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FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE

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Secretary

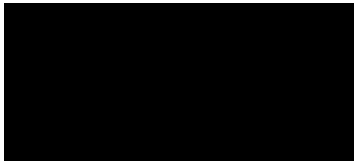
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WILLIAM M. COX, SR.
Commissioner

In the matter of:

██████████ CORPORATION

Contact:



FINAL RULING NO. 2008-20
April 30, 2008

Customer Deposits Determined to be Capital Employed
Tax Years 2002, 2003, and 2004

FINAL RULING

The Kentucky Department of Revenue has adjusted the taxpayer's 2002, 2003, and 2004 license tax returns as submitted to reflect the inclusion of **Customer Deposits** in capital employed for corporation license tax purposes, under KRS 136.070. The following table provides a breakdown of the amount of corporation license tax assessed and applicable accrued interest as of April 29, 2008.

Tax Year	Tax	Interest	Total
2002	██████████	██████████	██████████
2003	██████████	██████████	██████████
2004	██████████	██████████	██████████
Total	██████████	██████████	██████████

At issue is whether the account styled **Customer Deposits** is **Debt** for license tax purposes. The account in question is an accumulation of prepayments by the taxpayer's customers. The taxpayer states in a letter dated ██████████ 2007, that it believes **Customer Deposits** are not "long-term cash but rather true short term liabilities of the company and

should be included as a deduction on line 2(b) from **Total Assets** to arrive at the **Surplus** as required by the instructions to the KY license tax.” Further, in the taxpayer’s letter dated ██████████, 2007, the taxpayer states that the “deposit (down payment) is a current liability to the customer and must be returned to him if we do not fulfill our obligation to the customer. It remains a liability in full until the machine is shipped to the customer and the sale is recognized as revenue. The treatment has been audited by our Independent Auditors and found to be acceptable under Generally Accepted Accounting Principles. Accordingly, we believe that customer deposits is a liability of the company and must be deducted from Total Assets to arrive at Surplus as defined in the regulations and instructions to the Kentucky License tax.”

KRS 136.070(2)(a) states that “[t]he term “capital” as used in this section means capital stock, surplus, advances by affiliated companies, inter-company accounts, borrowed monies or any other accounts representing additional capital used and employed in the business.” The significant category in this case is **Surplus** in that it is explicitly enumerated in this statute as a component of capital for license tax purposes.

Surplus is defined in 103 KAR 20:020 § 1 (16) as “the excess of the net assets of a corporation over its capital stock.” The term “net assets” is defined in 103 KAR 20:020 § 1 (14) as “the amount by which total assets of a corporation exceeds total debt of the corporation.” The obvious license tax consequence, and benefit for any taxpayer, is that **Debt**, a deduction from Net Assets, reduces **Surplus** and therefore reduces capital for license tax purposes.

103 KAR 20:020 § 1 (8) defines **debt** to mean “an unconditional and legally enforceable obligation for the payment of money” and “does not include a contingent liability or an estimated liability.” 103 KAR 20:020 § 1 (9) defines **estimated liability** to mean a liability the existence of which is certain but for which the amount, due date, or payee is indeterminable.

In response to the taxpayer’s claim that the account in question is not long-term cash but rather short-term liabilities of the company, the mere fact that a liability is short-term or long-term has no effect in the determination of whether it is **Debt** for Kentucky license tax purposes. The Department of Revenue finds that **Customer Deposits** is not **Debt** as defined in 103 KAR 20:020 § 1 (8). This regulatory provision states that **Debt** is an unconditional and legally enforceable obligation for the payment of money and that **Debt** does not include estimated liabilities. **Estimated Liability** is defined as a liability the existence of which is certain but for which the amount, due date, or payee is indeterminable. The Department of Revenue finds that the account styled **Customer Deposits** is not an obligation to pay money. The Department of Revenue also further finds that **Customer Deposits** is an **Estimated Liability** in that the due date is indeterminable and thus is not includable in **Debt**. It is therefore determined to be a part of **Surplus** and therefore includable in capital for license tax purposes. Moreover, if the taxpayer performs, then this amount is never paid to the customer. Only in the event the taxpayer fails to perform would such a liability constitute debt.

In the alternative, should **Customer Deposits** be considered debt, even though it is not an obligation to pay money, then such receipts by the taxpayer would constitute borrowed monies and thus includable in capital for license tax purposes elsewhere on the return.

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

A handwritten signature in black ink, appearing to read "Jason Snyder", written in a cursive style.

Jason Snyder
Executive Director
Office of Legal Services

CERTIFIED MAIL
RETURN RECEIPT REQUESTED