



**FINANCE AND ADMINISTRATION CABINET
OFFICE OF THE SECRETARY**

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John R. Farris
Secretary

In the matter of:

[REDACTED], INC.

Contact: [REDACTED]
[REDACTED] Inc.

FINAL RULING NO. 2006-59
August 23, 2006

Corporation license tax assessments for
tax years 1997 and 1998

FINAL RULING

The Kentucky Department of Revenue (successor to the Kentucky Revenue Cabinet) has issued Corporation license tax assessments against [REDACTED], Inc. for the taxable periods ending December 31, 1997 and December 31, 1998 totaling \$ [REDACTED], plus applicable interest and penalties. The following table provides a breakdown of the amount of tax due, all assessed penalties, as well as accrued interest as of the date of this final ruling. Interest, determined in accordance with KRS 131.183, will continue to accrue daily on the unpaid balance. The penalties are assessed pursuant to KRS 131.180.

Tax Year	Tax Due	Interest	Penalties	Total
1997	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
1998	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Totals	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

The above referenced assessments were issued August 16, 2002, based on a field examination conducted by auditors from the Department of Revenue's Division of Field Operations. The assessments included several adjustments 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, 1997 and December 31, 1998. ██████████, Inc. is a Kentucky corporation based in ██████████, Kentucky. The property and payroll are 100% in Kentucky. The corporation's operation consists of purchasing used construction equipment, refurbishing it and then selling it at a profit.

At issue are the following adjustments. The apportionment and allocation, Schedule A, showed the corporation did not own or lease tangible property with a situs without this state or have employees receiving compensation without this state. Therefore, pursuant to KRS 141.010 (14)(a) and KRS 136.070(2)(b) the corporation was not subject to allocate and apportion net income or apportion total capital and therefore required to report one hundred percent (100%) of net income and total capital to Kentucky.

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;

The Department of Revenue included in the capital employed calculation the "Deferred FIT", "Loans from Stockholders", "Mortgages, notes, bonds payable in less than 1 year" and "Mortgages, notes, bonds payable in 1 year or more" accounts. These accounts reflect borrowed monies and represent additional capital used and employed in the business. These accounts have properly been included in the capital employed calculation.

The corporation has claimed that the Loans from Stockholders and the Mortgages, notes, bonds payable in less than and more than 1 year accounts represent monies borrowed for inventory. The above cited statute states that borrowed monies are to be included in capital employed, without any provision for purchases of inventory. The monies borrowed for inventory deduction claimed by the corporation 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 has been appealed, the result is that no exemption or deduction is allowed against capital for monies borrowed to finance inventory.

However, even if the monies borrowed for inventory deduction is a valid deduction, ██████████, Inc. must show that the borrowed monies were actually used to finance the purchase of inventory. For borrowed monies to be excluded from capital employed, ██████████, Inc. must provide evidence acceptable to the Department of Revenue showing that the monies were borrowed directly to finance inventory. The supporting information furnished by the corporation showed a detailed accounting of the loan in question, but did not detail the original cost of the machinery/equipment which was later refurbished then sold by the corporation. The original cost of the aforementioned machinery/equipment in inventory as of the last day of the calendar or fiscal year could not be determined. The monies borrowed for parts, labor, office expenses and other costs associated with refurbishing the equipment would not be allowed.

The Department of Revenue has requested numerous times detailed information that included the draw request form and the corresponding withdrawal entries from the payment/borrowing schedule for the machinery/equipment inventory at the end of each year in question. Despite the numerous requests, the corporation has not submitted the requested information. As a result, the corporation has failed to provide evidence showing how much, if any, of the machinery/equipment constitutes inventory, and what portion of the borrowed monies is related to such inventory, and the deduction is denied in its entirety.

After reviewing the available information and the applicable statutes, it is the position of the Department of Revenue that the license tax assessments issued against ██████████, Inc. for taxable periods ended December 31, 1997 and December 31, 1998 are valid liabilities due the Commonwealth of Kentucky.

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:

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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

