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ROBBIE RUDOLPH
SECRETARY

In the matter of:

██, INC.

Contact: ██████████
State Tax Manager

██

FINAL RULING NO. 2006-50
June 9, 2006

Corporation income tax denied refund for the
taxable periods ending December 31, 1995 and December 31, 2000

FINAL RULING

The Kentucky Department of Revenue (successor to the Kentucky Revenue Cabinet) has received a refund request from ██████████, Inc. (██████). The denied refund involves the Corporation income tax related expense field audit adjustments for the taxable years ending December 31, 1995 through December 31, 2000 which reduced the amount of refund received from the Department.

While ████████ has stated that none of ████████'s expense deductions should be denied, ████████ contends that the formula as provided in 103 KAR 16:060, Section 7(1)(a) is a more fair representation of the expense to be related to nontaxable income than the formula proposed and used by the Department.

The following table provides a breakdown of the amount of the alleged refund amount not issued based on using the formula proposed by ████████ instead of the formula proposed by the Kentucky Department of Revenue, with ████████'s officer salaries and general administrative expenses included in the formula, as proposed by ████████. The alleged refund amount includes incorporating the RAR adjustments and NOLD submitted during the on-going protest.

ALLEGED REFUND:

Tax Period	Income Tax	Interest to 2/10/06	Totals
FYE 12/00	\$ ██████████	\$ ██████████	\$ ██████████
Totals	\$ ██████████	\$ ██████████	\$ ██████████

The disputed related expense adjustments were based on a field audit examination conducted by auditors from the Department of Revenue's Division of Field Operations. The disputed adjustments 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, 1995 and December 31, 2000. ██████████ is a manufacturer of ██████████ material with two (2) facilities in Kentucky.

At issue are the related expense adjustments for the taxable years ending December 30, 1995 through December 30, 2000. ██████████ maintains that the formula proposed by the Department results in amounts of related expense far in excess of the actual non-business and non-taxable income for each period. ██████████ also has previously stated that the amount of the interest expense should be incorporated in the formula used for the related expense adjustment. ██████████ proposed formula uses the ratio of non-business and non-taxable income to total gross receipts times interest expense, officers' salaries and general administrative expenses.

Under the related expense theory, all expenses incurred to maintain nontaxable investments, investments producing or capable of producing income not taxable by Kentucky, are disallowed as deductions under the provisions of KRS 141.010(13)(d). Even if the investment does not produce income during a particular taxable period, expenses are nevertheless incurred in maintaining that investment. A review of the nontaxable income reveals inconsistent income being received while interest expense and the investment accounts remained fairly constant. The Department's position is that the same expenses will occur regardless of the amount of nontaxable income. The formula proposed by ██████████ does not adequately determine the related expense, due to the variance in the nontaxable income received.

The Department proposed and used the formula as provided in 103 KAR 16:060, Section 7(1)(d) which takes the ratio of nontaxable/nonbusiness assets to total assets times interest expense. This method satisfies ██████████'s request of including the interest expense in the related expense calculation and satisfies the Department's requirement of a more uniform related expense amount. ██████████, however, is still in disagreement with this related expense calculation.

After reviewing the available information and the applicable statutes/regulations, it is the position of the Kentucky Department of Revenue that ██████████'s alleged refund claim of \$██████████ is not valid and is denied.

This letter is the final ruling of the Kentucky 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

