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LORI HUDSON FLANERY
Secretary

THOMAS B. MILLER
Commissioner

In the matter of:

██████████ INC.

Contact: ██████████ CPA

ATTN: ██████████

FINAL RULING NO. 2015-35
August 21, 2015

Assessment of Limited Liability Entity Tax
Tax Years Ended December 31, 2008 and December 31, 2009

FINAL RULING

The Kentucky Department of Revenue (“the Department”) has issued limited liability entity tax (“LLET”) assessments against ██████████ Inc. (“the Taxpayer”) for the tax years ended December 31, 2008 and December 31, 2009. These assessments resulted from an adjustment to the cost of goods sold deduction on the Taxpayer’s Kentucky Schedule LLET for the tax years ended December 31, 2008 and December 31, 2009. While the taxpayer has included tax year ended December 31, 2008, as part of the protest, that notice has been paid in full and no refund has been requested. 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:

TAX YEARS	TAX	INTEREST	AMNESTY ASSESSMENT FEE	PENALTIES	TOTAL
2008	\$██████████	\$██████████	\$██████████	\$██████████	\$██████████
2009	\$██████████	\$██████████	\$██████████	\$██████████	\$██████████
TOTAL	\$██████████	\$██████████	\$██████████	\$██████████	\$██████████

The Taxpayer sells and leases golf carts, related parts, and supplies for horse shows. The Taxpayer contends that it is entitled to a LLET cost of goods sold deduction for the tax years ended December 31, 2008 and December 31, 2009 for its depreciation, parts, labor, enclosure, and show expenses.

KRS 141.0401(d) does allow a LLET cost of goods sold deduction for taxpayers who are engaged in manufacturing, producing, reselling, retailing or wholesaling activities if certain statutory requirements are met. One of these statutory requirements is that amounts allowable as cost of goods sold must be *directly* incurred in *acquiring or producing a tangible product* generating the Kentucky gross receipts. KRS 141.0401(1)(d)2. Consequently, cost of goods sold for purposes of computing the LLET shall only include direct labor costs and direct material costs.

“Direct labor” means labor that is incorporated into the tangible product sold or is an integral part of the manufacturing process KRS 141.0401(1)(f). “Direct material” means material that is incorporated into the tangible product sold or manufactured. Indirect costs, such as the indirect costs listed under Internal Revenue Code §263A and its regulations, do not fall within the realm of costs for which a Kentucky cost of goods sold deduction can be taken.

In this case, the Taxpayer has failed to establish that the costs included in its cost of goods sold deduction were directly incurred in acquiring or producing a tangible product. In fact, many of the Taxpayer’s costs, such as the depreciation, are classified as indirect costs under Internal Revenue Code §263A and its regulations. Furthermore, the Taxpayer has failed to submit documentation establishing that any of its costs were direct labor or direct material costs. As such, the Department properly disallowed the Taxpayer’s cost of goods sold deduction.

In addition, the assessments for tax years ended December 31, 2008 and December 31, 2009, have assessed interest that will accrue until the tax is paid. See KRS 141.220; 141.985; 131.183; 103 KAR 15:050 § 4. The Taxpayer is also liable for a penalty attributable to the failure to pay the tax due for tax years ended December 31, 2008 through December 31, 2009. KRS 131.180(2). The Taxpayer was also subject to the cost of collections amnesty fee. KRS 131.440(1).

After reviewing the available information, and the applicable statutes, it is the position of the Kentucky Department of Revenue that the outstanding LLET assessments issued against ████████, Inc. for the tax years ended December 31, 2008 and December 31, 2009 are valid liabilities due to 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 40601-3714, 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 3 of 802 KAR 1:010:

1. An individual may represent himself in any proceedings before the Board where his individual tax liability is at issue or he may obtain an attorney to represent him in those proceedings;
2. An individual who is not an attorney may not represent any other individual or legal entity in any proceedings before the Board;
3. In accordance with Supreme Court Rule 3.020, if the appealing party is a corporation, trust, estate, partnership, joint venture, LLC, or any other artificial legal entity, the entity must be represented by an attorney on all matters before the Board, including the filing of the petition of appeal. If the petition of appeal is filed by a non-attorney representative for the legal entity, the appeal will be dismissed by the Board; and
4. An attorney who is not licensed to practice in Kentucky may practice before the Board only 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,

DEPARTMENT OF REVENUE



Attorney Manager
Office of Legal Services for Revenue

CERTIFIED MAIL
RETURN RECEIPT REQUESTED