-14	3,749,257,830	0.7
2012-13	3,722,963,791	6.0
2011-12	3,512,075,128	2.8
2010-11	3,417,778,504	8.3
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

LIMITED LIABILITY ENTITY TAX (LLET)

Fiscal Year	Receipts	Percent Change
2014-15	$223,791,283	12.3
2013-14	199,344,400	-19.0
2012-13	246,123,181	22.6
2011-12	200,740,356	-7.0
2010-11	215,741,157	47.8
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
2014-15	$50,975,858	11.2
2013-14	45,843,849	10.9
2012-13	41,326,220	0.0
2011-12	41,312,904	-0.1
2010-11	41,350,929	11.2
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

OIL PRODUCTION TAX

Fiscal Year	Receipts	Percent Change
2014-15	$9,840,015	-25.0
2013-14	13,128,040	19.6
2012-13	10,974,127	-8.2
2011-12	11,955,961	44.3
2010-11	8,287,566	9.6
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

LOTTERY RECEIPTS

Fiscal Year	Receipts	Percent Change
2014-15	$221,500,000	0.9
2013-14	219,500,743	2.0
2012-13	215,266,568	2.1
2011-12	210,800,122	5.1
2010-11	200,500,000	0.3
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

PARI-MUTUEL TAX

Fiscal Year	Receipts	Percent Change
2014-15	$2,964,884	22.5
2013-14	2,421,099	-50.0
2012-13	4,842,847	34.5
2011-12	3,600,911	-21.8
2010-11	4,607,322	-----
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

MINERALS AND NATURAL GAS TAX

Fiscal Year	Receipts	Percent Change
2014-15	$30,489,982	-1.8
2013-14	31,334,688	22.0
2012-13	27,972,010	-7.8
2011-12	35,830,626	-9.4
2010-11	38,195,264	1.5
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

PROPERTY TAXES—REAL ESTATE

Fiscal Year	Receipts	Percent Change
2014-15	$259,228,298	0.4
2013-14	258,284,309	0.1
2012-13	257,970,441	2.7
2011-12	251,285,063	1.7
2010-11	247,034,036	-0.7
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

Revenue Receipts

PROPERTY TAXES—TANGIBLE

Fiscal Year	Receipts	Percent Change
2014-15	$226,137,118	1.2
2013-14	223,393,888	3.0
2012-13	216,942,082	4.4
2011-12	207,739,436	11.3
2010-11	186,665,683	-3.4
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

PROPERTY TAXES—INTANGIBLE

Fiscal Year	Receipts	Percent Change
2014-15	-----	-----
2013-14	-----	-----
2012-13	-----	-----
2011-12	-----	-----
2010-11	-----	-----
2009-10	-----	-----
2008-09	-----	-----
2007-08	-----	-----
2006-07	48,841	-99.8
2005-06	30,955,124	15.0

SALES AND USE TAX

Fiscal Year	Receipts	Percent Change
2014-15	$3,267,331,025	4.4
2013-14	3,131,126,876	3.6
2012-13	3,021,794,387	-1.0
2011-12	3,052,236,048	5.4
2010-11	2,896,251,816	3.7
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

BANK FRANCHISE TAX

Fiscal Year	Receipts	Percent Change
2014-15	$99.990,669	-2.8
2013-14	102,857,446	3.9
2012-13	98,971,258	5.1
2011-12	94,158,966	6.5
2010-11	88,400,971	28
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

ROAD FUND TOTAL RECEIPTS

Fiscal Year	Receipts	Percent Change
2014-15	$1,526,738,658	-2.2
2013-14	1,560,441,246	4.6
2012-13	1,491,623,669	3.3
2011-12	1,443,773,845	7.8
2010-11	1,338,811,926	11.0
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

MOTOR FUELS TAXES—Motor Fuels Normal

Fiscal Year	Receipts	Percent Change
2014-15	$850,276,246	-4.0
2013-14	886,161,042	5.7
2012-13	838,344,373	6.1
2011-12	790,229,379	7.8
2010-11	732,826,112	11.8
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

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

Revenue Receipts

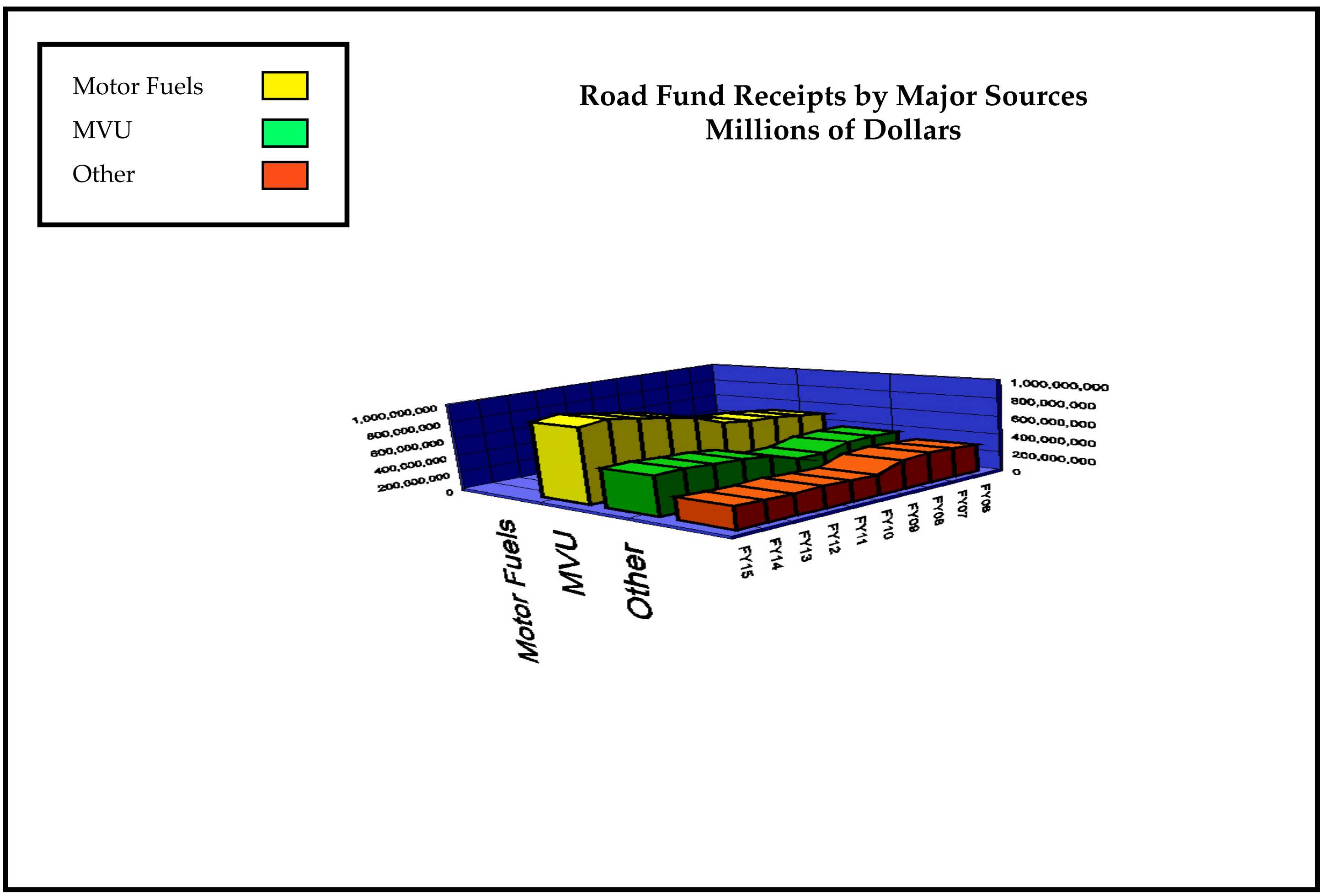
MOTOR VEHICLE OPERATOR'S LICENSE FEE

Fiscal Year	Receipts	Percent Change
2014-15	$15,958,491	-1.2
2013-14	16,150,032	0.6
2012-13	16,049,755	2.0
2011-12	15,737,651	0.0
2010-11	15,736,805	-1.3
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

MOTOR VEHICLE USAGE TAX

Fiscal Year	Receipts	Percent Change
2014-15	$432,769,932	-2.3
2013-14	443,047,087	3.8
2012-13	426,830,826	2.4
2011-12	416,852,951	9.2
2010-11	381,767,869	14.7
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

[1] *Reflects correction in reporting method.*



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MAJOR ACCOMPLISHMENTS IN FISCAL YEAR 2014-2015

OFFICE OF THE COMMISSIONER

The Commissioner's Office participated in the review and approval of 700 formal protest settlements that resulted in $140,000,000 in additional revenues being collected.

The Division of Special Investigations had 21 cases indicted in this fiscal year, involving 147 felony charges, and has opened 33 new cases. It brought in $560,809.99 in restitution paid to the Department, saved another $3,205,415 by identifying and stopping 1,554 fraudulent income tax refunds, and receiving $447,943.65 in payments to bills, for a total of $4,214,168.64, or approximately 1.6 times the amount for the prior fiscal year. During the fiscal year the courts ordered defendants to pay $630,889.12 in restitution to the DOR over time.

OFFICE OF PROCESSING AND ENFORCEMENT

The Office of Processing and Enforcement created a Training and Development Branch which is responsible for a variety of duties. Coordinating training, developing new training, conducting new employee orientation, an Office newsletter and maintaining a library of training materials are just a few of the responsibilities of the Branch.

Division of Collections

Delinquent tax collections for FY 2015 totaled approximately $178.5 million. Total collections for the Division of Collections were $219.6 million.

On September 2, 2014, the Division upgraded its automated collection system. The upgraded version allows for more automation of processes, freeing Collectors to concentrate on taxpayer service. In addition, the upgrade included a taxpayer self-service internet portal where taxpayers may make payments on-line. More than $19 million in additional revenue is attributed to this upgrade for FY 15.

Under authority created by KRS 131.130(11), the Division of Collections has collected delinquent child support. As of June 1, 2015, the Division is no longer collecting this debt. CHFS now has many automated collection processes in place and can keep up with their case load. DOR will continue to help them monitor cases previously assigned to ensure a smooth transition for debtors. This program began in January of 2003, and collected $193 million in delinquent child support debt.

As mandated by KRS 45.237 et.seq, the Division of Collections collects debt due other state agencies. The Enterprise Collections System allows agencies referring their debt to submit it either electronically or on-line. Participating agencies include the following:

- Board of Nursing
- Crime Victims Compensation Board
- Department of Financial Institutions
- Department of Insurance
- Department of Parks
- KCTCS (Kentucky Community and Technical College System)
- Kentucky Labor Cabinet
- Kentucky Lottery Corporation
- Kentucky Motor Vehicle Commission
- KHEAA (Kentucky Higher Education Assistance Authority)
- Medicaid Services
- Morehead State University
- Northern Kentucky University
- University of Kentucky Healthcare
- Western Kentucky University
- Kentucky State University (testing)
- CHFS Legal Services (testing)
- University of Kentucky (testing)
- Murray State University (testing)

For FY15, collections totaled $19.9 million. Since May 2007, total collections are $87 million. Of this total, $67.4 million has been distributed back to participating agencies.

Division of Operations

In January 2015, Modernized Electronic Filing (MeF) was enhanced to accept the Form 720–S—Kentucky S Corporation Income Tax and LLET Return for business income tax and the Form 40A102—Extension of Time to File Individual Income Tax Returns for Kentucky was added for individual income tax. In April, 2015, the Form 765—Kentucky Partnerships Income and LLET Return was added for business income tax. Development of electronic processing of the current year amended returns for individual income tax, Form 725—Kentucky Single Member LLC Individually Owned LLET Return, Form 765–GP—Kentucky General Partnership Income Return and Form 720–SL—Extension of Time to File Kentucky Corporation/LLET Return are underway for tax year 2015.

Electronic filing continued to grow during FYE June 30, 2015, representing 86.5 percent of individual income tax returns filed. There were 1,657,335 electronically filed individual income tax returns, an increase of 3.9 percent over the previous year.

The following represents the number of returns, for various type taxes, filed electronically and by paper in FY15:

The Division of Operations processed 1,657,335 individual income tax returns, representing 86.5 percent of the total number of current year returns filed, an increase of 3.9 percent from the previous year. In addition, 44,952 2D barcode returns and 257,664 paper returns were filed. There were 1,176,740 electronically filed returns requesting refunds. Direct deposit requests from the taxpayer totaled

844,413 which is approximately 72 percent of the total refunds requested. The Division of Operations processed over 109,000 prior year and amended individual income tax returns during FY15.

The Division of Operations and the Commonwealth Office of Technology are continuing to update the modernized electronic filing system (MeF), adapting to the tax changes made by the Internal Revenue Service and Kentucky Legislature.

In January, 2015, MeF was enhanced to accept the filing of Form 40A102—Application for Extension of Time to File Individual, General Partnership, and Fiduciary Income Tax Returns and the Form 720–S—Kentucky S Corporation Income Tax and LLET Return and supporting schedules and forms. A taxpayer may electronically pay tax due or estimate tax with the filing of the extension. The application is currently available for the Form 740 and Form 740–NP. In April 2015, the Form 765—Kentucky Partnerships Income and LLET Return and supporting schedules and forms was added to MeF.

Development of electronic processing of current year amended individual income tax returns, Form 725—Kentucky Single Member LLC Individually Owned LLET Return, Form 765–GP—Kentucky General Partnership Income Return and Form 720–SL—Extension of Time to File Kentucky Corporation/LLET Return is underway for tax year 2015.

Division of Registration and Data Integrity

The Division of Registration and Data Integrity answered 28,456 taxpayer assistance calls relating to registration inquiries and made 16,495 telephone calls requesting additional information in FY14.

The Division received and processed 31,673 Kentucky tax registration applications. The Kentucky Business One-Stop portal received 33% percent of the applications submitted. There were 6,277 update/cancellation forms received and processed and 7,500 additional pieces of taxpayer correspondence related to business registration and data cleansing. The Division completed over 124,000 business tax account maintenances for data integrity cleansing.

The Division of Registration and Data Integrity completed a review of over 62,500 possible noncompliant businesses; 25,519 were determined to be unregistered and were contacted to determine their registration requirements. Approximately 5,500 of the total noncompliant possibilities did not respond and were administratively registered.

Registrations from compliance efforts resulted in approximately $100.3 million in business tax revenues.

Effective May 1st, the Kentucky One Stop Business Portal was upgraded with a new online registration system. Currently, this system allows registration of entirely new businesses that need to register with both the Secretary of State and Department of Revenue (DOR) or with DOR only. The new system is an improvement over the previous system in the following ways:

- Taxpayers may now receive their tax account numbers online;
- Taxpayers may print their Sales and Use Tax permits themselves;
- Businesses may assign security roles for staff at their business or tax preparer's office to view or update tax account registration information.

Division of Protest Resolution

The Protest Resolution Division is responsible for resolving tax issues contested by taxpayers which arise from an audit assessment. In the fiscal year 2014-2015 the Division resolved over 700 taxpayer disputes representing over $140,000,000.

OFFICE OF SALES AND EXCISE TAXES

The Revenue Enhancement Initiative and Tobacco Compliance employees yielded compliance revenues of $10,728,694.

The training branch facilitated five courses for Office and Department staff, including Protest Resolution procedures, Forensic Accounting Fraud, and the annual Sales & Use Tax School.

Maintained participation in the national Streamlined Sales and Use Tax Agreement (SSUTA), which continues to yield benefits. For FY15, there were approximately 1,000 registered SST filers who remitted tax returns to Kentucky. The total paid by all SST filers for the fiscal year was over $22.8 million.

Received 180,428 electronically filed sales and use tax returns, approximately a 14 percent increase over FY14.

Received 12,415 electronically filed returns for utility gross receipts license (UGRL) tax.

Received 11,424 electronically filed motor fuels tax returns.

Received 4,307 electronically filed telecommunications tax returns.

Division of Sales & Use Taxes

Answered 68,401 phone calls relating to sales and use tax inquiries.

Made 12 distributions of the telecommunications tax totaling $36,407,926 to over 1,300 local political subdivisions.

Verified and transferred $13,046,871 to the Kentucky Horse Racing Authority from the sales tax on equine breeding fees.

Transferred $13,697,467 to the Road Fund from motor vehicle supplementary schedules.

Accomplishments

Collected $3,415,372 in county clerk's use tax transfers, including compliance of affidavits forwarded by the clerks.

Verified and issued 32 refunds totaling $6,023,391 in response to requests relating to completed Kentucky Enterprise Initiative Act (KEIA) projects.

Verified and issued 7 approved tourism project refunds totaling $3,079,784.

Prepared and mailed two *Kentucky Sales Tax Facts* newsletters during the year 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 website for future reference.

Verified and issued 5 TIF refunds totaling $9,876,387.

Received 63 applications for the Disaster Relief Sales and Use Tax Refund program, totaling $189,727. Of those applications received, 25 were approved by the end of the fiscal year for a total refund amount of $62,331.

Division of Miscellaneous Tax

Administered the utility gross receipts license (UGRL) tax and distributed $229,793,886 to 157 local school districts throughout the Commonwealth.

Answered 30,855 phone calls relating to Miscellaneous Tax inquiries.

Performed 92 retail cigarette inspections for compliance with the Master Settlement Agreement.

Presented Motor Vehicle Usage Tax overview for new County Clerks at their training seminar.

OFFICE OF INCOME TAXATION

Division of Individual Income Tax

Answered 117,579 telephone inquiries for individual income tax and 50,689 telephone inquiries for withholding tax for a total of 168,268 telephone inquiries received by the Division of Individual Income Tax.

Responded to 1,047 Live Chat conversations and 8,154 webmaster inquiries from individuals requesting individual income tax or withholding tax assistance.

Collected a total of $57,355,003 through compliance initiatives for the division.

Division of Corporation Tax

Completed the implementation of electronic capture of all filed 2014 corporation income and pass-through entity tax returns for the purpose of compliance and taxpayer assistance programs.

Completed the review of 6,016 requests for letters of good standing submitted by entities needing reinstatement with the Secretary of State.

The Division of Corporation Tax received 23,090 telephone inquiries.

Due to technological advances in electronic processing and data capture of corporate return information, the Division of Corporation Tax billed $44.0 million in compliance initiatives.

Responded to 727 web inquiries for corporation income and pass-through entities.

Communications and Training Branch

Conducted 30 training classes for DOR employees, 15 training classes for DOR managers and 25 external training classes for Kentucky tax practitioners, CPAs, attorneys, insurance adjusters, realtors and other interested parties.

Continued the partnership with the University of Kentucky and the IRS; and the University of Louisville's Louis A. Grief Tax Institute in presenting up-to-date income tax information for Kentucky tax practitioners, CPAs, attorneys, insurance adjusters, realtors and other interested parties.

OFFICE OF PROPERTY VALUATION

The Office of Property Valuation was reorganized during the 2013-14 fiscal year. This reorganization reinstated the three Divisions that previously existed within this Office and replaced the "sections" with branches. These Divisions and branches are:

Division of Local Support: Education and Compliance Branch; PVA Administrative Support Branch; Northern Field Branch; Southern Field Branch; and Western Field Branch.

Division of State Valuation: Personal Property Branch; Personal Property Compliance Branch; Public Service Branch; and the Motor Vehicle Branch.

Division of Minerals Taxation and GIS Services: Unmined Coal Property Tax Branch; Mineral Resources Valuation Branch; Cartography/GIS Branch; Mineral Severance Tax Branch; and the Mineral Information Branch.

Accomplishments

Division of Local Support

The performance audits for each property valuation administrator's (PVA) office for the 2011-2012 assessment years were completed during the fiscal year. Nearly one half of the 2013-2014 performance audits were also completed. The remaining 2013-2014 performance audits are scheduled to be completed during the upcoming fiscal year. These audits are utilized as one tool to evaluate how well a PVA is meeting the fair cash value standards of assessing real property in his or her county. Discussions are held with PVAs if there are any assessment issues that need to be addressed, and an action plan is developed to assist the county. All county assessments were certified and local property tax collections began on schedule. The 2014 state property tax rate was 12.2 cents per $100 of assessment. It has been the same since 2008.

As part of the Governor's Internet technology initiative, the Technical Support Section of the Office of Property Valuation was consolidated into the Commonwealth Office of Technology. Because COT has service representatives throughout the state, any PVA that uses COT's desktop services should be able to receive support within a short amount of time.

Division of State Valuation

Locally assessed tangible personal property assessments for calendar year 2014 totaled $67.176 billion. These assessments yielded an estimated $91.6 million in state taxes.

Omitted personal property tax assessments for FY15 totaled $5.6 billion, and approximately $37.8 million in state and local property taxes were collected on these omitted assessments.

State and local motor vehicle property tax collections for FY14 were approximately $124.5 million and 233.3 million, respectively.

Public Service Company assessments (Public Service Companies, Telecoms, Railroad Car Lines, Commercial Watercraft and Distilled Spirits in Bonded Warehouses) for calendar tax year 2014 were set at $32.6 billion and were expected to yield approximately $72.0 million in state tax revenues and approximately $182.0 million in local tax revenues.

In FY2015, the Freddie Freeroader Program targeted Kentucky residents with out-of-state license plates with an assessment totaling $53,521.

Combined state and local motor vehicle property tax collections for FY15 were $118.0 million and $221.5 million, respectively.

Division of Unmined Minerals, GIS Services

Cartography/GIS Branch

The Cartography and GIS Branch supports counties that do not have GIS software or cannot update their own GIS data. This Branch prints PVA maps using ArcGIS projects stored on the server. The staff uses pre-made ArcGIS templates for all counties allowing for fast and efficient reproduction of PVA maps and less down time for PVA offices. The staff also scans PVA maps or county clerk plats for paper reproduction or for geo-referencing into a county's GIS for accurate PVA parcel line updating.

Map Sales: The sale of PVA maps to the public and governmental agencies is distributed as follows:

> 80 percent of money received from paper map sales returned to PVA offices.
>
> 100 percent of money received from digital map sales go to PVA offices.

The Cartography/GIS Branch personnel continued their education efforts with PVA offices in five classes: ArcGIS for Editors, ArcGIS for Viewer, KY 60: Mapping, KY 62: Fieldwork, IAAO 600: IAAO Mapping.

Class	2014	2015
ArcGIS Class	6	7
KY 60	1	2
KY 62	2	1
IAAO 600	1	

The branch is on the cutting edge of technology testing tablets for fieldwork to replace paper maps, property cards, boxes, and digital cameras for PVA field staffs property inspections. This saves time and money for PVA offices across the state, in the field and in the office. Several counties use these techniques and continue to improve the use of tablets in PVA offices.

The flying or testing of drones for future disaster surveying and possible property assessments for locked gate properties. Drones could help counties recover from tornadoes, floods, and other disasters faster by supplying GIS users current aerials of the damaged areas.

This Cartography and GIS Branch started assisting PVAs with building sketches using Apex or Rapid Sketch. In 2015, our branch staff has completed projects in Calloway, Crittenden, Metcalfe, and Whitley counties. The creation of digital building footprints along with digital photos helps PVA offices better assist the public with quick accessible data.

The Branch uses remote control sessions using GoToAssist remote desktop software to assist PVAs with parcel sales, fix or set up projects, and technical support. This software allows our branch to set up GIS software and to fix data file structure. It also helps us return calls in a timely manner.

The branch now assists PVAs with their agricultural values using ArcGIS add-on tools. Staff can assess every property in a county using the USDA soils in less than ten minutes. This is a process that previously took multiple years to complete.

The ELA is an Enterprise License Agreement used by the Finance and Administration Cabinet and PVAs in 117 counties permitting the unlimited use of ArcGIS. The Cartography and GIS Branch records the ELA county payments and computer inventory list for all the PVAs.

Minerals Severance Branch

Severance tax receipts for FY15 totaled $220,535,364. One half of these receipts are distributed back to counties with mining activity.

Coal:	$179,229,517
Gas:	16,193,083
Oil:	9,655,166
Minerals:	15,457,598

Coal Severance revenues continue to decline which has resulted in more coal companies going out of business. The Minerals Severance Branch continues to communicate with companies to encourage continued compliance with state severance tax laws. The number of taxpayers who are using the CTS online filing has increased by 3 percent. Solid Minerals (other than coal) saw an increase in revenue of 14.60 percent for the fiscal year.

Unmined Coal and Mineral Resources Valuation Branch

Total unmined minerals 2015 tax receipts (2014 tax year):

Total:	$39,169,691
Gas:	10,834,701
Oil:	4,867,645
Limestone:	515,356
Clay:	5,240
Coal:	22,946,749

OFFICE OF FIELD OPERATIONS

During FY15, in-state audits were performed with net assessments of $33,431,471 and out-of-state audits generated net assessments of $36,771,842.

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2015 General Assembly

A Review of Tax Law Changes
Enacted by the 2015 General Assembly

2015 Legislation Affecting Kentucky Department of Revenue

NOTE: This 2015 legislative summary presents only general information concerning the major tax provisions the General Assembly has enacted and does not represent a complete analysis or specific interpretations of the law changes. The Department of Revenue (DOR) will provide more specific information as it implements these changes. Full text of enacted bills is available on the legislative home page, www.lrc.ky.gov

A REVIEW OF TAX LAW CHANGES

Enacted by the 2015 Regular Session of the General Assembly.

INDIVIDUAL INCOME TAX REFUND DESIGNATIONS

An individual income taxpayer required to file a return under KRS 141.180 who is entitled to an income tax refund may designate an amount, not to exceed the amount of the refund, to be paid to a selected fund. Effective for taxable years beginning on or after Jan. 1, 2016, new check boxes have been added to the Kentucky Individual Income Tax Return which allow a designation of all or a portion of an individual's refund to be contributed to the taxpayer's fund of choice. The new options are as follows:

Kentucky Special Olympics

HB 178 adds a check box which allows an individual's refund to be contributed to the Kentucky Special Olympics. Designated funds support health, education and athletic programs serving children and adults with intellectual disabilities in the Special Olympics Kentucky program.

Pediatric Cancer Research Trust Fund

SB 82 adds a check box which allows an individual's refund to be contributed to the Pediatric Cancer Research Trust Fund. Designated funds support pediatric cancer research and treatment for Kentucky patients.

Rape Crisis Center Trust Fund

SB 82 adds a check box which allows an individual's refund to be contributed to the Rape Crisis Center Trust Fund. Designated funds support centers which serve victims of rape and their families by providing counseling and other support.

INNOCENT SPOUSE RELIEF

HB 299 amends KRS 141.180 and establishes relief for an innocent spouse to be effective as of the date that the Internal Revenue Service approved the relief, or if there is no federal income tax liability as of the date that the Kentucky Department of Revenue (DOR) approved the relief. It also allows for payments made after the effective date of the relief to be refunded as applicable.

ADJUSTED PRIME RATE CAPTURE DATE

HB 299 amends KRS 131.183 to base the annual adjustment of the tax interest rate on the prime rate charged by banks in September rather than October. The adjusted prime rate is used to set the tax interest rate. The adjusted prime rate for 2015 is 4 percent. The interest rate charged on outstanding liabilities is 6 percent, and 2 percent interest is given on refunds, as appropriate.

MISCELLANEOUS TAXES

Motor Fuel Taxes

HB 299 made changes in the Motor Fuels Tax statutes. The average wholesale floor price increased from $1.786 to $2.177 per gallon and went into effect statutorily upon the date signed into law by the Governor. Other changes are effective June 26, 2015. The quarterly tax rate calculation changed to an annual calculation based on an average of the four quarterly average wholesale price calculations in the previous fiscal year. HB 299 limited the decrease in the average wholesale price to 90 percent of the average wholesale price in effect at the close of the previous fiscal year.

Motor Vehicle Usage Tax

HB 378 modifies KRS 138.470 to exempt resident military service members who are on duty in Kentucky from the usage tax on motor vehicles purchased from a Kentucky dealer. This is effective for vehicles purchased on or after June 28, 2015. HB 299 cleaned up statutes to reflect previous legal actions and removed unadministrable compliance language.

Pari-Mutuel Tax

HB 134 amends KRS 138.510 to exempt the excise tax on the track hosting a live two-day international horse racing event. In addition, the track does not have to report the amounts wagered to compute the daily average live handle.

Tobacco Taxes

Effective July 1, 2015, HB 512 made changes relating to the Tobacco Master Settlement Agreement. KRS 131.160 requires the DOR to provide a directory of all participating manufacturers and non-participating manufacturers that have been certified by the Attorney General as being in compliance with the Master Settlement Agreement and Model Act. The DOR updates the directory to add or remove a tobacco manufacturer or brand family that does not meet certification requirements as determined by the Attorney General. The DOR notifies wholesalers, distributors and retailers when there have been changes to the directory. Retailers should provide to their wholesalers and distributors updated email addresses to ensure prompt notification of removal of product from the directory. Directory updates may be found on DOR's tobacco tax website: *http://revenue.ky.gov/Business/Tobaccotax.htm*

Effective July 1, 2015, cigarettes and "roll your own" tobacco that have been removed from the directory are considered contraband and will be subject to seizure and destruction, even if a stamp had been applied.

HB 512 imposes penalties for violation under KRS 131.612, 248.752 and/or 248.754.

CORPORATION TAX

Film Production Tax Credit Program Expanded

HB 340 amends KRS 148.544 to expand the film tax credits for tax years beginning on or after Jan. 1, 2015, by reducing the threshold for qualifying expenditures for all companies and providing an enhanced incentive for Kentucky-based companies. The credits may be claimed against corporation income tax, limited liability entity tax (LLET) and personal income tax for qualifying production and payroll expenditures incurred by companies to film or produce a feature-length film, television program, industrial film, documentary, commercial or touring production of a Broadway show in Kentucky.

The new amounts are $250,000 for feature-length films, television programs or industrial films ($125,000 for Kentucky-based companies); $100,000 for commercials; and $20,000 for documentaries and/or Broadway shows ($10,000 for Kentucky-based companies for documentaries only).

If the production or filming takes place in an enhanced incentive county, the credit is 35 percent of the expenditures; otherwise, it is 30 percent, still increased from the original legislation's 20 percent. If expenditures are paid on Kentucky resident crew members, the company gets a 35 percent credit on those costs.

Historic Rehabilitation Tax Credit Regulation Adopted

The Kentucky Heritage Council has now adopted 300 KAR 6:010 to implement the Certified Historic Structures Rehabilitation Tax Credit that may be used to offset a taxpayer's liability for Kentucky corporation income tax, limited liability entity tax (LLET), bank franchise tax or personal income tax. The regulation provides a detailed explanation of the credit application process, the authority of the Executive Director of the Kentucky Heritage Council to recapture credits and to inspect property, the appeal process if there is a determination that the rehabilitation project does not qualify for the credit and the fees for processing rehabilitation certification requests.

The historic rehabilitation credit is equal to 30 percent of the qualified rehabilitation expenses for owner-occupied residential property and 20 percent of the qualified rehabilitation expenses for all other property. A minimum investment of $20,000 is required within a consecutive 24-month period for owner-occupied residential property. In the case of all other property, the minimum investment during the same time period must exceed the greater of $20,000 or the adjusted basis of the structure. The maximum credit that may be claimed by a taxpayer is $60,000 for owner-occupied residential property or $400,000 for all other property. The annual statewide cap for all taxpayers is $5 million per calendar year.

PROPERTY TAX

HB 20 allows for an annual depreciation of 10 percent on motor vehicles 20 years old or older. The effective date for this legislation is July 15, 2015, and it will affect motor vehicles for 2016 assessments.

HB 299 included technical changes to several property tax statutes. When a special exam has to be given to replace a Property Valuation Administrator (PVA), **KRS 132.380** was amended to allow a press release notification of the exam to be issued in the county where the vacancy occurs instead of a statewide press release. **KRS 133.020** was amended to allow qualified individuals other than the county judge/executive to swear in the local board of assessment appeals when the judge/executive is unavailable. **KRS 133.120** was amended to be more specific in stating what type of paid tax representatives can qualify to represent property owners at a PVA assessment conference and before the local board of assessment appeals. **KRS 136.180(5)** was removed because it was no longer needed when commercial watercraft statutes were revised in 2006, and it remained as an oversight. The amending of **KRS 136.1877** was a conforming change needed when KRS 136.180(5) was removed. **KRS 136.310(2)(a)** was amended to make clear that what is reported as Kentucky holdings for taxable Kentucky capital is the same as reported to the FDIC. **KRS 136.555** was amended to clarify that local bank deposit property tax refunds (2 year limitation) are directed to, and obtained from, the local taxing jurisdictions as specified in KRS 134.590, the statute for property tax refunds.

METROPOLITAN COLLEGE CONSORTIUM TAX CREDIT EXTENDED

HB 202 extends the sunset date to April 15, 2027, from the previous April 15, 2017. The Metropolitan College Consortium (MCC) tax credit is a nonrefundable credit that may be claimed against Kentucky corporation income tax, limited liability entity tax (LLET) and personal income tax. The new sunset date for the MCC tax credit is effective July 1, 2015.

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Legal Issues

Office of Legal Services for Revenue

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

The 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. The OLS is not responsible for personnel, bankruptcy, collection and criminal matters, which are handled elsewhere in the DOR or the Finance and Administration Cabinet.

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

Office of Legal Services for Revenue
Legal Developments and Court Decisions

The OLS represents the 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 the DOR before the KBTA and Board of Claims and at all levels of the state and federal court systems. This representation of the 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, the OLS again handled a number of cases having a significant fiscal impact or precedential value. These cases presented a wide range of issues and involved a number of the taxes administered by the DOR. The 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.

Commonwealth v. AT&T Corporation, **462 S.W.3d 399 (Ky. 2015).**

The taxpayer in this case (AT&T) filed an action for declaratory relief asserting that amendments to a sales and use tax statute (KRS 139.505, involving interstate communications service) were unconstitutional or being unconstitutionally applied. AT&T also asserted that this statute was being erroneously interpreted or applied, even if not done so in an unconstitutional manner, and further sought a money judgment for, or refunds of, the sales and use tax it alleged to have improperly or erroneously paid. The total amount of these claimed refunds was $13,000,000.

The Jefferson Circuit Court dismissed the action in its entirety for AT&T's failure to follow the statutory procedure governing tax disputes and refunds in particular. *See generally* KRS 134.580(3); 134.590(2); 131.110; 131.340; 131.370; *Popplewell's Alligator Dock No. 1, Inc. v. Revenue Cabinet,* 133 S.W.3d 456, 468-72 (Ky. 2004); *Revenue Cabinet v. Gillig,* 957 S.W.2d 206, 211 (Ky. 1997). In an opinion rendered on Nov. 15, 2013, the Court of Appeals affirmed this decision in part, to the extent the taxpayer alleged that the statute was being erroneously or unconstitutionally applied or misinterpreted, but held that the circuit court should not have dismissed AT&T's action to the extent that it asserted that the amendments to KRS 139.505 were facially unconstitutional. These issues, the Court of Appeals held, could not be decided by the KBTA.

The DOR's position in this case was that sovereign immunity and the rule requiring exhaustion of administrative remedies required the whole case to proceed in accordance with the statutory procedure referred to above — protest, final ruling, appeal to the KBTA, etc. — before the case could go to circuit court. *See also Beshear v. Haydon Bridge Co.,* 416 S.W.3d 280, 296 (Ky. 2013). Allowing the case to proceed first to the KBTA might obviate the need to address any constitutional issue, as the KBTA could rest its decision on a non-constitutional ground or basis. The circuit court could in any event decide the constitutional issue, should that become necessary, in an action for judicial review brought pursuant to KRS 131.370 and 13B.150(2)(a) in response to the KBTA's decision.

The Kentucky Supreme Court granted the DOR's motion for discretionary review and reversed the Court of Appeals' decision. The Supreme Court recognized that exhaustion of administrative remedies is not required where a statute is being challenged as void on its face. Otherwise, exhaustion of administrative remedies is required as a jurisdictional prerequisite.

In this case, AT&T's refund claims did include a facial challenge to a statute, KRS 139.505. Nevertheless, there were also several non-constitutional issues that needed to be resolved before any facial constitutional challenge could be addressed. Accordingly, the Supreme Court held that the circuit court properly dismissed AT&T's suit, requiring AT&T to pursue its administrative remedy in accordance with KRS 131.110.

The Kentucky Supreme Court's decision is final.

***Department of Revenue v. Roanoke Cement Company, LLC,* 443 S.W.3d 1 (Ky. App. 2014).**

The issue in this case was whether Roanoke Cement was entitled to a credit against the natural resources severance tax imposed by KRS 143A.020. Specifically, KRS 143.035 allows a credit when limestone is "sold to a purchaser outside of this state" by a taxpayer "who sells in interstate commerce not less than sixty percent (60%)" of the limestone it severs or processes.

It was undisputed that at least 90 percent of the taxpayer's sales of limestone were completed or consummated (i.e., passage of title and possession occurred) within Kentucky during the period in question. The purchasers of the limestone were located outside Kentucky, however, and they subsequently transported the limestone to points outside Kentucky following the consummation of the sales in Kentucky.

The DOR's position in this case was that the credit requires that at least 60 percent of the sales be consummated outside Kentucky, or in other words, made "in interstate commerce." "The DOR relied upon 103 KAR 30:190 § 2(1), which addresses the operation of the United States Constitution's Commerce Clause in the sales and use tax context, and case law discussing the meaning of the phrase 'in interstate commerce.'" Agreeing with the taxpayer, however, the circuit court and KBTA ruled that the out-of-state location of the purchasers was what determined whether the credit applied.

The Court of Appeals ruled in the taxpayer's favor on February 21, 2014. The Court agreed with the DOR that a "tax credit provision, like a tax exemption statute, should be narrowly construed in favor of the commonwealth" and that "the taxpayer has the burden of establishing its entitlement to the tax credit and must overcome the presumption that the taxing authority of the state has not been relinquished." The Court nevertheless held that the taxpayer was entitled to the credit in this case. It focused on the phrase "outside of this state" in KRS 143A.035(1) and, relying upon a prior corporation income tax decision (*Revenue Cabinet v. Rohm and Haas Kentucky, Inc.,* 929 S.W.2d 741 (Ky. App. 1996)), held that all that mattered in applying the credit was whether a sufficient percentage of the taxpayer's customers or purchasers were located outside Kentucky. The Court dismissed the DOR's arguments that KRS 143A.035 must be read as a whole and that Subsection 3 of KRS 143A.035 required that the sales themselves must be in interstate commerce, as implicating Commerce Clause concerns relevant to the "fundamentally different" sales and use tax and thus not material to the severance tax's application.

The DOR filed a motion for discretionary review with the Kentucky Supreme Court on March 24, 2014, which was denied on October 15, 2014. The Court of Appeals' decision is therefore final.

***Ohio Valley Aluminum Co., LLC v. Department of Revenue,* 2013-CA-000507 (Kentucky Court of Appeals).**

This sales and use tax case concerned the application of the exemption or, to be more precise, the partial exemption provided in KRS 139.480(3) for energy or energy producing fuels used in the course of manufacturing, processing, mining or refining, to the extend the cost of the energy or energy-producing fuel exceeds 3 percent of the cost of production. The taxpayer, Ohio Valley Aluminum, LLC (Ohio Valley), processed scrap and raw aluminum. Ohio Valley transferred its entire inventory of raw materials and finished goods to a wholly owned subsidiary it created, OVACO; Ohio Valley thereafter confined its business to the processing of aluminum.

The Court of Appeals' opinion in this case describes the relevant facts as follows:

> Following the formation of OVACO, and pursuant to a subsequent "Tolling Agreement" between Ohio Valley and OVACO, Ohio Valley heated and processed all of OVACO's scrap aluminum and charged OVACO for the service. OVACO then sold the aluminum billets to various buyers. OVACO was Ohio Valley's only customer during the tax periods in question and the fees paid between them under the tolling agreement constituted Ohio Valley's only income. In addition, Ohio Valley was OVACO's sale member; OVACO had no employees; and both companies commingled their assets in a single bank account owned by Ohio Valley's parent company, Interlock Industries, Inc.

Ohio Valley sought a refund of sales and use tax based upon its contention that it did not have to include the cost of raw aluminum when calculating its cost of production for purposes of arriving at its tax liability under KRS 139.480(3). Ohio Valley asserted that it did not have to include this raw material in the energy exemption calculation because OVACO owned the raw materials, limiting Ohio Valley's role as a fee processor or "toller" of raw materials owned by OVACO.

Affirming rulings of the KBTA and the Shelby Circuit Court, the Court of Appeals found that the prior court decisions governing this case were *Louisville Edible Oil Products, Inc. v. Revenue Cabinet,* 957 S.W.2d 272 (Ky. App. 1997) and *Revenue Cabinet v. James B. Beam Distilling Co.,* 798 S.W.2d 134 (Ky. 1990). These decisions found that "cost of production" was an "inclusive, expansive" term under the applicable regulation, 103 KAR 30:140, that required the inclusion of all raw material costs in the energy exemption calculation. Furthermore, Ohio Valley and OVACO were clearly dependent upon one another for the production of the finished product in question (i.e., heated and refined aluminum billets) and the cost of their respective operations should be included in cost of production of these items.

The Court of Appeals further agreed with the KBTA's ruling that "the allegedly separate relationship between Ohio Valley and OVACO [did] not withstand scrutiny." The Court concluded:

> Despite its status as a wholly owned subsidiary, OVACO was Ohio Valley's only customer during the tax periods in question and the fees paid between them under the tolling agreement constituted Ohio Valley's only income. In addition, Ohio Valley is OVACO's sole member, OVACO has no employees, and both companies commingle their assets in a single bank account owned by Ohio Valley's parent company, Interlock Industries, Inc. From this Court's perspective, these facts reveal not two distinct companies, but a single company which has attempted to limit its tax liability by dividing the same processes, i.e., hedging, purchasing, selling, and processing and tolling, between a parent company and a subsidiary which exists merely on paper.

The Court found its ruling supported by the principle that tax exemptions are disfavored and must be strictly construed. It agreed with the DOR that the General Assembly's intent in enacting the energy exemption — to encourage the location and expansion of industries in Kentucky — was "not served by permitting a company, which has merely transferred assets to a subsidiary that employs no one and expands no element of its operation, to claim exemptions to which it would not otherwise be entitled."

The Court of Appeals' decision is now final. The Kentucky Supreme Court denied Ohio Valley's motion for discretionary review of the Court of Appeals' on Aug. 12, 2015.

***Department of Revenue v. AT&T Corporation and Subsidiaries,* 2014-SC-00430 (Kentucky Court of Appeals)**

At issue in this corporation income tax case was the application and validity of KRS 141.200(1) to (7), which permitted corporations making up an affiliated group as defined in Section 1504(a) of the Internal Revenue Code to elect to file a consolidated tax return, computing their income tax liability in accordance with that return instead of filing separate returns. This election once made was to be binding on both the corporation taxpayers in question and DOR for the ensuing 96 months.

AT&T took advantage of these statutory provisions, electing to file a consolidated return with those subsidiaries with which it formed such an affiliated group. It later filed refund claims totaling in excess of $6.5 million based upon its contention that only corporations having a nexus with, or property or payroll in, Kentucky could be part of the affiliated group. AT&T also argued that the inclusion in the affiliated group of subsidiaries lacking such a nexus would violate the Commerce and Due Process Clauses of the United States Constitution.

The KBTA ruled in the DOR's favor. The Jefferson Circuit Court reversed the KBTA's decision, however, holding that the subsidiaries in question should be excluded from the affiliated group. This holding was based upon the circuit court's interpretation of the effect of KRS 141.040(l)(i), which during the period in question exempted from the corporation income tax "[c]orporations having no individuals receiving compensation as defined in KRS 141.120(8)(b) in this state, and whose only owned or leased property located in this state is located at the premises of a printer with which it has contracted for printing, if such property consists of the final printed product, property which becomes a part of the final printed product, or copy from which the printed product is produced." Specifically, the circuit court viewed KRS 141.200(1) and (2) as providing that only those corporations *subject to tax* could be part of an affiliated group.

The DOR appealed the circuit court's decision to the Kentucky Court of Appeals. Briefs were filed in this appeal and oral argument was held on Aug. 5, 2009.

On July 3, 2014, the Kentucky Court of Appeals rendered an opinion affirming the Jefferson Circuit Court's decision. The Court of Appeals did not reach the constitutional issue. The Court of Appeals instead found the relevant provisions of KRS 141.200 to be ambiguous and held that this ambiguity must be resolved in the taxpayer's favor. It accordingly ruled that all of the taxpayer's subsidiaries without Kentucky property or payroll must be removed from the affiliated group, thereby entitling AT&T to a refund.

The Kentucky Supreme Court denied the DOR's motion for discretionary review of the Court of Appeals' opinion on May 6, 2015. This decision is therefore final.

***Department of Revenue v. Eco Power Solutions (USA) Corp.,* Civil Action No. 13-CI-942 (Franklin Circuit Court, Aug. 24, 2014)**

At issue in this sales and use tax case was the DOR's denial of a pollution control tax exemption certificate to Eco Power Solutions (USA) Corp. (Eco Power). An exemption from sales and use tax is provided in KRS 139.480(12) for "[p]roperty which has been certified as a pollution control facility as defined in KRS 224.01-300." Eco Power's application for a certificate was based upon the following language of KRS 224.01-300(1)(a) defining "pollution control facility" as:

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

Eco Power's application related to its construction or installation of two of its COMPLY 2000 units at its demonstration facility in Louisville. This facility simulated the COMPLY units' emissions control and energy recovery capacity for purposes of marketing and selling these devices and equipment to prospective utility and industrial clients.

The KBTA reversed DOR's denial of the pollution control exemption certificate. It ruled that the property in question was designed for pollution control and being used for that purpose.

The Franklin Circuit Court reversed the KBTA's decision. The court noted that tax exemptions must be strictly construed, with any doubts resolved against an exemption's application, and that an exemption will not be presumed or implied, but must be clearly stated. The court found erroneous the KBTA's reasoning that under the exemption in question, there is no distinction made between air pollution that is the byproduct of a manufacturing process and air pollution that is the byproduct of the demonstration of equipment for purposes of sale or marketing. Instead, the circuit court agreed with the DOR's contention that the proper focus under the relevant statutory provision is not how the property or units in question functioned, but rather the *primary purpose* for which they were designed, constructed or installed.

The court further found the "exemption [was] unwarranted on its face" because the property's primary purpose was *not* to reduce pollution but to market Eco Power's property or equipment. Indeed, the court concluded, "[t]he cumulative environmental effect of the use of these units at this sales office is to actually produce more air pollution in the community in which it is located, in order to demonstrate the capacity of the units to reduce the amount of pollution for prospective buyers when compared to other available technologies for large commercial or industrial operations."

No appeal having been taken, the Franklin Circuit Court's decision in this case is final.

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 four divisions:

1. The Division of Collections has the responsibility of maintaining a professional and well-trained staff that can provide courteous, accurate and efficient services to taxpayers. The division's primary goal is to assist taxpayers in resolving their tax liability/debts in the most expeditious manner, while considering their ability to pay. However, in instances where taxpayers willfully attempt to evade their tax obligations, the Division of Collections has the responsibility to utilize all administrative and legal actions available to enforce in a fair and equitable manner, the collection of all taxes owed the Commonwealth. These enforcement actions may, but are not limited to, seizure of bank accounts, wages, accounts receivables, real property and personal property. The division may also deny or revoke a driver's license, vehicle registration or professional license.
2. 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.
3. 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/Data Quality Branch is responsible for maintaining data integrity for DOR processes and prepares requested reports and statistics for Department, Cabinet and legislative inquiries. Both branches assist the taxing areas in proper procedures to make sure that data remains accurate over time.
4. The Division of Protest Resolution is responsible for arbitrating cases where the taxpayer has protested an action of the DOR, including assessments, refund denials and exemption denials.

THE OFFICE OF PROPERTY VALUATION

The Office of Property Valuation supervises and assists Kentucky's 120 Property Valuation Administrators (PVAs) 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 divisions:

1. **Local Support Division,** which oversees the real property tax assessment and collection process throughout the state in each county's property valuation administrator's, sheriff's and county clerk's office.
2. **State Valuation Division,** which administers all state-assessed taxes, including public service property tax, motor vehicle property tax, and the tangible and intangible tax program.
3. **Minerals Taxation and GIS Services Division,** which 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.

The **PVA Administrative Support Branch** is found within the Local Support Division. The branch oversees budget, fiscal, personnel, payroll, and timekeeping administration for PVAs in all counties and more than 600 deputies throughout the Commonwealth. It also coordinates open enrollments for Health and Life insurance plans. The branch teaches property tax educational courses and conducts workshops and roundtable discussions during property assessment conferences. It provides information to the Division of Local Government Services, Governor's Department for Local Government, and the Auditor of Public Accounts. While PVA employees serve as nonmerit unclassified state employees, the Branch has the responsibility to see that PVA employees are treated fairly within the grade classification system and must ensure the integrity of the classification system among PVAs.

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, 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; 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; advance deposit wagering tax; 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)(f). The Office is responsible for administering all matters related to the individual income, withholding, corporation income, corporation license, non-resident withholding, 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, and analyzing and drafting legislation and regulations. The Office is comprised of the Division of Individual Income Tax, the Division of Corporation 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 telephone, by written correspondence, via email, 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 comprised of the Corporate Income and License Tax Branch, Pass-through Entity Branch, Communications and Training Branch, and director's office. The Division 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 Corporation Income and License Tax Branch and the Pass-through Entity Branch perform the same basic functions for taxpayer assistance and compliance, both branches examining different types of tax returns.

The Communications and Training Branch is responsible for tax-specific training, public announcements, and publications.

OFFICE OF FIELD OPERATIONS

"Service is our Role, Compliance is our Goal"

The mission of the Office of Field Operations is to support the DOR 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 DOR employees located in Frankfort. Multiple issues involving various taxes can be resolved in these service centers. In essence, these service centers are mini-DORs that provide one-stop tax resolutions for taxpayers.

The Field Compliance duties are aimed at 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; and issuing temporary permits for transient vendors selling in the Commonwealth of Kentucky.

The Audit Program is an essential part of the DOR'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.

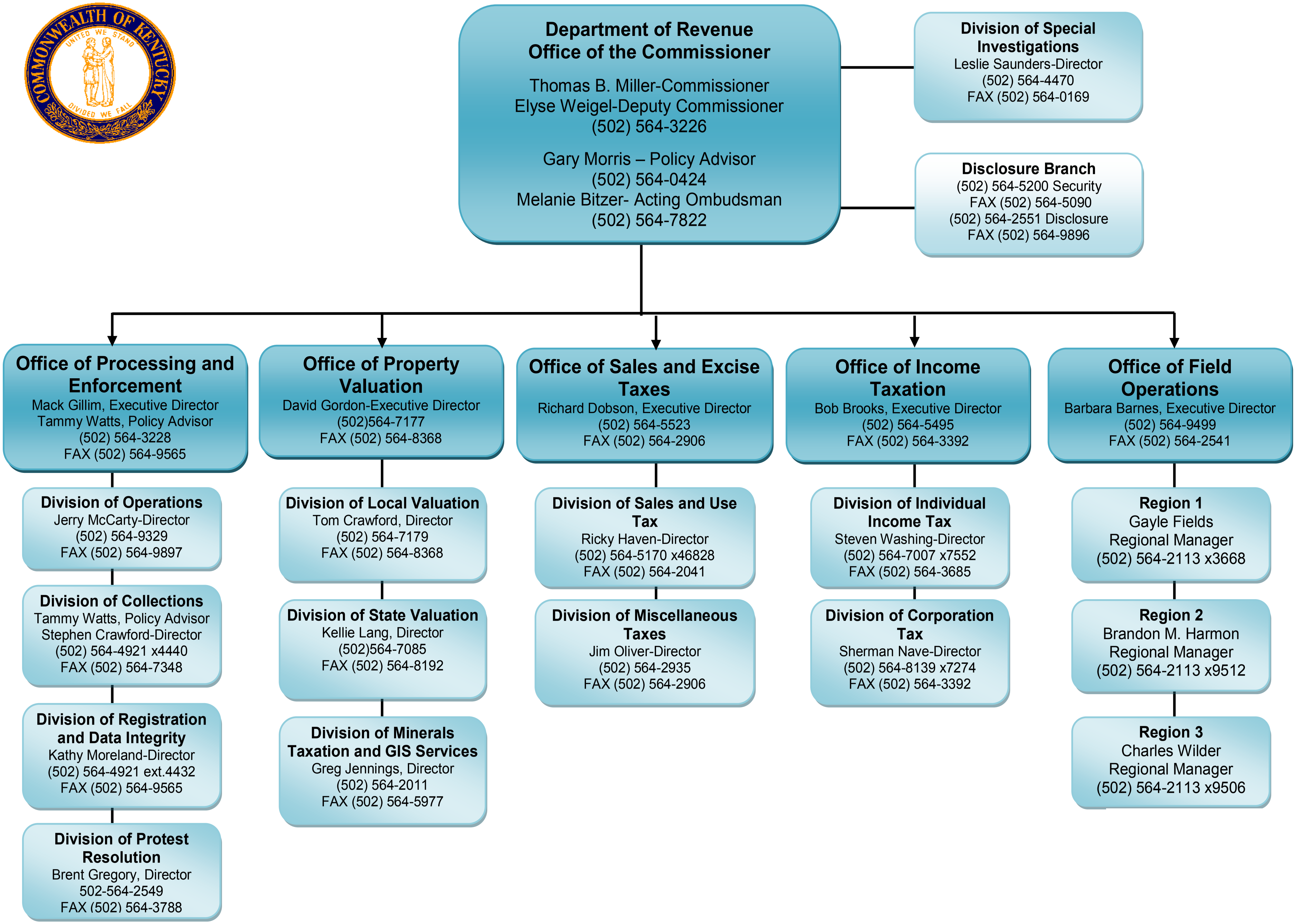
Department of Revenue

Expenditures for FY2015 - All Funds

(Excluding PVAs)

Expenditure Category	General Fund	Road Fund	Agency Fund	Tobacco Settlement Fund	Total
Salaries And Wages	30,627,619.65	1,042,052.31	5,750,912.71	139,798.15	37,560,382.82
Fringe Benefits	21,474,558.01	585,077.53	2,331,053.72		24,390,689.26
Other Personnel Costs	622,815.32	1,780.00	10,627.77		635,223.09
Pro Contract (Inc Per Serv)	241,298.15		14,192.99		255,491.14
Non Pro Contract	4,271,089.15		824,766.66		5,095,855.81
Utilities And Heating Fuels	1,103,943.49				1,103,943.49
Rentals	3,039,784.32	686,527.14	(624,149.23)		3,102,162.23
Maintenance And Repairs	656,425.82		272,789.55		929,215.37
Postage And Related Services	5,650,300.85		363.75		5,650,664.60
Miscellaneous Services	760,327.07		191,061.38	110,201.85	1,061,590.30
Telecommunications	423,042.49		93,856.95		516,899.44
Internal Computer Services	15,901,920.91	181,063.01	1,793,091.46		17,876,075.38
Items For Resale	255,756.46		975.00		256,731.46
Supplies	72,189.53	2,535.23	65,978.69		140,703.45
Commodities	422,697.33	390,038.49	35,971.39		848,707.21
Travel Exp & Exp Allowances	121,837.78	22,069.63	112,725.94		256,633.35
Misc Commodities & Other Exp	680,928.61	1,656.66	438,000.76		1,120,586.03
Claims	5,460.28		13.55		5,473.83
Transfer to Capital			1,639,600.00		1,639,600.00
Operating Transfer Out			6,000,000.00		6,000,000.00
Total Expenditures	**86,331,995.22**	**2,912,800.00**	**18,951,833.04**	**250,000.00**	**108,446,628.26**

Finance and Administration Cabinet
Department of Revenue



Taxes Administered

Advance Deposit Wagering Tax Changes (KRS 138.513) *(Effective Aug. 1, 2014)*—KRS 138.513 was enacted in 2014 in response to HB 445 (General Assembly 2014), allowing an excise tax on all advance deposit account wagering licensees, licensed under KRS 230.260 at a rate of one-half of one percent (0.5%) of all amounts wagered through the licensee by Kentucky residents: 15 percent of total collections goes into the General Fund.

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. 4-R Rates apply.

Alcoholic Beverage Wholesale Sales Tax (KRS 243.884)—11 percent of wholesale sales of distilled spirits, wine and malt beverages. The rate for wine and malt beverages effective July 1, 2015 will be 10.75% and be reduced each year in July by a quarter percent until at a rate of 10%. 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)—0.003 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 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/Limited Liability Entity Tax (KRS 141.010 et seq.)—An annual limited liability entity tax (LLET) as provided by KRS 141.0401(2) shall be paid by every corporation and every limited liability pass-through entity doing business in Kentucky on all Kentucky gross receipts or Kentucky gross profits. The LLET is the greater of $175 or the lesser of $0.095 per $100 of a corporation's or limited liability pass-through entity's Kentucky gross receipts or $0.75 per $100 of a corporation's or limited liability pass-through entity's Kentucky gross profits.

A small business exclusion from the LLET is provided to a corporation or a limited liability pass-through entity, if gross receipts or gross profits from all sources are $3 million or less. Also, marginal LLET relief is provided to a corporation or a limited liability pass-through entity, if gross receipts or gross profits from all sources are in excess of $3 million but less than $6 million. The small business exclusion cannot reduce the LLET below the $175 minimum.

A corporation is also subject to corporation income tax provided by KRS 141.040. Corporate income tax rates: first $50,000 of net income – 4 percent; next $50,000 – 5 percent; and all over $100,000 – 6 percent. A corporation is allowed a tax credit against its corporation income tax equal to its LLET liability reduced by $175. A corporation that is a partner or member of a limited liability pass-through entity is allowed a tax credit against its corporation income tax equal to its proportionate share of the LLET of the limited liability pass-through entity after the subtraction of any credits identified in KRS 141.0205 and the minimum tax of $175; however, the tax credit cannot exceed the corporation income tax assessed on the corporation's share of distributive income from the limited liability pass-through entity, and any remaining tax credit shall be disallowed.

An individual that is a partner, member or shareholder of a limited liability pass-through entity is allowed a tax credit against the individual's income tax provided by KRS 141.020 equal to the individual's proportionate share of the LLET of the limited liability pass-through entity after the subtraction of any credits identified in KRS 141.0205 and the minimum tax of $175; however, the tax credit cannot exceed the income tax assessed on the individual's share of distributive income from the limited liability pass-through entity, and any remaining tax credit shall be disallowed.

Every pass-through entity, except publicly traded partnerships as defined in KRS 141.0401(6)(r), is required to withhold Kentucky income tax at the maximum rate provided in KRS 141.020 or KRS 141.040 on the distributive income, of each: (i) nonresident individual partner, member or shareholder; and (ii) corporate partner or member that is doing business in Kentucky only through its ownership interest in a pass-through entity. Effective for taxable years beginning on or after Jan. 1, 2012, every pass-through entity required to withhold Kentucky income tax on partners, members or shareholders shall make a declaration and payment of estimated tax for the taxable year if: (i) for an individual partner, member or shareholder, the estimated tax liability can reasonably be expected to exceed $500; or (ii) for a corporate partner or member, the estimated tax liability can reasonably be expected to exceed $5,000.

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.

Distilled Spirits in Bonded Warehouses (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 assessments) state rate and full local rates.

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.

Goods in Transit—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.

Health Care Provider Tax (KRS 142.301 to 142.359) *(Effective July 1, 2013)*—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; $1.82-$12.85 per non-Medicare patient bed day for nursing facilities services.

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.

The 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: 2014—$2,400 and 2015—$2,440

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 and this change is set to expire on Dec. 31, 2013. 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)—1.5 percent of premiums, prior to April 1, 2010. Since April 1, 2010 the rate is 1.8 percent of premiums. An insurance premium surcharge on insured Kentucky risks. There are statutory exemptions.

Insurance Premium Taxes (KRS 136.320, 136.330 to 136.390, 299.530, 304.3-270, 304.4-030, 304.11-050, 304.49220)—All domestic and foreign life companies 1.5 percent tax rate. Annuities are exempt from tax. All other insurance companies 2 percent tax rate. Fire insurance*—0.75 percent.

*Represents additional tax on applicable premiums.

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

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

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

Legal Process Taxes (KRS 142.010 et seq.)*(Effective Jan. 1, 2007)*—Conveyances of real property (deeds) - $4; 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 Energy and Environment 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) on tangible personal property only. 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.

Racing Taxes

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

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

Admission Tax (KRS 138.480 et seq., 139.100(2)(c))—Tracks under jurisdiction of the Kentucky Horse Racing Authority (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 and Television 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. 4-R Rates apply.

Railroads–Intrastate (KRS 136.120, 136.180(4), 132.020(1)(o))—10 cents (per $100 of assessment). Multipliers applied to local rates and subject to annual adjustment. 4-R Rates apply.

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 through 2014. 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; Sales tax is imposed on the retailer for the privilege of making retail sales of tangible personal property, digital property or taxable services within Kentucky. (KRS 139.200)

Use tax—6 percent; Use tax is imposed on the use, storage or other consumption in the state of tangible personal property or digital property purchased for use, storage or other consumption in this state. (KRS 139.310)

Vendor's compensation is allowed up to $50 per timely filed and paid return. Deduction 1.75 percent of the first $1,000 of tax and 1.5 percent of the amount in excess of $1,000 up to the cap of $50.

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 the DOR. Buses and nonapportioned Kentucky registered vehicles are subject to KRS 132.487. Semi-trailers of interstate motor carriers are exempt.

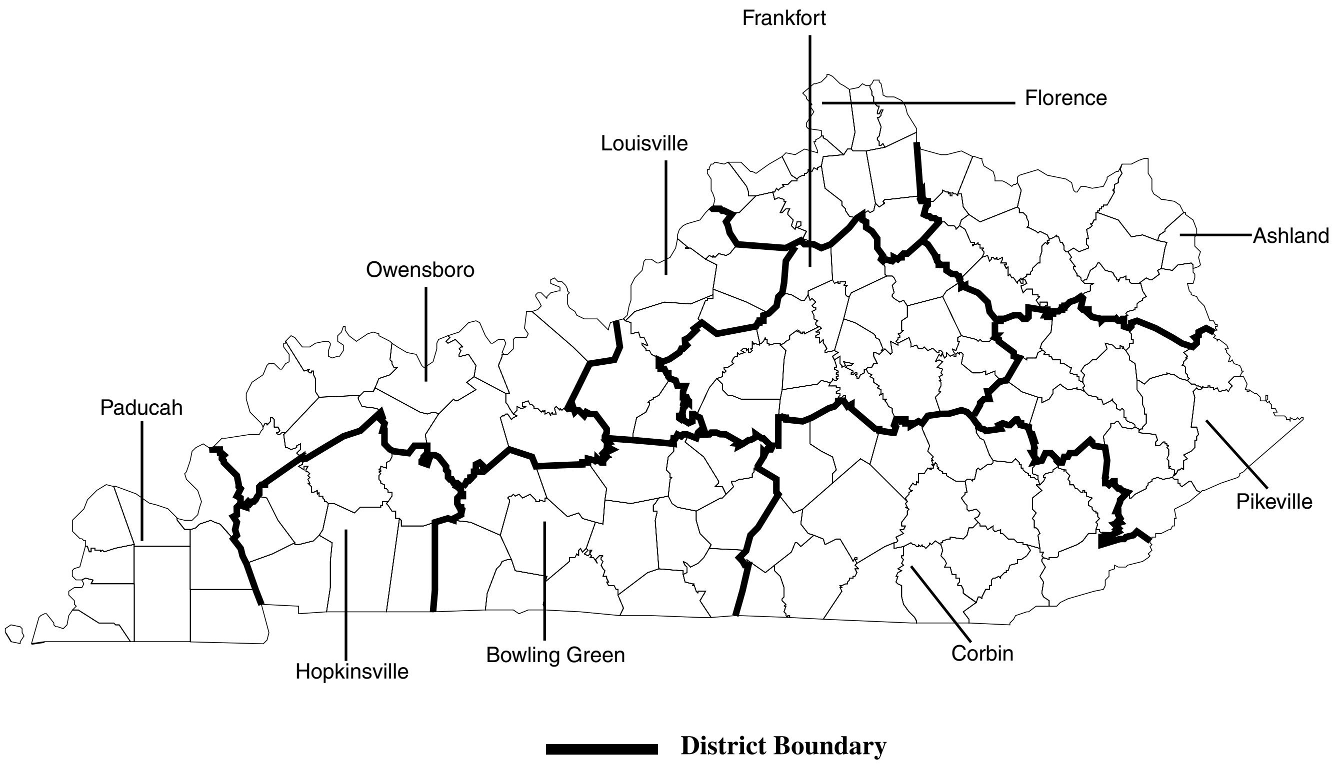
Unmined Coal, Oil and Gas Reserves and Other Mineral or Energy Resources held separately from Surface Real Property (KRS 132.820)—Same tax rates as shown for real estate.

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, 41101–7695
1539 Greenup Avenue
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

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

Frankfort, 40601
501 High Street, Tenth Floor
Telephone: (502) 564-5930
Fax: (502) 564-8946

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