



At issue for the tax years ended December 31, 1989 through 1992 for income and license tax are the values given to assets included in the property factor for calculating the standard four-factor apportionment formula under KRS 141.120(8)(a) and KRS 136.070(3)(b). On ██████████, 1985, ██████████ acquired ██████████ Corporation which owned one hundred percent (100%) of ██████████ stock. As a result of the acquisition, a write down of the asset values of ██████████ for book purposes (book basis) was required by ██████████'s purchase accounting group. These decreased asset values were utilized and reported for Kentucky income tax purposes, although the bases of the property were not changed for federal income tax purposes. Therefore, the auditor made an adjustment to the property factor to reflect each asset's basis for federal income tax purposes (tax basis) for all years under audit.

The adjustments were made under the provisions of KRS 141.120(8)(a) and KRS 136.070(3)(b).

KRS 141.120(8)(a) which applies when calculating Kentucky's income tax states:

“The property factor is a fraction, the numerator of which is the average value of the corporation's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the corporation's real and tangible personal property owned or rented and used during the tax period; provided, however, that property which has been certified as pollution control facility as defined in KRS 224.01-300 shall be excluded from the property factor.

1. Property owned is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero (0) the property shall be valued by the department pursuant to administrative regulations promulgated by the department. Property rented is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental paid by the corporation less any annual rental rate received by the corporation from subrentals, provided that the rental and subrentals are reasonable. If the department determines that the annual rental or subrental rate is unreasonable, or if a nominal or zero (0) rate is charged, the department may determine and apply the rental rate as will reasonably reflect the value of the property rented by the corporation.
2. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the department may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the property.”

KRS 136.070 (3)(b) which applies when calculating Kentucky's license tax states:

“The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period; provided, however, that property which has been certified as pollution control facility as defined in KRS 224.01-300 shall be excluded from the property factor.

1. Property owned by the taxpayer is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero, such property shall be valued by the department under regulations promulgated by the department. Property rented by the taxpayer is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals, provided that such rental and such subrentals are reasonable. If the department determines that the annual rental or subrental rate is unreasonable, or if a nominal or zero rate is charged, the department may determine and apply such rental rate as will reasonably reflect the value of the property rented by the taxpayer; and
2. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the department may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the property;”

Effective for the tax year ended December 31, 1989, the Department also relied on Regulation 103 KAR 16:080 – Apportionment Factor; property factor Section 5 - Valuation of Owned Property.

103 KAR 16:080 Section 5(1) states in part:

“Property owned by the corporation shall be valued at original cost. As a general rule “original cost” is deemed to be the basis of the property for federal income tax purposes...”

In its protest, ██████████ presented two arguments. First, ██████████ argued that the auditor's adjustments to the property factor to reflect the tax basis rather than the book basis as reported results in an apportionment factor that does not fairly represent the extent of ██████████'s business activity in the state. ██████████ contended that a more accurate method would be to use as a

property factor a figure which more closely approximates the ratio of ██████'s production activities in Kentucky to those activities everywhere and quoted, in part, KRS 141.120(9)(a):

“(9)(a) If the allocation and apportionment provisions of this section do not fairly represent the extent of the taxpayer’s business activity in this state, the taxpayer may petition for or the cabinet may require, in respect to all or any part of the taxpayer’s business activity, if reasonable:

1. Separate accounting;
2. The exclusion of any one or more of the factors;
3. The inclusion of one or more additional factors which will fairly represent the taxpayer’s business activity in this state; or
4. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer’s income.”

Regarding this first argument of the protest, the Department has stated and maintains that the corporation did not submit information necessary to show that the standard three factor apportionment formula unfairly represented the extent of its business activity in this state.

In its second argument, ██████ stated that it regularly and consistently used “original cost” book basis for calculating Kentucky’s property factor until 1985, but that after the acquisition by ██████ Corporation, ██████ used the new book basis to calculate Kentucky’s property factor. ██████ contends that “while neither Book basis nor Federal basis reflects the “original cost” of ██████ property as required by KRS 141.120(8)(a), either, over time, when consistently used, should accurately and adequately do so.” In support of this, ██████ quoted KRS 141.120(8)(a) section 1:

“Property owned is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero (0) the property shall be valued by the department pursuant to administrative regulations promulgated by the department”

In addition, the taxpayer quoted Revenue Policy 41P180 in part:

“Generally, the value of owned property is “cost” as determined under regulations of the IRS. Leased Property is valued at 8 times net rental expense. Because of the various methods of accounting recognized for both book and tax purposes, the cabinet has generally recognized the method of accounting elected for book purposes to be more consistent than the various tax methods which may be elected to minimize the tax liability.” (Emphasis added.)

Regarding this second argument, the Department maintains that Revenue Policy 41P180 is not applicable to ██████'s property values. Revenue Policy 41P180 was written for a specific property factor issue different from the one at issue here: “What values are used in determining

inventories, intangible drilling costs, and facilities financed through local bond issuance.” In addition, the same adjustment was made to the property factor in the prior audit cycle without protest from ██████████. Therefore, the Department maintains that the tax basis is the consistent and proper value given to the properties included in the property factor as required under KRS 141.120(8)(a); KRS 136.070(3)(b); and Regulation 103 KAR 16:080 Section 5.

Therefore, the corporation income and license tax assessments for the tax years ended December 31, 1989 through December 31, 1992 are proper. This 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

