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WILLIAM M. LANDRUM III
Secretary

DANIEL P. BORK
Commissioner

In the matter of:

[REDACTED] LLC

Contact: [REDACTED], LLP
ATTN: [REDACTED]
[REDACTED]

FINAL RULING NO. 2015-53
December 15, 2015

Assessment of Limited Liability Entity Tax
For the Period January 1, 2008 through December 31, 2011

FINAL RULING

The Kentucky Department of Revenue ("the Department") has issued limited liability entity tax ("LLET") assessments against [REDACTED], LLC ("[REDACTED]") for the period January 1, 2008 through December 31, 2011 ("the audit period"). These assessments resulted from an adjustment to the cost of goods sold deduction on [REDACTED]'s Kentucky Schedule LLET for the audit period. The following table provides a breakdown of the amount of tax due, all assessed penalties and fees, as well as accrued interest as of the date of this final ruling:

TAX YEARS	TAX	INTEREST	AMNESTY FEE	PENALTIES	TOTAL
2008	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
2009	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
2010	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
2011	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
TOTAL	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]

[REDACTED] provides transportation logistics services. Specifically, [REDACTED] enters into contracts with its customers to fulfill their transportation and logistics needs and to coordinate the delivery of their goods. Since [REDACTED] does not have its own trucks, it

must contract with other carriers to haul its customers' freight. ██████████ enters into these hauling contracts with both unrelated carriers and with carriers owned by its sister company ██████████, LLC ("██████████").¹

██████████ contends that its cost of goods sold deduction should not have been adjusted by the Department because these costs represent amounts paid by ██████████ to its contract haulers. However, pursuant to KRS 141.0401(1)(d)(3), only entities that have manufacturing, producing, retailing, reselling, or wholesaling activities are entitled to claim a cost of goods sold deduction. Transportation logistics is a service industry which simply does not fall within the realm of industries entitled to take a cost of goods sold deduction for the LLET. As such, the Department properly disallowed ██████████' cost of goods sold deduction.

██████████, relying on KRS 141.0401(1)(c) and 2(b), also asserts that the portion of its receipts paid to ██████████ should be netted with the receipts of ██████████, thereby reducing ██████████' LLET. Specifically, ██████████ contends that it is in a "combined group" entitled to make eliminating entries for its intercompany transactions with ██████████. KRS 141.0401(2)(b) does provide that for purposes of determining a taxpayer's eligibility for LLET reductions, "a member of a combined group shall consider the combined gross receipts and combined gross profits from all sources of the entire combined group, including eliminating entries for transactions among the group." However, in order to be a member of a combined group under KRS 141.0401(1)(c), the "affiliated group" definition in KRS 141.200(9)(b) must be met. Pursuant to KRS 141.200(9)(b), for taxable periods beginning after December 31, 2006, an "affiliated group" is one (1) or more chains of includable corporations connected through stock ownership with a common parent *corporation*." (Emphasis added). Since ██████████ and ██████████ are both owned by an individual instead of a common parent corporation, the statutory definition of an affiliated group cannot be met. As such, the combined group status in KRS 141.0401(2)(b) is inapplicable and ██████████ is not entitled to reduce its LLET on this basis.

██████████ also argues that its LLET should be reduced by the amount of its payments to ██████████ because ██████████ was merely passing on these receipts. In support of this argument, ██████████ states that ██████████ paid LLET on this same portion of its receipts. However, both ██████████ and ██████████ are legally independent taxable entities; and there is not any statutory authority for netting out their gross receipts. In addition, Section 4 of the ██████████ Contract between ██████████ and ██████████ provides that "██████████, LLC directly, shall not invoice the Customer, and shall look solely to ██████████, LLC and to no other person, including the customer, for payment of freight charges under this Contract. Carrier hereby waives any right it may otherwise have to

¹ Both ██████████ and ██████████ are 100 percent owned by an individual, ██████████.

proceed or commence any action against any Customer for the collection of any freight bills arising out of transportation services performed by Carrier under this Contract.” This provision makes it clear that ██████████ is the only party liable to ██████████ and that ██████████ is using its own gross receipts to fulfill its own obligations. Consequently, ██████████’ LLET should not be reduced on this basis.

Finally, ██████████ argues that the Department’s LLET interpretation discriminatorily favors individuals who are members of multi-level parent-subsidiary limited liability structures over similarly-situated individuals who are owners of brother-sister limited liability entities because had the individual established another limited liability entity to act as a parent, the individual would have been able to enjoy the credits. However, KRS 141.0401(3) states that a nonrefundable credit based on the Limited Liability Entity Tax (“LLET”) shall be allowed against the tax imposed by KRS 141.020 or 141.040. Since KRS 141.020 governs the income tax on individuals, it is possible that the nonrefundable credit could be claimed on the individual return. Furthermore, Kentucky courts have long held that “corporations and individuals may be placed in different categories for tax purposes without violating constitutional limitations.” Square D Company v. Kentucky Board of Tax Appeals, 415 S.W.2d 594, 596 (Ky. 1967).

Based on the above, it is the position of the Department that the outstanding LLET assessments issued against ██████████ for the audit period are valid liabilities due to the Commonwealth of Kentucky. In addition, the assessments for the audit period have assessed interest that will accrue until the tax is paid. See KRS 141.220; 141.985; 131.183; 103 KAR 15:050 § 4. ██████████ is also liable for a penalty attributable to its failure to pay the tax due for the audit period and for an amnesty fee. KRS 131.180(2); KRS 131.440.

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