



ERNIE FLETCHER
GOVERNOR

FINANCE AND ADMINISTRATION CABINET

P.O. Box 3, 200 FAIR OAKS LANE
FRANKFORT, KY 40602-0003
(502) 564-6734
FAX (502) 564-3788

ROBBIE RUDOLPH
SECRETARY

February 20, 2004

In the matter of:

██████████, INC. AND AFFILIATES

Contact: ██████████, Liquidator
██████████ Company

FINAL RULING NO. 2004-10
February 20, 2004

Disallowance of Income Tax Refund Claims (1991—1994)
Disallowance of License Tax Refund Claims (1994)

FINAL RULING

The Department of Revenue of the Finance and Administration Cabinet of the Commonwealth of Kentucky has reviewed the “unitary” corporation income and license tax returns filed by “██████████, Inc. and Affiliates” (the “██████████”) for the taxable years 1991 through 1994. The returns constitute refund claims for (i) an aggregate alleged overpayment of corporation income tax of \$██████████, and (ii) an aggregate alleged overpayment of corporation license tax of \$██████████, for a total of \$██████████, exclusive of statutory interest.

Corporation Income Tax

Each of the 1991 — 1994 unitary returns constitutes a claim for refund of alleged corporation income tax overpayments made primarily by five separate corporations¹ to Kentucky. Each of these five separate corporations initially filed separate company returns in Kentucky. None of these separate company returns indicated in any way that the separate corporation was part of some alleged unitary group.

¹ ██████████, Inc. (Ky. Acct. No. ██████████); ██████████, Inc. (Ky. Acct. No. ██████████); ██████████ Company, Inc. (Ky. Acct. No. ██████████); ██████████ Company, Inc. (Ky. Acct. No. ██████████); and ██████████ Corporation (Ky. Acct. No. ██████████).

According to the materials submitted by the ██████████ Group in support of the refund claims, the five separate corporations that paid these taxes are part of a larger federal affiliated group (“██████████ Group”) of which ██████████ ██████████ Company (“██████████”) is the common parent. Eight or nine separate corporations are included in the ██████████ Group. Ten or twelve separate corporations are included in the ██████████ Group.

Each of the five separate companies appears to be a direct or indirect subsidiary of ██████████ Life, but the ultimate parent corporation has not been included as a member of the ██████████ Group.

The separate corporation named ██████████, Inc. appears to be a second tier subsidiary of ██████████. ██████████, Inc. made no income tax payments to Kentucky for the years in question. ██████████, Inc. appears to have conducted no business, but to have merely owned interests in various real estate partnerships and the stock of one other corporation. The other members of the partnerships are unknown.

According to the information submitted by the ██████████ Group, ██████████ owned all of the stock of ██████████ Co., Inc., one of the five separate corporations that paid income taxes to Kentucky for the years in question. ██████████ in turn owned all of the stock of ██████████ Co., Inc., another of the five corporations that paid income taxes to Kentucky. ██████████ in turn owned all of the stock of ██████████, Inc. and ██████████, Inc., two of the five corporations that paid income taxes to Kentucky. Finally, ██████████ itself owned ██████████% of the stock of ██████████ Corporation, the last of the five corporations that paid income taxes to Kentucky for the years in question.

None of the five separate corporations that paid taxes to Kentucky for the years in question were either direct or indirect subsidiaries of ██████████, Inc., the alleged parent of the unitary group. None of the five separate corporations that paid taxes to Kentucky for the years in question were, according to the information supplied by the ██████████ Group, controlled or managed by ██████████, Inc. Rather, these five separate corporations were allegedly controlled and managed by ██████████.

The unitary return for 1991 was filed on or about April 15, 1996. The unitary returns for 1992 through 1994 were filed on or about August 12, 1996.

The unitary returns of “██████████, Inc. and Affiliates” for 1991 — 1994 are incorrectly labeled as “amended” returns. No unitary or combined return for the alleged

unitary corporate taxpayer “██████████, Inc. and Affiliates” was timely filed within the period prescribed by law, plus extensions (i.e., not later than October 15 of the year following each taxable year). Each of the “amended” returns for the alleged unitary corporate taxpayer for each of the years 1991 — 1994 was in fact an initial or original return of the alleged unitary corporate taxpayer, not an amendment of a previously filed return of the alleged unitary corporation.

No tax payments were ever made to Kentucky by the alleged unitary corporation identified by the 1991 — 1994 unitary returns. All tax payments in issue for 1991 — 1994 were remitted by separate corporations in payment of their respective separate company tax liability as computed on initially filed separate company returns.

The unitary method returns for 1991 — 1994 reflect alleged aggregate Kentucky corporation income tax overpayments (exclusive of statutory interest) of \$██████████.

Taxable Year	Unitary Return Filed	Alleged Tax Overpayment
1991	04.15.96	\$██████████
1992	08.12.96	\$██████████
1993	08.12.96	\$██████████
1994	08.12.96	\$██████████
Total		\$██████████

The ██████████ Group contends that ██████████, Inc. and the other eight separate corporations included in the ██████████ Group comprise a “unitary business” required to be treated as a single taxpayer.

Sovereign Immunity

Each of the refund claims for 1991 — 1994 was made by a combined or unitary return filed no earlier than April 15, 1996, based on a change from initially filed separate returns for five separate corporations with property or payroll in Kentucky, to a combined return including eight or nine separate corporations.

The refund claims for the 1991 — 1994 taxable years are barred by KRS 141.200(9). That statute provides in pertinent part that “no claim for refund . . . of a tax overpayment for any taxable year ending on or before December 31, 1995, made . . . after December 22, 1994, and based on a change from any initially filed separate return . . . to a combined return under the unitary business concept . . . shall be effective or recognized for any purpose.”

The refund claims of the ██████████ Group for the 1991 — 1994 taxable years are therefore barred by sovereign immunity. A refund claim against the Commonwealth cannot be entertained in the absence of statutory authorization. Revenue Cabinet v. Gossum, 887 S.W.2d 329, 334 (Ky. 1994); Department of Conservation v. Co-De Coal Co., 388 S.W. 2d 614 (Ky. 1964); Hurry Up Broadway Co. v. Shannon, 102 S.W.2d 30, 31 (Ky. 1937); Department of Revenue v. Jack Cole Co., 474 S.W.2d 70, 72 (Ky. 1971).

The unitary method refund claims made by the ██████████ Group for the taxable years 1991 — 1994 are disallowed based on KRS 141.200(9) and the sovereign immunity of the Commonwealth of Kentucky.

“Unitary Business”

Under a well established line of Kentucky cases, the taxpayer has the burden of providing sufficient information to the Department of Revenue to support a refund claim. Eagle Mach. Co., Inc., v. Com. by Gillis, 698 S.W.2d 528, 529 (Ky. App. 1985); Scotty’s Const. Co., Inc. v. Revenue Cabinet, 779 S.W.2d 234, 235 (Ky. App. 1989).

Based on information supplied by the ██████████ Group, it appears that the separate corporations which are members of the ██████████ Group are engaged in at least four distinct lines of business. The distinct businesses are:

- ██████████ broadcasting.
- ██████████ investment.
- ██████████ broadcasting.
- ██████████ ownership.

The information provided by the ██████████ Group does not demonstrate substantial interdependence of basic operations between the separate corporations engaged in these four distinct lines of business. None of the separate corporations appears to be engaged in more than one distinct business enterprise.

Based on the information supplied by the ██████████ Group, there is no substantial reason to think that the separate company returns of the members of the ██████████, do not appropriately reflect each corporation’s “income derived from business activity fairly attributable to the taxing state” of Kentucky. GTE v. Revenue Cabinet, 889 S.W.2d, 788, 791 (Ky. 1994). A combined or unitary return does not appear

to be necessary to fairly measure the income of each of the members of the ██████████ Group that is properly taxable by Kentucky.

According to the information supplied by the ██████████ Group, various administrative services are provided to the members of the ██████████ Group by ██████████, the common parent corporation, which is not treated as a member of the ██████████. None of these administrative services appears to be provided by any of the members of the ██████████ to other members of the ██████████. Such administrative services do not make the four discrete businesses conducted by the separate corporations unitary. Unless there is substantial interdependence of basic operations between different corporations, the corporations do not conduct a unitary business.

Stated another way, multiple corporations should be treated as a unitary business only if their basic operations are substantially interdependent. Otherwise, there is no reason to think that separate returns filed by separate corporations under the normal apportionment formula, do not appropriately reflect the “income from business activity fairly attributable to the taxing state” of each corporation. GTE v. Revenue Cabinet, 889 S.W.2d 788, 791 (Ky. 1994).

Nor has there been any showing by the ██████████ Group of any flow of value between the separate corporations which are members of the group, that is not adequately measured by the management fees and intercompany prices charged by ██████████ Group members to each other, or otherwise appropriately reflected in the separate company returns filed by the members of the ██████████ Group. The mere existence of intercompany financing and administrative services, demonstrates neither a substantial flow of value, nor substantial functional integration, nor substantial interdependence of basic operations.

The unitary method refund claims made by the ██████████ Group for the taxable years 1991 — 1994 are disallowed, on the ground that the ██████████ Group has not established that the ██████████ Group conducts a “unitary business” which would require the separate corporations included in the ██████████ Group to be treated as a single “unitary” corporate taxpayer.

The unitary method refund claims made by the ██████████ Group for the taxable years 1991 — 1994 are disallowed, on the ground that the ██████████ Group has not established that the component corporations claimed to constitute the unitary corporate taxpayer have been correctly identified. The ultimate parent company, ██████████, has been omitted from the alleged unitary group. For at least one of the years in

question, another alleged group member, ██████████, has also been omitted from the alleged unitary group.

It is irrelevant that ██████████, considered as a separate corporation, was a ██████████ insurance company and paid taxes under KRS 136.320. Whether a group of corporations conducts a unitary business, depends upon the interdependence of their basic business operations, not on what taxes the corporations may pay. The ██████████ Group may be entitled to a credit, against its corporate income tax liability, of taxes remitted by ██████████ under KRS 136.320, but that does not change the analysis required to determine whether a group of corporations conducts a unitary business. Based on the information submitted by the ██████████ Group, it appears that unless ██████████ is treated as a member of the unitary group, the group has no centralized management.

It is also irrelevant that for at least one of the years in question, ██████████'s separate company return has been audited and closed pursuant to a closing agreement. If, as contended by the ██████████ Group, the separate corporation known as ██████████ was a member of the unitary group for all of the years in question, then the taxable income of the unitary corporate taxpayer for the years cannot be determined without including the income of ██████████. That ██████████'s separate company return is closed to assessments or refund claims, never precludes the consideration of ██████████'s income and apportionment factors in determining the correct taxable income of the alleged unitary group.

The unitary method refund claims made by the ██████████ Group for the taxable years 1991 — 1994 are disallowed, on the ground that the ██████████ Group has not established the correct taxable income of the alleged unitary group for the years in question. The unitary returns incorrectly include net operating loss carryovers from non-unitary years. A net operating loss incurred by a corporation in a year for which a separate company return is filed, may never be carried over to a year for which a unitary return is filed, except to the extent of the corporation's separate company income for the unitary year. The federal consolidated return regulations, and the Kentucky regulations which deal with the filing of consolidated returns, do not apply to this situation because a consolidated return is elective, whereas a unitary return is mandatory.

No Accrual of Interest Prior to Filing of Unitary Returns

If it is determined that the ██████████ Group conducts a unitary business based on the facts and applicable law, no interest will accrue on any alleged tax overpayment made prior to the filing of "unitary" returns for the taxable year in question.

KRS 134.580 only authorizes a refund of a tax “overpayment” to “the person who paid the tax” or to that person’s “assigns.” The “person who paid the tax” in question here is a group of five separate corporations (the “██████████ Corporations”). All the remittances were paid by the ██████████ Corporations. No tax payments for the years 1991 — 1994 were made by “██████████, Inc. and Affiliates,” the alleged unitary corporation. None of the tax payments in issue were made by or on behalf of the other four or five alleged members of the ██████████ Group, some of which never filed tax returns in Kentucky.

The ██████████ Corporations, each of which is a separate corporate entity, do not claim to have overpaid their own respective separate company taxes. The tax payments made by each of the ██████████ Corporations are no greater than each corporation’s separate company tax liability computed on its initially filed separate returns.

The alleged unitary group composed of ██████████, Inc. and eight or nine other separate corporations cannot claim to have overpaid its taxes, because the alleged unitary group never paid any taxes to Kentucky in the first place. The alleged unitary group cannot claim to be an “assignee” of the ██████████ Corporations under KRS 134.580, because none of the ██████████ Corporations has an “overpayment” to assign.

Only if (i) the separate component corporations of the ██████████ Group are treated as a “unitary corporation” whose tax liability to Kentucky is computed on a “unitary” income tax return, and (ii) the tax payments made by the ██████████ Corporations are treated as having been made by the alleged unitary corporate taxpayer, can an “overpayment” of tax be said to have been made by any corporation.

The earliest that any “overpayment” of the tax liability of the ██████████ Group for any year in question can be said to have been made, was when the “unitary” returns were filed. Prior to that date the only tax that was paid, was paid by the ██████████ Corporations, and those payments did not exceed any separate corporation’s tax liability. Prior to that date, no “unitary corporation” had filed a Kentucky income tax return which computed a tax liability less than the payments made, *i.e.*, an alleged overpayment.

KRS 131.183 only authorizes statutory interest to be paid on an “overpayment” of tax, and provides that interest “shall begin to accrue” 60 days after the later of (i) the due date of the return, or (ii) “the date the tax was paid.” No interest accrues on tax

payments made by a corporation which do not exceed the corporation's correct tax liability.

No statutory interest can accrue on the remittances made by the ██████████ ██████████ Corporations with their separate corporate income tax returns, because there was no "overpayment" of their separate company tax liability computed on their separate corporate income tax returns. The earliest that ██████████ Group, the alleged "unitary corporation," can be said to have "paid" any tax to Kentucky, and the earliest that it can be said that there was an "overpayment" of the tax liability of that unitary corporation is when the "unitary" returns were filed.

Internal Revenue Code § 6611(b)(3) provides that when an income tax return for a year — like the untimely "unitary" returns filed for the years 1991 through 1994 — "is filed after the last date prescribed for filing such return . . . no interest shall be allowed or paid for any day before the date on which the return is filed." This rule applies in Kentucky.

Statutory interest under KRS 131.183 did not begin to accrue on the alleged "overpayment" at issue for 1991 through 1994, until 60 days after the unitary return for each of the years in question was filed. Prior to that date no tax return was filed by the alleged unitary corporation ██████████ Group and no "overpayment" was made by ██████████ Group. See Columbia Gas of Kentucky v. Revenue Cabinet (KBTA No. K00-R-7, October 15, 2001) (where a taxpayer incurred NOL in 1983 which was carried back to 1980 and 1981 returns, the "overpayment" of tax for 1980 and 1981 did not "arise" until the taxpayer filed its 1983 income tax returns, and interest did not begin to accrue until the 1983 returns were filed). Powell v. Board of Education of Harrodsburg, 829 S.W.2d 940 (Ky. App. 1992) (no interest allowed on claims against Commonwealth absent express statutory authorization).

Inclusion of ██████████ and ██████████

KRS 131.180(4) provides that "if any taxpayer fails or refuses to make and file a report or return or furnish any information requested in writing by the cabinet, the cabinet may make an estimate of the tax due from any information in its possession, assess the tax at not more than twice the amount estimated to be due, and add a penalty equal to five percent of the tax assessed for each thirty days or fraction thereof that the return or report is not filed."

Pursuant to KRS 131.180(4), the Department of Revenue hereby requests that you file "unitary" returns for each of the years 1991 through 1994 reflecting the combined taxable income and loss of the ██████████ Group, specifically including ██████████

██████████ and ██████████ Investment for each year, and excluding any net operating loss carryovers and carrybacks from any year prior to 1991 or subsequent to 1994, except to the extent of the income (determined on a separate company basis) during the unitary year of the group member who incurred the loss in the non-unitary year.

License Tax

Two separate corporations, ██████████ Inc. and ██████████, Inc., have also made claims for refund of corporation license taxes paid with their respective 1994 corporate income and license tax returns. ██████████, Inc.'s refund claim, made on or about August 12, 1996, alleges a license tax overpayment of \$83,231. ██████████, Inc.'s refund claim, made on or about August 12, 1996, alleges a license tax overpayment of \$██████████.

According to the license tax refund claims, both corporations sold their assets during the tax year ended December 31, 1994, and during 1995 were “required to hold the sales proceeds until the liquidation and sales order have been approved by the Kentucky Supreme Court.” ██████████, Inc. and ██████████, Inc. take the position that they “ceased operating” in Kentucky in 1994,” that “holding sales proceeds . . . does not constitute operations of any kind in Kentucky in 1995,” and that the corporations are therefore not subject to the license tax for 1994.

KRS 136.070 imposes the corporation license tax on “every corporation organized under the laws of this state.” The statute does not contain any exception for corporations organized under the laws of Kentucky which have allegedly “ceased operations” in Kentucky during a particular year. If a corporation remains incorporated under Kentucky law, the corporation is liable for the license tax, regardless of whether the corporation does business or “operates” in Kentucky, and regardless of the reason for which the corporation maintains its license.

While the license tax is computed based on capital as of December 31, the license tax is considered to be paid in advance for the year subsequent to the year for which the return is filed. That is, license tax paid with the return for 1994, is paid in advance for 1995.

Both ██████████, Inc. and ██████████, Inc. were organized under the laws of Kentucky, and both were still incorporated in Kentucky on January 1, 1995. According to the Secretary of State's Office, both corporations were voluntarily dissolved on December 27, 1995. Even if it is true, as stated in the unitary return for 1994, that these corporations did not “operate” in Kentucky 1995, both corporations are

still liable for the corporate license tax because they were incorporated in Kentucky on January 1, 1995.

The license tax is a privilege or franchise tax for the right to do business in Kentucky. It is initially payable via the corporate organization tax in advance when a corporation files articles of incorporation, regardless of whether the corporation ever does business or “operates” in Kentucky subsequent to the filing of articles of incorporation.

Any reliance on Revenue Policy 41P510 is misplaced. That Revenue Policy clarifies the Department of Revenue’s position as to the period for which the license tax is paid, *i.e.*, for the year subsequent to the year for which the return is filed.” Revenue Policy 41P510 provides that neither ██████████, Inc. nor ██████████, Inc. is required to pay corporation license tax with its return for 1995, and that no part of the license tax paid with the return for 1994 is to be refunded, notwithstanding that the corporations were dissolved in ██████████ of 1995.

The corporation license tax is imposed by statute on “every corporation organized under the laws of this state,” and is based on “capital” as statutorily defined. A Revenue Policy can no more change the incidence of the corporation license tax by mistake than it can on purpose. Kentucky Board of Tax Appeals v. Citizens Fidelity Bank & Trust Co., 525 S.W.2d 68, 75 (Ky. 1975). To the extent that Revenue Policy 41P510 can be misread to exempt corporations organized under the laws of Kentucky from the corporation license tax because a corporation allegedly does not “operate” in Kentucky at any time subsequent to its incorporation and prior to its dissolution, Revenue Policy 41P510 is erroneous and will not be followed. Delta Air Lines, Inc. v. Commonwealth, 689 S.W.2d 14, 20 (Ky. 1985).

FINAL RULING

Based on the foregoing, the unitary refund claims of the ██████████ Group for the taxable years 1991 — 1994 are disallowed based on KRS 141.200(9) and the sovereign immunity of the Commonwealth of Kentucky.

Based on the foregoing, the tax returns and supporting information filed by the ██████████ Group, and all related information submitted by the ██████████ Group, the Department of Revenue has determined that the ██████████ Group (i) has not established that it conducted a unitary business under applicable law during the years in question, (ii) has not established that it has correctly identified the members of the alleged unitary group, and (iii) has not established that it has correctly determined the income of the alleged unitary group for the years in question. The unitary refund claims for the taxable years 1991 — 1994 are therefore disallowed.

Based on the foregoing, if it is determined that the ██████████ Group conducts a unitary business based on the facts and applicable law, no interest will accrue on any alleged tax overpayment made prior to the filing of “unitary” returns for the taxable year in question.

Based on the foregoing, the claims for refund of 1995 corporation license tax paid with the tax returns filed for 1994 by ██████████, Inc. and ██████████, Inc. are disallowed because both corporations were organized under the laws of Kentucky on January 1, 1995 and were not dissolved under the corporate law until ██████████, 1995.

This is the final ruling of the Kentucky Revenue Cabinet, and its successor agency, the Finance and Administration Cabinet.

APPEAL

You may appeal this ruling to the Kentucky Board of Tax Appeals pursuant to the provisions of KRS 131.110, KRS 131.340-131.365, 103 KAR 1:010 and 802 KAR 1:010. If you decide to appeal this ruling, you must file your complaint or petition of appeal with the Clerk, Kentucky Board of Tax Appeals, 128 Brighton Park Boulevard, Frankfort, Kentucky 40601, within thirty (30) days from the date of this letter. The rules of the Kentucky Board of Tax Appeals, which are set forth in 802 KAR 1:010, require that the complaint or petition of appeal must:

1. Be filed in quintuplicate;
2. Contain a brief statement of the law and facts in issue;
3. State the petitioner's position regarding the law, facts or both; and
4. Include a copy of this final ruling letter with each copy of the complaint or petition.

Proceedings before the Kentucky Board of Tax Appeals are conducted in accordance with 103 KAR 1:010, 802 KAR 1:010 and KRS 131.340-131.365 and KRS Chapter 13B. Formal hearings are held by the Board concerning the tax appeals before it, with all testimony and proceedings officially reported. Legal representation of parties to appeals before the Board is governed by the following rules set forth in Section 2 (3) of 802 KAR 1:010:

1. An individual may represent himself in hearings before the Board;
2. An individual who is not an attorney may not represent any other individual, corporation, trust, estate, or partnership before the Board; and

3. An attorney who is not licensed to practice in Kentucky may practice before the Board if he complies with Rule 3.030(2) of the Rules of the Kentucky Supreme Court.

You will be notified by the Clerk of the Board of the date and time set for any hearing.

Sincerely,
FINANCE AND ADMINISTRATION CABINET



GEORGE D. RENFRO
Assistant Director
Division of Protest Resolution

CERTIFIED MAIL
RETURN RECEIPT REQUESTED