



STEVEN L. BESHEAR
Governor

FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE
501 HIGH STREET
FRANKFORT, KENTUCKY 40620
Phone (502) 564-3226
Fax (502) 564-3875
www.kentucky.gov

JONATHAN MILLER
Secretary

THOMAS B. MILLER
Commissioner

In the matter of:

████████████████████
LIMITED PARTNERSHIP

Contact: ██████ & Company
████████████████████

FINAL RULING NO. 2010-02
January 15, 2010

Alternative Method of Separate Accounting

FINAL RULING

The Kentucky Department of Revenue ("Department") received a request on behalf of ██████ Limited Partnership ("Taxpayer"), to grant apportionment factor relief based on KRS 141.120(9)(a)(1). Specifically, ██████ Limited Partnership requested a change from the statutory method required by KRS 141.206(9) with the factors determined in the same manner as provided in KRS 141.120(8), the use of separate accounting as prescribed under KRS 141.120(9)(a)(1). The taxpayer believes that the use of KRS 141.206(9) to apportion taxable income unfairly represents the Limited Partnership's activity within Kentucky. Furthermore, the taxpayer believes that the specific accounting method as provided by KRS 141.120(9)(a)(1) would more accurately provide the State of Kentucky with its share of true taxable income.

The Department denied the request on ██████, 2009, and the Taxpayer later requested a clarification of the Department of Revenue ruling. In a letter dated ██████, 2009, the Department provided a further explanation of the required use of the three-factor apportionment factor under KRS 141.120(8) as applied to KRS 141.206(9). The Department of Revenue responded in its letter of ██████, 2009 further denying the use of the Alternative Method of Separate Accounting. Another request was made to the Office of Legal Services for the Department of Revenue. Subsequently, the Branch of Protest and Review denied the use of an alternative method of separate accounting and two different letters were sent to the Taxpayer's representative without receiving any response from the Taxpayer.

KRS 141.206(9) provides that:

A pass-through entity doing business within and without the state shall compute an apportionment fraction, the numerator of which is the property factor, representing twenty-five percent (25%) of the fraction, plus the payroll factor, representing twenty-five percent (25%) of the fraction, plus the sales factor, representing fifty percent (50%) of the fraction, with each factor determined in the same manner as provided in KRS 141.120(8), and the denominator of each is four (4), reduced by the number of factors, if any, having no denominator, provided that if the sales factor has no denominator, then the denominator shall be reduced by two (2).

Additionally, KRS 141.120(9)(a) provides that:

If the allocation and apportionment provisions of this section do not fairly represent the extent of the corporation's business activity in this state, the corporation may petition for or the department may require, in respect to all or any part of the corporation's business activity, if reasonable:

1. Separate accounting;
2. The exclusion of any one (1) or more factors;
3. The inclusion of one (1) or more additional factors which will fairly represent the corporation's business activity in this state; or
4. The employment of any other method to effectuate an equitable allocation and apportionment of income.

The apportionment method set forth in KRS 141.120(8) (the "Standard Apportionment Method") has been held to be both fair and reasonable and not violative of either the Commerce Clause or the Due Process Clause of the United States Constitution. Liquid Transporters, Inc. v. Revenue Cabinet, 721 S.W.2d 722 (Ky. App. 1986), appeal dismissed, 482 U.S. 901 (1987). In addition, the three-factor formula "can be justified as a rough, practical approximation of the distribution of either a corporation's sources of income or the social costs which it generates." General Motors Corp. v. District of Columbia, 380 U.S. 553, 561, 85 S. Ct. 1156, 14 L.Ed. 2d 68 (1965). In seeking alternative apportionment, the burden is upon the Taxpayer to establish that the Standard Apportionment Method, as applied to the Taxpayer, fails to reflect the amount of the Limited Partnership's business activities in the state. The Taxpayer has failed to meet its burden.

The Taxpayer bases its request on its belief that the use of an apportionment formula for the reporting of Kentucky taxable income would not be equitable. The aforementioned taxpayer owns and rents commercial buildings but has only one rental property in the state of Kentucky. The Taxpayer has claims that its only income having situs in Kentucky is the rental receipts in Kentucky, the payment of Kentucky real estate taxes and insurance premiums. The Taxpayer believes that the inclusion of income from the

other activities of the Taxpayer distorts the statutory apportionment formula, and will not fairly represent the extent of the Taxpayer's business activity in Kentucky.

The Taxpayer misunderstands how alternative apportionment works. Specifically, while the Taxpayer alleges that the standard apportionment method does not lead to the same result as separate accounting, it has failed to establish that the standard apportionment method is not reflective of the extent of its business activities in Kentucky. Ruby Construction Co., Inc. v. Department of Revenue 578 S.W.2D 248, 252 (KY App.1978) The test is not based upon the Taxpayer's Kentucky receipts, nor is it based upon whether a taxpayer can calculate an amount using separate accounting. Business activity is not limited to rental income and property taxes. This is inconsistent with 103 KAR 16:330 Section 1(2) which provides that; "The fact that taxable income is greater or lesser, that the corporation's accounting records reflect income by contracts or by states shall not be sufficient to support a request for separate accounting." In this case, the Taxpayer has even shown what its tax liability under the standard apportionment method would be, so it is quite impossible to tell what the actual difference is between the two methods or how it compares to the claimed Kentucky income.

While the taxpayer complains about this situation, the fact remains that this is not a unique set of circumstances. Many other real estate companies have property in other states, and keep records for each property. They also file using the standard apportionment formula, and unlike industries such as financial organizations or public service companies, the legislature has not seen fit to pass a separate apportionment method for this industry.

This letter is the final ruling of the Department.

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.

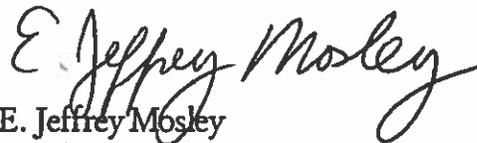
The petition of appeal must be in writing and signed by the petitioner or appellant. Filings by facsimile or other electronic means shall not be accepted.

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



E. Jeffrey Mosley
Interim Executive Director
Office of Legal Services

CERTIFIED MAIL
RETURN RECEIPT REQUESTED