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OFFICE OF THE SECRETARY
FINANCE AND ADMINISTRATION CABINET
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ROBBIE RUDOLPH
SECRETARY

In the matter of:

[REDACTED], INC. AND SUBSIDIARIES

Contact: [REDACTED]
Director, Global Tax
[REDACTED], Inc.

FINAL RULING NO. 2006-34
April 7, 2006

Corporation income tax denied refunds for the
taxable periods ending December 31, 2000 and December 31, 2001

FINAL RULING

The Kentucky Department of Revenue (successor to the Kentucky Revenue Cabinet) has received a refund request from [REDACTED], Inc. and Subsidiaries ([REDACTED]). The following table provides a breakdown of the amount of the alleged refund amount not issued.

ALLEGED REFUND:

Tax Period	Income Tax	Interest to 4/7/06	Totals
FYE 12/00	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
FYE 12/01	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
Totals	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

The above disputed refunds were based on the Corporation income tax refund reduction resulting from the Corporation license tax assessments for the tax period ending December 31, 2000 and December 31, 2001. The assessments were based on an office audit examination conducted by auditors from the Department of Revenue's Division of Corporation Tax. The disputed Corporation license tax assessments are the result from adjustments made to [REDACTED]' "capital employed" calculation and are based on information obtained from the corporate records and the Kentucky Corporation Income and License Tax

Returns, Kentucky Form 720, filed for the taxable years ended December 31, 2000 and December 31, 2001.

At issue are adjustments made to ██████████ "capital employed" involving the moneys borrowed for inventory deduction not allowed by the Department of Revenue and the inclusion of other liabilities in the calculation of capital, specifically Accrued Postretirement Health Benefits, Accrued Environmental, Accrued Pension and Other Accrued Expenses, none of which are listed as current expenses on the balance sheet.

KRS 136.070(2)(a) states that accounts defined as capital shall be reported at the value reflected on financial statements prepared for book purposes as of the last day of the calendar or fiscal year.

KRS 136.070(2)(a) provides:

The term "capital" as used in this section means capital stock, surplus, advances by affiliated companies, intercompany accounts, borrowed moneys or any other accounts representing additional capital used and employed in the business. Accounts properly defined as "capital" in this section shall be reported at the value reflected on financial statements prepared for book purposes as of the last day of the calendar or fiscal year;

██████████ claims a deduction, based on monies borrowed to finance inventory. This deduction is contained in Revenue Policy 41P520. The relevant portion of this policy provides that "monies borrowed to finance inventory are excluded from capital if the corporation can show, by evidence acceptable to the cabinet, that the moneys were borrowed directly to finance inventory." However, KRS 136.070(2) was amended to provide that borrowed monies are to be included in capital employed, without any exclusion for monies borrowed to finance inventory or any other purpose. The Kentucky Board of Tax Appeals ruled in Dana Corporation v. Revenue Cabinet, File No. 01-R38, that the borrowed monies policy is void because it is contrary to KRS 136.070(2). While this order is not yet final, the result is that no exemption or deduction is allowed against capital for monies borrowed to finance inventory.

However, even if the moneys borrowed for inventory deduction is a valid deduction, ██████████ must show that the borrowed moneys were actually used to finance the purchase of inventory. For borrowed monies to be excluded from capital employed, ██████████ must provide evidence acceptable to the Department of Revenue showing that the moneys were borrowed directly to finance inventory. To claim the exclusion, ██████████ needs to submit a copy of the loan agreement or other document executed at the time the line of credit was established. If the borrowed moneys were indeed

used for the purchase of inventory, then the proceeds from the sale of the inventory should be used to pay off the loan. When this does not occur, the borrowed moneys are no longer being used to finance inventory. Therefore, the moneys borrowed cannot exceed ending inventory.

The documentation provided by ██████████, which included the loan document, indicated the loan's purpose was to effect the asset acquisition of ██████████, Inc. by ██████████. Based on the available information, the purpose of the loan was to acquire ██████████ in a stock transaction and was not for the direct purpose of purchasing inventory.

With respect to the other liabilities, they are properly included in the definition of capital as surplus, because they are contingent or estimated liabilities. Contingent liability means a liability, including a deferred tax liability, not yet fixed or certain but dependent on events to occur in the future. 103 KAR 20:020, Section 1(7). Estimated liability means a liability the existence of which is certain but for which the amount, due date or payee is indeterminable. 103 KAR 20:020, Section 1(9).

In this case, none of the four accounts are listed as current liability accounts, but instead are listed as "other liabilities," meaning they are not going to be paid in the present tax year. As a result, these liabilities are either contingent or estimated liabilities. The fact that the accrued post-retirement health care obligation is an actuarial calculation does not change the fact that it is a contingent liability. The Kentucky Board of Tax Appeals has recently held that a post-employment benefit reserve account is a contingent liability properly included in the calculation of capital as surplus. Dana Corporation v. Revenue Cabinet, File No. K01-R-38 (Order No. K-19424). While this order is not yet final, the result is that these accounts are all properly included in the calculation of capital as surplus.

After reviewing the available information and the applicable statutes/regulations, it is the position of the Kentucky Department of Revenue that the license tax adjustments issued against ██████████ and the resulting income tax refund reduction is valid and the alleged refund is denied.

This letter is the final ruling of the Department of Revenue.

APPEAL

You may appeal this final 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 final ruling, your petition of appeal must be filed at the principal office of the Kentucky Board of Tax Appeals, 128 Brighton Park Boulevard, Frankfort, Kentucky 40602-2120, within thirty (30) days from the date of this final ruling. The rules of the Kentucky Board of Tax Appeals, which are set forth in 802 KAR 1:010, require that the petition of appeal must:

1. Be filed in quintuplicate;
2. Contain a brief statement of the law and facts in issue;
3. Contain the petitioner's or appellant's position as to the law and facts; and
4. Include a copy of this final ruling with each copy of the petition of appeal.

The petition of appeal must be in writing and signed by the petitioner or appellant. Filings by facsimile or other electronic means shall not be accepted.

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



THOMAS H. BROWN
Director
Division of Protest Resolution

CERTIFIED MAIL
RETURN RECEIPT REQUESTED



