

# KENTUCKY DEPARTMENT OF REVENUE

Daniel P. Bork, Commissioner

## ANNUAL REPORT 2016-2017



**MATTHEW G. BEVIN, GOVERNOR**

Commonwealth of Kentucky

**WILLIAM M. LANDRUM III, SECRETARY**

Finance and Administration Cabinet



# KENTUCKY DEPARTMENT OF **REVENUE**

*Putting People* **FIRST**

## **Fairness**

We are committed to the unbiased administration of tax laws.

## **Integrity**

We conduct ourselves in a manner that promotes public confidence and safeguards taxpayer information.

## **Respect**

Our goal is to treat every taxpayer interaction with the highest regard for civility.

## **Service**

Serving taxpayers with expertise, pride, professionalism, and enthusiasm is our highest priority.

## **Teamwork**

We pledge to work hand in hand with taxpayers and community partners. We are “One Department, One Team.”

## **Mission Statement**

The Kentucky Department of Revenue serves the citizens of our Commonwealth through the fair administration of tax laws, adherence to the Taxpayer Bill of Rights, and collection of revenues used to fund public services, programs, and the protection of natural resources. We perform our duties in a manner that is professional, efficient, and merits the utmost in public confidence while demonstrating the highest level of integrity.



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Finance and Administration Cabinet  
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**William M. Landrum III**  
Cabinet Secretary

**Daniel P. Bork**  
Commissioner

January 10, 2018

The Honorable Matthew G. Bevin  
Commonwealth of Kentucky  
The State Capitol  
Frankfort, KY 40601

Dear Governor Bevin:

We are proud to serve alongside the employees of the Kentucky Department of Revenue (DOR) and are pleased to present the Annual Report for the fiscal year July 1, 2016 through June 30, 2017. DOR is charged with the task of consistently and objectively administering tax laws while providing quality customer service to the taxpayers and tax professionals living and working in Kentucky. We balance our resources in order to efficiently and thoroughly complete this undertaking.

This report reflects the hard work and dedication of the many professionals who constitute the workforce of DOR. Amongst many other things, we are pleased to report that in Fiscal Year 2016-17 DOR:

- Deposited in excess of \$10.4 billion of taxes and related payments into the General Fund
- Deposited over \$1.5 billion of taxes and related payments into the Road Fund
- Received and responded to more than 550,000 phone calls, over 100,000 letters, and more than 100,000 electronic communications from taxpayers and tax professionals
- Stopped in excess of \$34 million of fraudulent tax refund requests (calendar year 2017)
- Revised over 150 forms and instruction booklets and eliminated more than 50 others
- Repealed 7 administrative regulations and amended an additional 35

More detail about the work we conduct and the accomplishments we are proud to report are included in the body of the Annual Report. We appreciate all of the support we receive and are honored to serve the Commonwealth.

With kind regards,

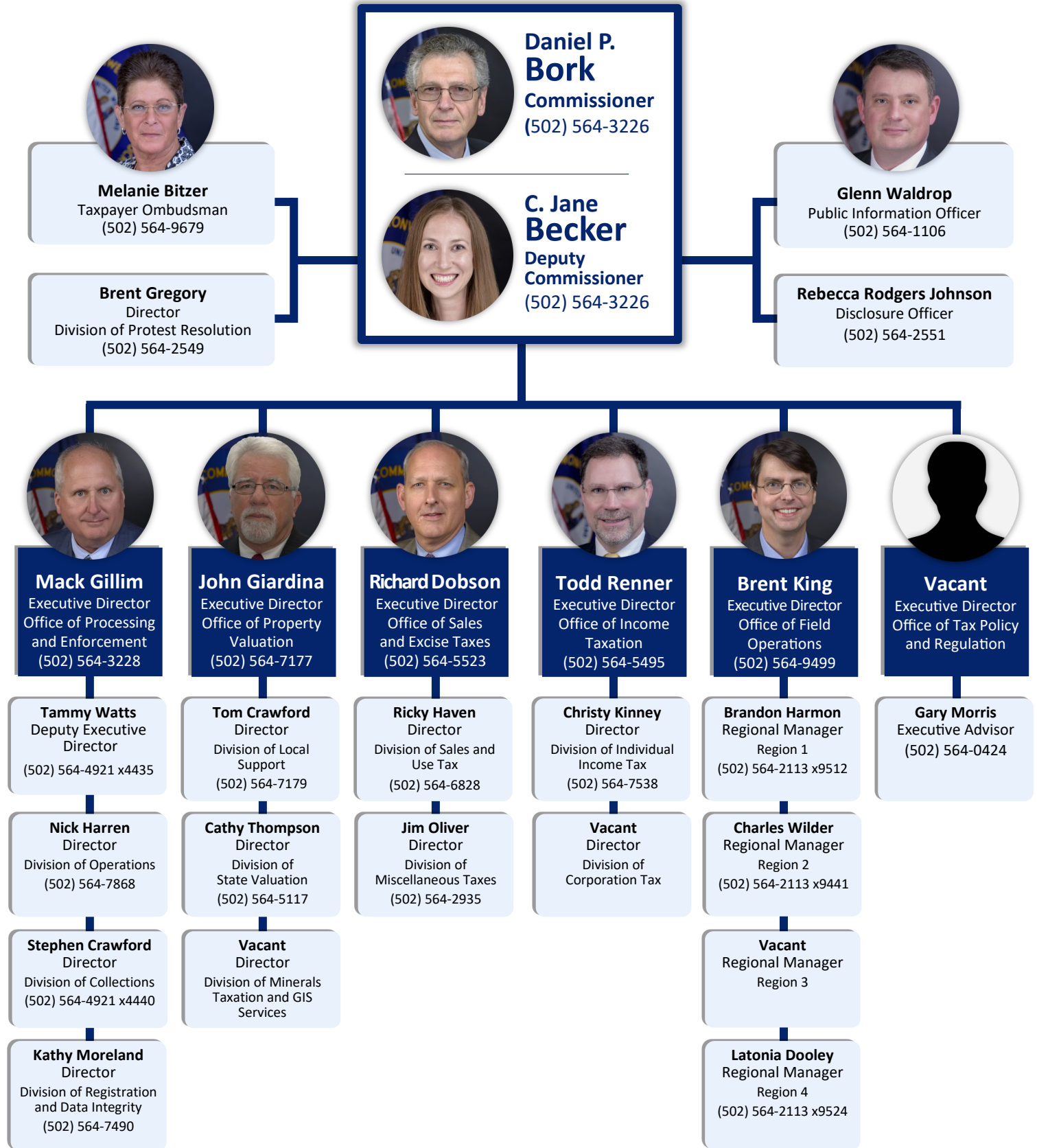
**Daniel P. Bork**  
Commissioner

Approved by:

**William M. Landrum III**  
Finance and Administration Cabinet Secretary



# KENTUCKY DEPARTMENT OF REVENUE





## EXECUTIVE SUMMARY

### Office of Processing and Enforcement

- Deposited receipts in excess of \$3.2 billion electronically via image cash letter and deposited over \$5.3 billion via electronic funds transfer
- Processed more than 1.9 million individual income tax returns in calendar year 2017
- Processed over \$575.6 million of individual income tax refunds to taxpayers in calendar year 2017
- Processed more than 33,000 business tax registration applications
- Collected in excess of \$203 million of unpaid tax obligations
- Collected more than \$24.7 million of debt on behalf of enterprise agencies

### Office of Property Valuation

- Collected in excess of \$518 million in state property tax through sheriffs' offices
- Collected over \$30 million of state and local omitted personal property tax payments
- Collected in excess of \$400 million of state and local motor vehicle property taxes
- Determined assessment values of over \$37.4 billion related to public service and centrally assessed companies (2.74% increase compared to prior fiscal year)
- Certified to local government partners assessment values of approximately \$65 billion related to bank franchise deposits (5.8% increase compared to prior fiscal year)
- Assessed the valuation of more than \$70 billion worth of tangible personal property through the PVA offices
- Collected in excess of \$128.6 million in severance tax receipts
- Assessed more than \$12 million of unmined mineral taxes in calendar year 2017

### Office of Sales and Excise Taxes

- Collected in excess of \$47 million through tax compliance programs and refund request reductions
- Registered 1,175 sellers and collected more than \$29 million in sales and use tax through the national Streamlined Sales Tax Registration System
- Collected over \$217 million of Utility Gross Receipts License Tax (UGRLT) and telecommunications taxes
- Conducted 159 retail cigarette inspections

### Office of Income Taxation

- Assessed over \$65.2 million of individual income tax through compliance measures
- Assessed more than \$124.7 million of corporate income tax through compliance measures
- 88% of individual income tax returns electronically filed in calendar year 2017
- 40% of corporate income tax returns electronically filed in calendar year 2017 (89% increase compared to 2016)

### Office of Tax Policy and Regulation

- Implemented new tax guidance procedures under House Bill 245
- Repealed 7 administrative regulations and amended an additional 35
- Coordinated DOR administration of Tax Increment Financing (TIF) incentives
- Reviewed and provided analysis on over 125 pieces of proposed legislation as well as hundreds of proposed legislative amendments associated with tax-related bills

### Office of Field Operations

- Assessed more than \$39 million of tax due as a result of 1,025 audits conducted
- Assessed over \$6 million of tax due as a result of compliance measures
- Collected in excess of \$21.2 million in payments through taxpayer assistance programs
- Received and responded to over 30,000 in-person inquiries from taxpayers who visited Taxpayer Service Centers
- Prepared approximately 2,300 individual income tax returns for qualified taxpayers

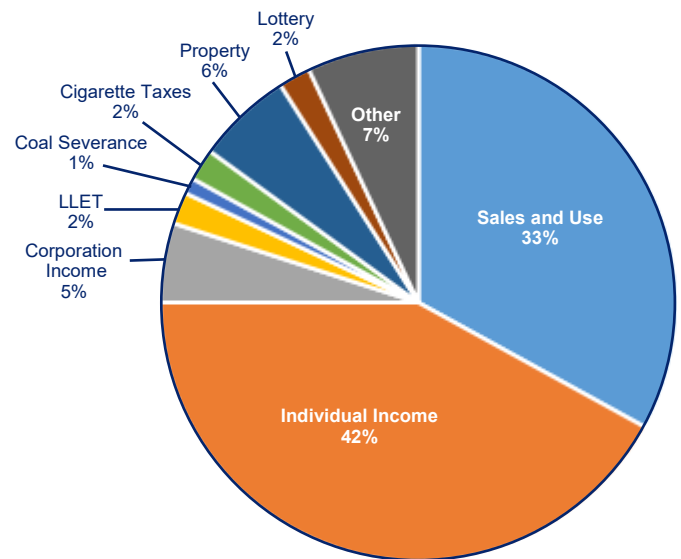


# REVENUE RECEIPTS

## General Fund

### General Fund Revenue Compared To Last Year (\$ Millions)

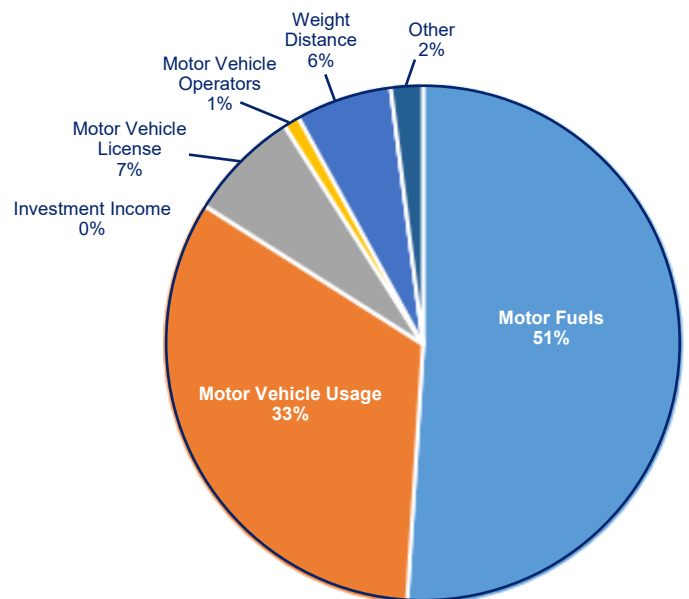
	Full Year		Growth Rate
	FY 17	FY 16	FY 17
Individual Income	4,393.9	4,282.1	.62
Sales and Use	3,485.2	3,462.7	0.7
Property	602.1	577.5	4.3
Corporation Income	497.5	526.6	-5.5
LLET	245.6	203.0	21.0
Cigarette Taxes	221.4	224.3	-1.3
Lottery	241.6	241.8	-0.1
Coal Severance	100.5	120.6	-16.7
Other	690.1	700.2	-1.4
<b>Total</b>	<b>10,477.8</b>	<b>10,338.9</b>	<b>1.3</b>



## Road Fund

### Road Fund Revenue Compared To Last Year (\$ Millions)

	Full Year		Growth Rate
	FY 17	FY 16	FY 17
Motor Fuels	760.5	750.0	1.4
Motor Vehicle Usage	499.8	484.4	3.2
Motor Vehicle License	111.9	113.1	-1.1
Motor Vehicle Operators	16.1	16.3	-1.3
Weight Distance	82.9	81.4	1.9
Income on Investments	1.6	2.4	-34.6
Other	35.1	34.9	0.8
<b>Total</b>	<b>1,508.0</b>	<b>1,482.5</b>	<b>1.7</b>





# PUBLIC OUTREACH AND STAFF DEVELOPMENT

## Public Outreach

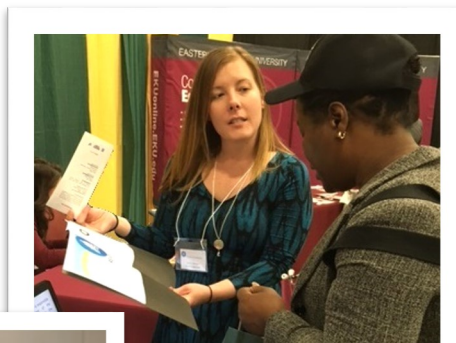
With the goal of making it easier for taxpayers to do business with Kentucky, the Department of Revenue retained its first ever Public Information Officer and charged him with the task of broadening communications platforms, working with staff to improve internal communication methods, softening DOR's public image, and implementing procedures to foster better communication between staff and taxpayers.

- Staffed a booth at the Kentucky State Fair daily with approachable employees
- Participated in the Public Protection Cabinet's 2017 Senior Scam Jam
- Created new pages for DOR website, including several specifically for tax professionals and others to address fraud and identity theft issues

## Staff Development

DOR operates its training efforts from a centralized unit in order to provide training consistently for all of our staff. The training team focuses on trainings that are universal to all staff and coordinates tax specific trainings across DOR.

- More than 30 DOR employees were enrolled in the Certificate of Supervisory Essentials program
- Two DOR employees accepted into the Governor's Minority Management Training Program
- Coordinated video, online, and in-person training and education courses for DOR employees
- Coordinated DOR presentations for many events including the annual University of Kentucky Income Tax Seminar Program, the KyCPA Kentucky State Tax Conference, and the Kentucky Digital Government Summit



A DOR staff member discusses employment opportunities with a KSU job fair visitor.



Secretary Landrum and Commissioner Bork welcome new DOR employees.



Fairgoers visit the Finance and Administration Cabinet booth at the 2017 Kentucky State Fair.





# TAXPAYER SERVICE CENTERS

The Department of Revenue supports 10 Taxpayer Service Centers (TSCs) throughout the Commonwealth. DOR employees at these TSCs assist taxpayers with a range of tax matters involving all tax types.

**1 Paducah Taxpayer Service Center**  
Clark Business Complex, Suite G  
2928 Park Avenue  
Paducah, KY 42001  
(270) 575-7148

**2 Hopkinsville Taxpayer Service Center**  
181 Hammond Drive  
Hopkinsville, KY 42240  
(270) 889-6521

**3 Owensboro Taxpayer Service Center**  
401 Frederica St, Bldg C, Suite 201  
Owensboro, KY 42301  
(270) 687-7301

**4 Bowling Green Taxpayer Service Center**  
201 West Professional Park Court  
Bowling Green, KY 42104  
(270) 746-7470

**5 Louisville Taxpayer Service Center**  
600 West Cedar Street  
2nd Floor West  
Louisville, KY 40202  
(502) 595-4512

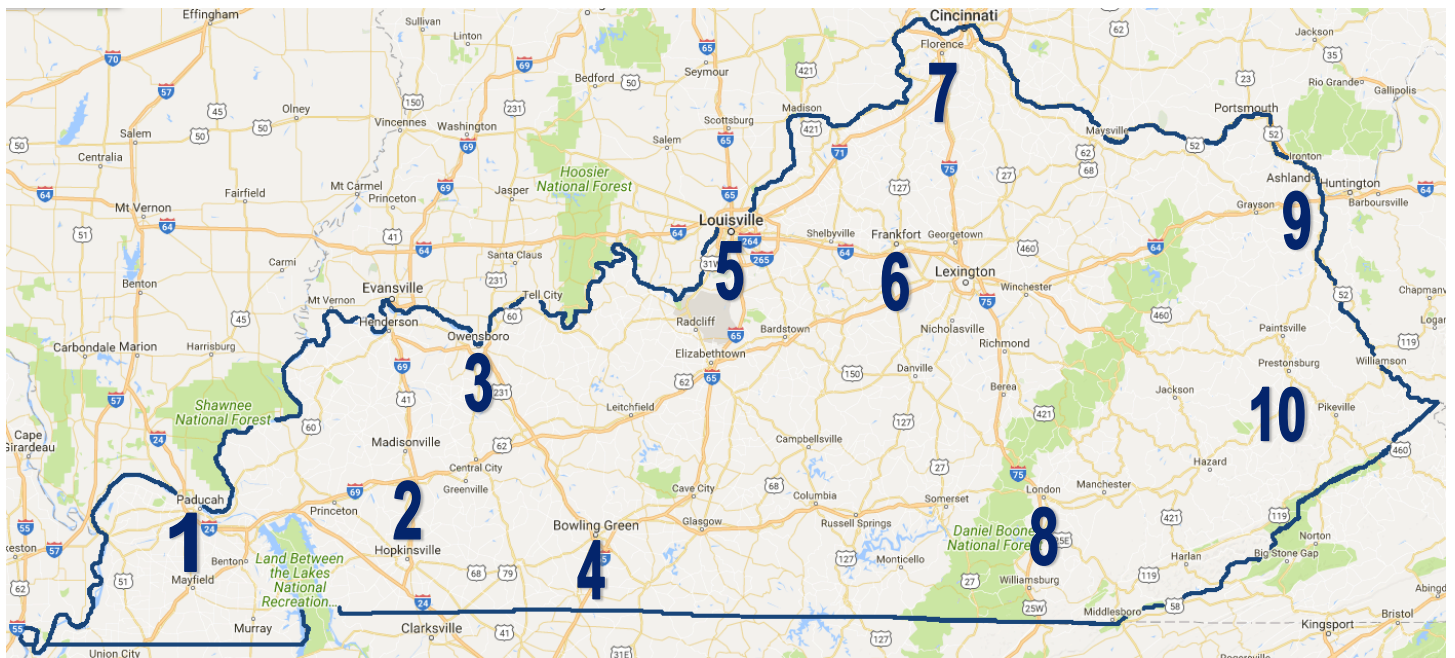
**6 Frankfort Taxpayer Service Center**  
501 High Street  
Station 38  
Frankfort, KY 40601  
(502) 564-5930

**7 Northern Kentucky Taxpayer Service Center**  
7310 Turfway Rd, Ste 190  
Florence, KY 41042  
(859) 371-9049

**8 Corbin Taxpayer Service Center**  
15100 North US 25E, Ste 2  
Corbin, KY 40701  
(606) 528-3322

**9 Ashland Taxpayer Service Center**  
1539 Greenup Avenue  
Ashland, KY 41101  
(606) 920-2037

**10 Pikeville Taxpayer Service Center**  
Uniplex Center  
126 Trivette Drive, Suite 203  
Pikeville, KY 41501  
(606) 433-7675





## OFFICE OF THE COMMISSIONER

### DIVISION OF PROTEST RESOLUTION DIVISION OF TAXPAYER OMBUDSMAN DISCLOSURE BRANCH

The Office of the Commissioner of the Kentucky Department of Revenue includes Commissioner Daniel P. Bork, the Deputy Commissioner, the Public Information Officer, the Division of Protest Resolution, the Division of the Taxpayer Ombudsman, and the Disclosure Branch. The Office of the Commissioner is responsible for the overall management of DOR.

The **Division of Protest Resolution** is responsible for managing all formal protests filed with DOR (except residential real estate protests). The Division of Protest Resolution independently reviews each case before attempting to resolve the matter directly with the taxpayer. Protests can encompass all tax types and typically involve a taxpayer disagreement as to a position, legal interpretation, and/or action taken by DOR. Tax protests frequently relate to assessments, denials of full and partial tax refund requests, and tax exemption denials.

- Received 647 new tax protest cases amounting to more than \$153 million in protested taxes
- Resolved 688 tax protest cases and collected in excess of \$210 million as a result (*30% increase compared to prior fiscal year*)
- Reduced average time for protest resolution by 3.72 months
- Reduced outstanding inventory of tax protest cases by over \$57 million

The **Division of the Taxpayer Ombudsman** receives thousands of telephone, written, and electronic inquiries from taxpayers, tax practitioners, and other government agencies, including the legislative constituent office. The Division of the Taxpayer Ombudsman also maintains the Practitioner Hotline which provides an avenue of communication between tax practitioners and DOR. The Division of the Taxpayer Ombudsman responds to inquiries encompassing all tax types and acts as a liaison between taxpayers and DOR to ensure protection of taxpayer rights. The Taxpayer Ombudsman provides essential services to citizens of the Commonwealth who need assistance with issues that are not resolved through regular channels.

- Responded to more than 500 telephone inquiries received by the Practitioner Hotline (*232% increase compared to prior fiscal year*)
- Responded to over 3,200 telephone inquiries received by the Taxpayer Ombudsman

The **Disclosure Branch** coordinates DOR's physical and electronic security internally and with other agencies and third parties. The Disclosure Branch also oversees exchange of information agreements and coordinates the flow of data between the Kentucky Department of Revenue and the Internal Revenue Service (IRS).

- Collected over \$78.6 million through exchange of information agreements (*25% increase compared to prior fiscal year*)



# OFFICE OF PROCESSING AND ENFORCEMENT

## DIVISION OF OPERATIONS DIVISION OF REGISTRATION AND DATA INTEGRITY DIVISION OF COLLECTIONS

The Office of Processing and Enforcement is comprised of three divisions: (1) Operations, (2) Registration and Data Integrity, and (3) Collections. The three divisions work closely with all DOR offices and tax types in addition to external enterprise agencies as contractually agreed upon.

The **Division of Operations** is responsible for receiving documents (including tax returns), capturing and storing relevant data, receiving and depositing payments, and initial processing of tax returns for all tax types. The Division of Operations also provides these services to external enterprise agencies as contractually agreed upon.

- Average processing time for individual income tax returns was 7.5 days in calendar year 2017 (*reduction of 4.5 days compared to calendar year 2016*)
- Processed more than 1.9 million individual income tax returns in calendar year 2017
- Processed over \$575.6 million of individual income tax refunds to taxpayers in calendar year 2017 (*the average refund amount was \$427 per taxpayer*)
- Moved paper tax return receiving, check depositing, and initial processing of returns to a third party vendor processing center in Louisville
- Deposited receipts in excess of \$3.2 billion electronically via image cash letter and deposited over \$5.3 billion via electronic funds transfer
- Scanned, imaged, cataloged, and thereafter destroyed over 2 million historical paper tax documents

The **Division of Registration and Data Integrity** receives and processes all business tax applications, both those received on paper as well as those submitted electronically through Kentucky Business One Stop. The division also identifies businesses that need to register for business taxes through compliance programs. The majority of business information updates are handled in the division, and data quality is an ongoing process to ensure that taxpayer data is accurate and complete.

- Processed more than 16,000 tax registration applications received on paper and reviewed over 17,000 tax registrations completed through Kentucky Business One Stop
- Administratively registered over 8,500 noncompliant businesses
- Answered more than 54,000 calls from taxpayers and preparers

The **Division of Collections** works with taxpayers to resolve their tax liabilities and debts. The division implements all administrative and legal actions available to enforce the collection of unpaid tax obligations owed to the Commonwealth. Enforcement actions are done in a fair and equitable manner and include, but are not limited to: seizure of real and personal property, bank accounts, and accounts receivable; garnishment of wages; and revocation or denial of a driver's license, vehicle registration, or professional license. Additionally, the Division of Collections engages in collection efforts for external enterprise agencies as contractually agreed upon.

- Collected a total of over \$228 million (*9.25% increase compared to prior fiscal year*)
  - Collected more than \$24.7 million of debt on behalf of enterprise agencies



# OFFICE OF PROPERTY VALUATION

## DIVISION OF LOCAL SUPPORT DIVISION OF MINERALS TAXATION AND GIS SERVICES DIVISION OF STATE VALUATION

The Office of Property Valuation is comprised of three divisions: (1) Local Support, (2) Minerals Taxation and GIS Services, and (3) State Valuation. All three divisions oversee and address different aspects of state and local property valuation and property tax matters.

The **Division of Local Support** supervises and assists the Property Valuation Administrators (PVAs), sheriffs, and county clerks in all 120 Kentucky counties with property tax assessment and collection duties. Further, the Division of Local Support provides guidance and establishes policies for all PVA offices involving budgets, payroll, accounting, and administrative support.

- Collected in excess of \$518 million in property tax receipts on behalf of the Commonwealth through sheriffs' offices (*2.54% increase compared to prior fiscal year*)
- Assisted county fiscal courts across the state with the receipt of \$315.5 million in property tax revenue (*3.44% increase compared to prior fiscal year*)
- Assisted school districts across the state with the receipt of \$1.6 billion of property tax revenue (*3.9% increase compared to prior fiscal year*)
- Assisted local jurisdictions in all counties with the receipt of \$2.5 billion in property tax revenue (*4.6% increase compared to prior fiscal year*)
- Presented a number of training sessions about property tax for PVAs, county attorneys, sheriffs and county clerks

The **Division of Minerals Taxation and GIS Services** is responsible for administering the severance taxes and the unmined minerals property taxes. The division also coordinates cartography utilizing Geographical Information Systems ("GIS") mapping efforts.

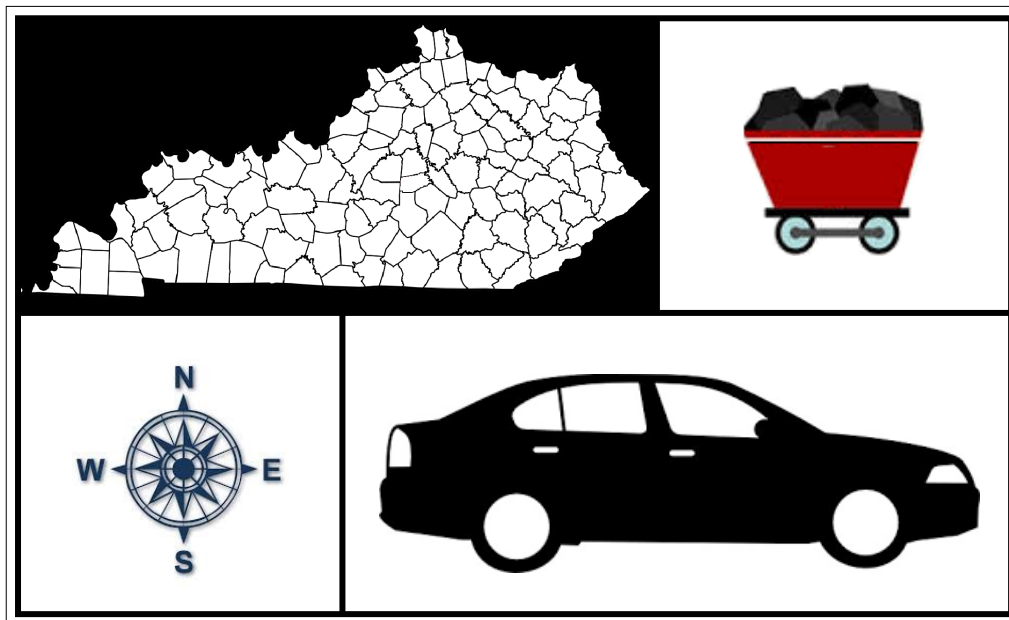
- Collected in excess of \$128.6 million in severance tax receipts, which includes over:
  - \$7 million of natural gas tax payments (*8.44% increase compared to prior fiscal year*)
  - \$99 million of coal severance tax
- Assessed more than \$12 million of unmined mineral taxes in calendar year 2017, which includes over:
  - \$6.1 million of unmined coal tax
  - \$1.8 million of oil tax
  - \$3.8 million of natural gas tax
  - \$489,000 of limestone tax
  - \$3,700 of clay tax



## OFFICE OF PROPERTY VALUATION

The **Division of State Valuation** administers all state-assessed property taxes, including public service property tax and motor vehicle property tax, as well as tangible and intangible tax programs. The Division of State Valuation also plays a critical role in the valuation of property of public service companies, valuation of motor vehicle property tax, and the valuation of tangible and intangible property.

- Assessed the valuation of more than \$70 billion worth of tangible personal property through PVA offices
- Collected over \$30 million of combined state and local omitted personal property tax payments (*8.2% increase compared to prior fiscal year*)
- Collected in excess of \$400 million of combined state and local motor vehicle property taxes (*5% increase compared to prior fiscal year*)
- “Freddie Freeroader Program” assessed over \$419,000 of tax owed by residents fraudulently using out of state license plates on their vehicles (*469% increase compared to prior fiscal year*)
- Determined assessment values of over \$37.4 billion related to public service and centrally assessed companies (*2.74% increase compared to prior fiscal year*)
- Certified to local government partners assessment values of approximately \$65 billion related to bank franchise deposits (*5.8% increase compared to prior fiscal year*)
- Collected in excess of \$34.6 million of TVA in Lieu of Tax payments before distributing to local governments (*8% increase compared to prior fiscal year*)





# OFFICE OF SALES AND EXCISE TAXES

## DIVISION OF SALES AND USE TAX DIVISION OF MISCELLANEOUS TAXES

The Office of Sales and Excise Taxes (OSET) is comprised of two divisions: (1) Sales and Use Tax and (2) Miscellaneous Taxes. Both divisions carefully review tax returns, implement compliance measures, assist taxpayers and tax preparers with general and specific issues, coordinate efforts with other DOR offices and outside agencies, and develop sales, use, and miscellaneous tax publications. OSET participates in workgroups and related initiatives sponsored through the national Streamlined Sales Tax Governing Board and the Federation of Tax Administrators.

The **Division of Sales and Use Tax** is responsible for administering the sales and use tax, telecommunications excise, gross revenue taxes, and the CMRS 911 fee. The Division of Sales and Use Tax implements compliance measures including office or “desk” audits; administers a number of tax exemption and tax refund incentive programs; receives and responds to taxpayer inquiries; and reviews and processes requests for tax refunds.

The **Division of Miscellaneous Taxes** administers over forty taxes, conducts systematic audits, administers a number of economic development incentive programs involving tax exemption and tax refunds, receives and responds to taxpayer inquiries, reviews and processes tax refund requests, and implements compliance measures. The Division of Miscellaneous Taxes administers both General Fund and Road Fund taxes, including:

- Affordable housing trust fund fee
- Alcoholic beverage taxes
- Cigarette enforcement fee
- Chewing tobacco tax
- Other tobacco products and snuff taxes
- Gasoline tax
- Liquefied petroleum gas tax
- Special fuels taxes
- Petroleum storage tank environmental assurance fee
- Health care provider tax
- Inheritance tax
- Insurance premiums and insurance surcharge taxes
- Bank franchise tax
- Legal process tax
- Marijuana and controlled substance tax
- Motor vehicle tire fee
- Motor vehicle usage taxes
- Loaner-rental program tax
- Public Service Commission annual assessment
- Pari-mutuel excise tax
- Racing license and admissions tax
- Advance deposit wagering tax
- Rural Electric Cooperative Corporation tax
- Rural Telephone Cooperative Corporation tax annual assessments
- Transient room tax
- Utility gross receipts license tax (UGRLT)
- Spouse abuse shelter fund



## OFFICE OF SALES AND EXCISE TAXES

- Collected in excess of \$47 million through tax compliance programs and refund request reductions
- Implemented E-911 fee imposed on prepaid calling arrangements as required by HB 585 (effective January 1, 2017)
  - Registered over 600 E-911 fee accounts from January 1 through June 30, 2017
  - Collected over \$4 million from January 1 through June 30, 2017
- Implemented direct to distributor (DtD) cigarette stamp fulfillment system with third party vendor
- Registered over 1,175 sellers and collected more than \$29 million in sales and use tax through the national Streamlined Sales Tax Registration System (*11% increase compared to prior fiscal year*)
- Collected over \$217 million of UGRLT and telecommunications taxes
  - Distributed more than \$36 million of UGRLT payments received to 1,300 local jurisdictions and school districts across the Commonwealth
- Verified and issued 4 sales tax TIF refunds totaling over \$12.7 million
- Verified and issued 14 tourism attraction project tax refunds totaling more than \$3.9 million
- Verified and issued 29 KEIA refunds totaling over \$4.8 million
- Conducted 159 retail cigarette inspections as required by the Tobacco Master Settlement Agreement
- Received and responded to more than 95,000 phone calls and over 18,700 electronic inquiries from taxpayers and tax professionals





# OFFICE OF INCOME TAXATION

## DIVISION OF INDIVIDUAL INCOME TAX DIVISION OF CORPORATION TAX

After DOR receives tax returns and inputs the information and images into its databases, the Office of Income Taxation assumes responsibility for the continued processing and careful review of individual, corporate, and withholding tax returns. In calendar year 2017, DOR received more than:

- 1.9 million individual income tax returns
- 168,900 corporate income and limited liability entity tax returns
- 800,000 withholding tax returns

The Office of Income Taxation comprises two divisions: (1) the Division of Individual Income Tax and (2) the Division of Corporation Tax. Although one is focused on individuals and the other on businesses, both divisions carefully review tax returns, implement compliance measures, assist thousands of taxpayers and preparers with general and specific issues, coordinate efforts with other DOR offices and government agencies, administer millions of dollars of tax credits, implement federal and state government cooperative compliance programs, and develop income and withholding tax forms and instruction booklets, amongst a number of other operational tasks.

### Compliance Initiatives

- Assessed over \$65.2 million of individual income tax due and refund request reductions through compliance measures
- Assessed more than \$124.7 million of corporate income tax due and refund request reductions through compliance measures
- Assessed over \$50.4 million of withholding tax due through compliance measures

### Taxpayer and Preparer Assistance

- Received and responded to over 9,100 webmaster inquiries from taxpayers
- Received and responded to over 49,500 other correspondence inquiries from taxpayers
- Received and responded to more than 263,000 phone calls involving individual and withholding tax inquiries from taxpayers and preparers
  - 2-minute average hold time for calls
  - 8,100 callers utilized the new call-back assist feature
- Received and responded to more than 29,000 calls involving corporate tax inquiries from taxpayers and preparers
- Processed over 6,000 corporate “Letter of Good Standing” requests

### Electronic Filing of Income Tax Returns

- 88% of individual income tax returns were filed electronically in calendar year 2017 (*1% increase compared to prior calendar year*)
- 40% of corporate income tax returns were filed electronically in calendar year 2017 (*89% increase compared to prior calendar year*)





## OFFICE OF INCOME TAXATION

### Tax Credits

The Division of Corporation Tax compliances many incentive tax credits for the Commonwealth. Some examples and the amounts claimed in Fiscal Year 2016-17 are listed below.

#### Examples of Economic Development Tax Credits Managed by DOR (FY 2016-17)

Kentucky Business Investment	\$24,448,151
Kentucky Industrial Development Act	10,090,918
Kentucky Industrial Revitalization Act	8,470,509
Kentucky Jobs Development Act	6,824,390
Kentucky Reinvestment Act	8,709,195
Kentucky Rural Economic Development Act	38,945,120
Kentucky Jobs Retention Act	23,434,583
	<b>\$120,922,866</b>

#### Examples of Additional Tax Credits Managed by DOR (FY 2016-17)

Film	\$8,525,924
Skills Training Investment	131,003
Distilled Spirits Ad Valorem	1,502,456
Energy Efficiency	207,458
Energy Star Home and Manufactured Home	24,031
	<b>\$10,390,872</b>



## OFFICE OF TAX POLICY AND REGULATION

DOR's **Office of Tax Policy and Regulation** was formally established in Fiscal Year 2016-17. The Office of Tax Policy and Regulation develops and implements tax policies and programs and reviews and provides commentary regarding proposed policies, regulations, legislation, and determinations. The Office of Tax Policy and Regulation also provides economic and policy analysis for tax policy decisions and acts as a liaison between DOR, the Finance and Administration Cabinet, and other agencies, especially the Kentucky Legislative Research Commission.

- Implemented new tax guidance procedures under House Bill 245
- Repealed 7 administrative regulations and amended an additional 35
- Coordinated DOR administration of Tax Increment Financing (TIF) incentives
- Reviewed and provided analysis on over 125 pieces of proposed legislation as well as hundreds of proposed legislative amendments associated with tax-related bills

### 2017 GENERAL ASSEMBLY

#### Changes to the Publication of Tax Guidance by DOR

**House Bill 245** permits DOR to publish more guidance on complex tax issues. The passage of this new law is the result of a joint effort between DOR and the Kentucky Society of CPAs (KyCPA) to improve transparency in tax guidance. The additional guidance will be published on DOR's website and via other methods of communication. DOR will continue to issue some guidance via the administrative regulation process that requires approval by the General Assembly. DOR has received input from KyCPA on topics for possible new guidance. This legislation amended KRS 131.130 and became effective on June 29, 2017.

**House Bill 50** changed the statutes that govern the ability of Executive Branch agencies and taxpayers to continue to rely on the guidance provided in administrative regulations. The new law requires that an ordinary administrative regulation will expire seven years after its last effective date. An administrative regulation that has a last effective date prior to July 1, 2012 shall expire on July 1, 2019. The bill provides a process for Executive Branch agencies to certify to the legislature the reasons for not letting a regulation expire. DOR recognizes that administrative regulations provide valuable guidance for taxpayers

and their representatives and is evaluating each of the applicable regulations.

#### Organizational and Administrative Changes

**House Bill 262** was enacted to provide the state with the legislative authority necessary to allow criminal background checks and fingerprinting of DOR employees. DOR has an exchange of information agreement with the Internal Revenue Service (IRS) that allows DOR to receive federal tax information for use in DOR compliance programs. As part of the exchange agreement, DOR must follow IRS security requirements for the use of federal tax information, including performing criminal background checks and fingerprinting of employees. HB 262 became effective on March 21, 2017.

**House Bill 284** made two changes to assist Property Valuation Administrators (PVAs) in the administration of property taxes:

1. HB 284 extended the filing deadline for real property tax appeals when needed. Previous law required a property tax appeal to be filed within one (1) day of the end of the inspection period. If a large volume of taxpayers contact





## 2017 GENERAL ASSEMBLY

the PVA on the final day of the inspection period, or if a major reassessment was completed, the PVA may not have time to adequately review all assessments. Extending the deadline to up to 25 days allows the PVA to complete the review and still give the taxpayer time to file an appeal if no agreement can be reached on the assessment.

2. HB 284 also amended the requirement that the PVA perform an on-site examination when property is reviewed. An on-site examination will still be required when property is first placed on the tax roll, but subsequent examinations may be completed using current DOR-approved technology, such as digital aerial photography. This change accomplishes the legal requirement of an inspection of the property while reducing the cost of inspections and inconvenience to the property owner. HB 284 became effective on March 21, 2017.

**House Bill 395** ratified the DOR reorganization of its structure established by Executive Order 2016-602. This confirmed the establishment of the Office of Tax Policy and Regulation and placed the Division of Protest Resolution directly under the Office of the Commissioner. HB 395 also included the departure from DOR and the establishment of the Division of Special Investigations within the Office of Inspector General.

**House Bill 453** confirmed Executive Order 2016-576 that reorganized the Kentucky Board of Tax Appeals and created the Kentucky Claims Commission. If a taxpayer cannot resolve a protest of DOR's tax position, the taxpayer may appeal to the Kentucky Claims Commission.

### Tax Incentive Changes

**House Bill 368** allows persons who contract with certificated air carrier(s) for the transportation by air of persons, property, or mail to qualify for a sales and use tax credit on purchases of aircraft fuel equal to the amount of sales tax due exceeding \$1,000,000 each fiscal year. HB 368 became effective June 29, 2017.

**House Bill 330** amended the Tax Increment Financing (TIF) statutes to increase the life of pilot programs from 20 to 45 years. DOR's TIF revenue verification process could extend for up to 25 additional years. DOR is responsible for verifying the tax revenues refunded to a TIF project. HB 330 became effective on April 11, 2017.

**House Bill 388** amended the TIF statutes regarding mixed-use development projects to include a mixed-use development with a technology park. HB 388 became effective on April 10, 2017.

### Public Benefit Corporations

**House Bill 35** created a new form of corporation, the Public Benefit Corporation. Public Benefit Corporations are now recognized business entities in the Commonwealth. For Kentucky tax purposes, this new corporation type will be treated like other corporations. Public Benefit Corporations doing business in Kentucky will file corporate income tax returns on Form 720 or Form 720S, depending on how the corporation is taxed for federal income tax purposes.

An existing corporation that reorganizes as a Public Benefit Corporation will see no change in its Kentucky income tax liability calculations or the forms required. HB 35 became effective on June 29, 2017.

This summary is intended to provide a general overview of important tax matters addressed during the 2017 legislative session. It does not represent a full and complete list, nor does it provide a complete and thorough analysis of all tax matters addressed during the 2017 legislative session. Additional information, including proposed legislation and full text of enacted bills is available at [www.lrc.ky.gov](http://www.lrc.ky.gov).



## OFFICE OF FIELD OPERATIONS

4 REGIONAL DIVISIONS  
10 TAXPAYER SERVICE CENTERS

The Office of Field Operations (OFO) consists of ten Taxpayer Service Centers (TSCs) strategically located throughout the Commonwealth of Kentucky. Through its TSCs, OFO serves two critical functions: (1) to provide direct assistance to taxpayers in close physical proximity to the localities where they live and work and (2) to implement DOR compliance measures, primarily in the form of field audits and “desk” audits.

Services available to taxpayers at the TSCs include: receiving assistance to help understand and resolve tax bills or outstanding collection matters, receiving answers related to filing or amending returns, registering a tax account for a new business, receiving temporary permits for transient vendors engaging in sales within the Commonwealth, and having a local DOR liaison with the Central Office on other tax matters. Also, OFO partners with the Internal Revenue Service (IRS) and each TSC serves as a Volunteer Income Tax Assistance (VITA) site that provides tax return preparation and filing assistance to eligible low-income individuals and families as well as employees of the Commonwealth.

The Office of Field Operations serves an essential role in DOR compliance initiatives and has developed audit and compliance functions that ensure fair and equitable tax treatment for taxpayers. OFO selects and conducts field audits in all 120 counties throughout Kentucky as well as in many other states.

- Assessed more than \$39 million of tax due as a result of the 1,025 audits conducted
- Assessed over \$6 million of tax due as a result of other compliance measures
- Collected over \$1.4 million from more than 10,000 out of state or unregistered transient vendors identified by OFO staff attending over 800 local events across the Commonwealth
- Collected in excess of \$21.2 million in payments through taxpayer assistance programs
- Received and responded to more than 60,000 phone calls from taxpayers and tax professionals
- Received and responded to over 30,000 in-person inquiries from taxpayers who visited TSCs
- Prepared approximately 2,300 individual income tax returns for low-income individuals and families as well as employees of the Commonwealth through OFO VITA sites

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**VITA**  
Volunteer Income Tax Assistance





## FAC DIVISION OF SPECIAL INVESTIGATIONS

The **Division of Special Investigations**, organized through the Finance and Administration Cabinet's Office of the Inspector General, investigates allegations of tax law violations (particularly tax evasion, tax preparer fraud, and tendering of cold checks for tax payment), recommends criminal prosecution when warranted, and works with prosecutors around the Commonwealth to take legal action against tax law violators. The Division of Special Investigations represents the legal interests of DOR in criminal tax cases and coordinates its efforts with law enforcement agencies and Commonwealth Attorneys to prosecute criminal activity around the state.

The Division of Special Investigations directly assisted with the receipt of 15 indictments of tax law violations, including 88 felony charges that were found and presented by Kentucky grand juries in Fiscal Year 2016-17. The division opened 41 new cases and investigated 667 tips received by mail, telephone tip line, and the Department of Revenue's website. In FY 2016-17 the Division of Special Investigations helped obtain judgments in excess of \$1.1 million for future restitution payments and collected in excess of \$1.1 million, including: over \$475,000 in restitution directly paid to DOR; more than \$664,000 of income tax refund request denials associated with 864 fraudulent income tax refund requests; and over \$17,000 of collections from assessments and bills generated.

The Division of Special Investigations regularly investigates theft of trust taxes, tax fraud and evasion, failure to file income tax returns, tax preparer fraud, and the tendering of cold checks for the payment of taxes. In Fiscal Year 2016-17 the Division of Special Investigations was involved with many criminal tax cases including:

- A Franklin County Grand Jury found and presented an indictment of **three Class D felony counts** of tax evasion for years 2013, 2014, and 2015 against a Frankfort tax preparer and gym operator.
- A Jefferson County Grand Jury found and presented an indictment of **eight Class D felony charges** against a Louisville man who prepared and filed fraudulent Kentucky state individual income tax returns.
- A Franklin County Grand Jury found and presented an indictment of **six Class D felony counts** of tax evasion against a daycare operator in Louisville.
- A Franklin County Grand Jury found and presented an indictment of **seven Class D felony counts** of tax evasion against a flooring installation contractor that failed to report and pay tax on over \$1.7 million of income since 2008.
- A Franklin County Circuit Court found and presented an indictment of **seven Class D felony counts** of theft by failure to make a required disposition of property and **four Class D felony counts** of theft by deception against a Louisville man who failed to remit withholding taxes collected from his employees and wrote cold checks to DOR. The tax law violator was sentenced to five years on each count; however, because he pled guilty, pretrial diversion for five years was granted on the condition he pay over \$271,000 in restitution.





## FAC OFFICE OF LEGAL SERVICES FOR REVENUE

The **Office of Legal Services for Revenue** (OLS), organized through the Finance and Administration Cabinet General Counsel's Office, represents DOR in administrative proceedings before the Kentucky Claims Commission (f/k/a Kentucky Board of Tax Appeals) and judicial actions at all levels of the state and federal court systems.

OLS performs a wide range of services and functions, which include: representing the legal interests of DOR in judicial actions and before administrative bodies; rendering legal advice on a wide range of matters involving and affecting DOR; providing legal review of tax information and guidance issued by DOR in the form of Technical Advice Memorandums (TAMs), Private Letter Rulings (PLRs), and General Information Letters (GILs); issuing legal opinions to and on behalf of DOR; conducting thorough analysis and preparation of language for policies, legislation, statutes, and regulations; providing advice and assistance in connection with open records requests and other disclosure matters that involve DOR. Legal cases handled by OLS address Kentucky state tax issues and have resulted in precedents of significant importance and interest to taxpayers and the Commonwealth. Cases of particular significance are highlighted below.

***Wal-Mart Stores East, LP v. Department of Revenue, Finance and Administration Cabinet, 2015-CA-001054-MR (Ky. App. September 9, 2016), review denied (March 15, 2017)*** Refund claims in the amounts of \$8,414,926 and \$455,090 plus interest were at issue in this sales and use tax case. The taxpayers were (and are) retailers allowed sales tax deductions for the purpose of reimbursing their cost of collecting and remitting the tax. The deduction is 1.75% of the first \$1,000 of tax due and 1.5% of the tax in excess of \$1,000; however, "[t]he total reimbursement allowed for each seller in any reporting period shall not exceed one thousand five hundred dollars (\$1,500)." KRS 139.570(1)(a) and (b).

The \$1,500 limitation on reimbursement for the retailers' cost of collection and remittance of the sales tax represented a change in the law. This cap first appeared as modifications or suspensions of KRS 139.570 pursuant to Ky. Const. §15 in budget bills enacted in 2003, 2005, and 2006. See, e.g., *Commonwealth ex rel. Armstrong v. Collins*, 709 S.W.2d 437 (Ky. 1986); *Beshear v. Haydon Bridge Co., Inc.*, 304 S.W.3d 682 (Ky. 2010), as corrected (Mar. 17, 2010). In 2008, KRS 139.570 was formally amended to impose the cap permanently.

Then in 2009, KRS 139.570 was repealed and reenacted to impose the \$1,500 cap retroactively.

The taxpayers in this case asserted that the budget bills and 2009 act were unconstitutional, arguing that the budget bills violated Ky. Const. §51 that legislative acts cannot relate to more than one subject. They contended that KRS 139.570 contravened Ky. Const. §180 and its command that an act levying a tax must specify the purpose for which that tax is levied and that "no tax levied and collected for one purpose shall ever be devoted to another purpose." They asserted that the General Assembly's imposition of a cap upon the retailers' reimbursement for collecting and remitting the tax amounted to diverting the tax's proceeds from the purpose for which they claimed the sales tax was levied (i.e., providing the retailers that reimbursement.) Finally, the taxpayers asserted that the refund claims were governed by the four-year time limitation imposed by KRS 139.580 rather than the two-year deadline imposed by KRS 139.590 for taxes paid under a statute held unconstitutional.

The circuit court rejected both of the taxpayers' constitutional challenges. Affirming the circuit



## FAC OFFICE OF LEGAL SERVICES FOR REVENUE

court's opinion and order, the Court of Appeals addressed only the Ky. Const. §180 issue, finding it unnecessary to address the other issues or arguments in the case. The court found there was no violation of Ky. Const. §180 in this case, holding that reimbursement of a retailer's cost of collection and remittance of the tax was not a purpose of the tax itself. The purpose of the tax was not to levy a tax but instead to pay off the veterans bonus enacted by the General Assembly in 1960 and to replenish the General Fund.

The Kentucky Supreme Court denied the taxpayers' motion for discretionary review of the Court of Appeals' opinion. The Court of Appeals' opinion was designated "Not To Be Published" and thus is not "binding precedent in any other case in any court of this state." CR 76.28(4)(c). However, this opinion "may be cited for consideration by the court if there is no published opinion that would adequately address the issue before the court." *Id.*

**Department of Revenue, Finance and Administration Cabinet v. Sommer, et. al., 2017-SC-000071.** In this Open Records Act case, the plaintiffs sought copies of final rulings that had been issued by DOR pursuant to KRS 131.110.

Specifically at issue were final rulings issued but not appealed to the Kentucky Board of Tax Appeals pursuant to KRS 131.340. (The Kentucky Board of Tax Appeals was abolished and replaced with the Kentucky Claims Commission by Executive Order No. 2016-576 on August 8, 2016, which was ratified by HB 453 and signed into law on March 21, 2017.)

DOR took the position that these unappealed final rulings constitute confidential information that DOR was forbidden from disclosing by KRS 131.190(1)(a). See also KRS 131.081(15); 131.990(2); 61.878(1)(k) and (l); *Maysville Transit Co. v. Ort*, 296 Ky. 524, 177 S.W.2d 369 (1943). The law provides exceptions to this prohibition and final rulings *that are appealed* are made matters of public record.

Thus, some final rulings would fall within an exception to this prohibition. However, final rulings that are not appealed would not fall within this exception and would remain confidential and not subject to disclosure. KRS 131.190(1).

In an opinion designated "To Be Published," the Court of Appeals held that the final rulings should nevertheless be divulged by DOR provided that suitable redactions are made. One judge of the three judge panel dissented from this decision.

DOR filed a motion for discretionary review of the Court of Appeals' opinion with the Kentucky Supreme Court on February 13, 2017, which was granted. This case is currently being briefed.

***Interstate Gas Supply, Inc. v. Commonwealth, 2013-CA-001766-MR (Ky. App. Feb. 26, 2016), reh'g denied (Apr. 29, 2016), review granted (Oct. 13, 2016), not to be published.*** At issue in this case was whether the exemption for institutions of purely public charity provided in Ky. Const. §170 applied to the use tax imposed by KRS Chapter 139, which is an excise tax. Reversing the circuit court's opinion and order, the Kentucky Court of Appeals held that the Ky. Const. §170 exemption was not confined to ad valorem or property taxes. The court relied upon a decision by the former Court of Appeals that dealt with another exemption in Ky. Const. §170, which applies to public property used for public purposes. It found inapplicable a recent decision by the Kentucky Supreme Court (*Children's Psychiatric Hosp. of Northern Kentucky, Inc. v. Revenue Cabinet, Commonwealth of Ky.*, 989 S.W.2d 583 (Ky. 1999)), which held that the exemption for institutions of purely public charity did not apply to another excise tax, the health care provider tax.

This decision is not final; the Kentucky Supreme Court granted DOR's motion for discretionary review on October 13, 2016 and oral arguments were heard on April 20, 2017.









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