



ERNIE FLETCHER  
GOVERNOR

OFFICE OF THE SECRETARY  
FINANCE AND ADMINISTRATION CABINET  
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ROBBIE RUDOLPH  
SECRETARY

In the matter of:

[REDACTED] & [REDACTED]

Contact: [REDACTED] & [REDACTED]  
[REDACTED]

FINAL RULING NO. 2005-89  
December 12, 2005

Individual income tax assessments  
for the periods ended  
December 31, 1993, December 31, 1995 & December 31, 1996

FINAL RULING

The Kentucky Department of Revenue (successor to the Kentucky Revenue Cabinet) has issued individual income tax assessments against you for the taxable years 1993, 1995 and 1996 totaling \$ [REDACTED], plus applicable interest. The following table provides a breakdown of the amount of tax due and the accrued interest as of the date of this final ruling.

Tax Period	Tax	Interest	Fees	Penalty	Total
1/01/93-12/31/93	\$ [REDACTED]	\$ [REDACTED]			\$ [REDACTED]
1/01/95-12/31/95	\$ [REDACTED]	\$ [REDACTED]			\$ [REDACTED]
1/01/96-12/31/96	\$ [REDACTED]	\$ [REDACTED]			\$ [REDACTED]
Totals	\$ [REDACTED]	\$ [REDACTED]			\$ [REDACTED]

During the assessment periods, [REDACTED] and [REDACTED] were residents of Kentucky. [REDACTED] main source of income for the above tax periods is electrical work performed as an employee for [REDACTED] and the [REDACTED]. [REDACTED] also received a W-2 from [REDACTED] for part-time [REDACTED] in both 1995 and 1996. In addition, [REDACTED] had a [REDACTED] business reported on Schedule C. [REDACTED] was employed by [REDACTED], Kentucky for 1995 and 1996.

The Individual Income tax assessments resulted from a field examination conducted by auditors from the Division of Field Operations. At issue is Kentucky Schedule A deductions which were adjusted. These adjustments for 1995 included a \$██████████ reduction in the contribution deduction, an \$██████████ reduction in the real estate taxes deduction, a \$██████████ increase in the personal property taxes deduction and a \$██████████ reduction in the 1098 mortgage interest deduction. The adjustments for 1996 included a \$██████████ reduction in the personal property taxes deduction and a \$██████████ reduction in the local taxes deduction.

The contribution adjustments resulted from contributions made to non-profit organizations where items of value were received. These items of value consisted of ██████████, ██████████, and ██████████. Kentucky follows the federal income tax as provided in KRS 141.050(1). Pertaining to Charitable Contributions, IRS Publication 17 states, in part:

If you receive a benefit as a result of making a contribution to a qualified organization, you can deduct only the amount of your contribution that is more than the value of the benefit you receive.

Real estate taxes were reduced to reflect the amount of taxes actually supported by receipts. Adjustments were made to the personal property tax deduction allowed by removing licensing fees which are not deductible. An adjustment was made to reduce 1098 mortgage interest to the amount documented by the 1098 statement. An adjustment was also made to correct an error in calculating the local income tax withheld.

Also at issue are Schedule C losses disallowed. ██████████ was a sole proprietor in the ██████████ business. The taxpayer had losses for 1993 through 1996.

IRS Code Sec. 183(d) states:

“If the gross income derived from an activity for 3 or more of the taxable years in the period of 5 consecutive taxable years which ends with the taxable year exceeds the deductions attributable to such activity (determined without regard to whether or not such activity is engaged in for profit) then, unless the Secretary establishes to the contrary, such activity shall be presumed for purposes of this chapter for such taxable year to be an activity engaged in for profit.”

IRS Code Sec. 183(d) requires a business to show a profit in any three of five consecutive tax years. Otherwise, the business is deemed a hobby, and expenses are only allowed to the extent of income produced by the activity. As a result, the losses claimed for 1995 and 1996 were disallowed on Schedule A.

The 1993 tax return was audited in accordance with KRS 141.210, which states in part:

(2) As soon as practicable after each return is received the department shall examine and audit it. If the amount of tax computed by the department is greater than the amount returned by the taxpayer, the additional tax shall be assessed and a notice of assessment mailed to the taxpayer by the department within four (4) years from the date the return was filed, except as otherwise provided in this subsection.

(b) In the case of a return where a taxpayer other than a Corporation understates his net income or omits an amount properly includable in net income or both which understatement or omission or both is in excess of twenty-five percent (25%) of the amount of net income stated in the return, the additional tax may be assessed at any time within six (6) years after the return was filed.

In 1993 the \$10,000 section 179 depreciation expense deduction was disallowed because the amount of the deduction is limited to the total amount of taxable income derived from the active conduct of any trade or business during the taxable year. This resulted in the 25% understatement of net income referenced above and the Schedule C net loss was disallowed.

After reviewing the available information, and the applicable statutes and case law, it is the position of the Kentucky Department of Revenue that the outstanding individual income tax assessments issued against you for the 1993, 1995 and 1996 tax years 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:

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

