



Annual Report 2001-02

Paul E. Patton
Governor
Commonwealth of Kentucky

Dana B. Mayton
Secretary
Revenue Cabinet

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The Kentucky Revenue Cabinet does not discriminate on the basis of race, color, national origin, sex, religion, age or disability in employment or the provision of services.

PAUL E. PATTON
GOVERNOR



DANA B. MAYTON
SECRETARY

REVENUE CABINET
OFFICE OF THE SECRETARY
FRANKFORT, KENTUCKY 40620

January 15, 2003

The Honorable Paul E. Patton, Governor
Commonwealth of Kentucky
The State Capitol
Frankfort, Kentucky 40601

Dear Governor Patton:

I am pleased to present the Annual Report of the Revenue Cabinet for the fiscal year ended June 30, 2002. This report reflects the dedicated work of the many fine professionals who comprise the Revenue workforce.

During Fiscal Year 2001-02 General Fund revenues declined 1.4 percent from the previous year, reflecting the impact of the current national recession. However, Road Fund receipts improved 5.2 percent over Fiscal Year 2000-01. Consequently, the two funds experienced a combined 0.5 percent decrease from the prior year. This translated into a \$617 million revenue shortfall for the first year of the biennium.

The Revenue Cabinet participated in both rounds of executive branch budget reductions ordered during the year. Those reductions equaled 5.27 percent of the Cabinet's General Fund appropriation or \$3.5 million. Various cost saving measures were implemented to effect the cuts. These included consolidation of field offices, reduced scope of some technology projects, cancellation of planned projects, elimination of all discretionary travel, reduction in vehicle fleet, deferred furniture replacements, deferred building maintenance, and greater emphasis on energy conservation. Other measures too numerous to mention were also implemented.

The cost saving initiatives challenged managers throughout the Cabinet to find ways to increase efficiencies and productivity in their respective programs. They were quite successful in this endeavor. Thus, I can report that, despite budgetary constraints, taxpayers experienced no significant decrease in service levels. Our continuing emphasis on e-government is rapidly transforming into a culture of *everyday-government*. This vehicle for commerce is proving a very cost effective and efficient manner in which to interact with and meet the demands of taxpayers and the professional tax-preparer community.

The Cabinet's *EMPOWER* Kentucky programs, first begun in Fiscal Year 1996-97, continued to prove extremely effective in closing the gap between taxes rightfully due and taxes actually paid. In the fiscal year just ended, the total state revenue realized from the programs was \$70 million. Had these programs not been in place, the revenue shortfall would have been even greater. An additional \$26 million was collected from property tax programs for local taxing jurisdictions. This is money that furthers the goals of education as well as other city and county priorities. Since Fiscal Year 1997, the total additional state and local revenue collected from Revenue's *EMPOWER* program is \$341 million.

As Fiscal Year 2002 closed, the Cabinet was gearing up for a Tax Amnesty program. The final results of that extremely successful program will be reported in the second year of the biennium.

Thank you for your continued support of the Revenue Cabinet and its employees and for your confidence in our abilities.

Sincerely

A handwritten signature in cursive script that reads "Dana Bynum Mayton".

Dana Bynum Mayton, Secretary
Kentucky Revenue Cabinet



AN EQUAL OPPORTUNITY EMPLOYER M/F/D

Contents

Revenue Receipts	1
Accomplishments	9
Major KRC Accomplishments in Fiscal Year 2001-02	9
Taxpayer Service	9
Collection of Tax Revenues	9
Business Practices	10
Technological Advances	10
Use of Electronic Filing Increases	11
Compliance Initiatives	11
EMPOWER Kentucky	12
\$300 Million and Counting	12
Kentucky Cities, Counties, and School Benefit	12
State Budget Decifit Impact on <i>EMPOWER</i>	12
Strategic Planning	13
Revenue Cabinet Strategic Plan—Fiscal Years 2003-06 Receives Approval	13
Taxpayer Service	18
Office of Taxpayer Ombudsman	18
Expanding Taxpayer Services to Limited English-Speaking Persons	18
2002 General Assembly	19
A Review of Tax Law Changes Enacted by the 2002 General Assembly	19
Tax Amnesty	19
General Administration	19
Income Tax	20
Motor Vehicle Usage Tax	21
Property Tax	21
Sales and Use Tax	21
Miscellaneous Taxes	22
Interim Studies	22
Legal Issues	23
Legal Developments and Court Decisions	23
KRC Administration	26
KRC Administrative Expenditures	26
KRC Departments, Divisions, and Their Duties	27
Office of the Secretary	27
Department of Information Technology	27
Department of Law	27
Department of Tax Administration	28
Department of Property Valuation	28
KRC Management Appointments	28
Organization Chart	29
KRC Management	30
Chart of Taxes Administered by the Revenue Cabinet	31
Kentucky Taxpayer Service Centers	inside back cover

Revenue Receipts

(Reprinted from the Governor's Office for Economic Analysis
Fourth Quarter Report—Annual Edition
Fiscal Year 2002)

As shown in Table 1, combined tax and nontax receipts for the General and Road Funds decreased by 0.5 percent over the combined receipts in Fiscal Year 2000-01. Table 2 compares only tax receipts for the two funds which decreased by 0.3 percent. Table 3 compares combined nontax receipts, which decreased by 3.9 percent over the previous year.

Table 1
Total Receipts
(millions of dollars)

	FY02	FY01	Percent Change
General Fund	\$6,560.2	\$6,653.9	-1.4
Road Fund	1,119.0	1,064.2	5.2
Combined	\$7,679.2	\$8,818.1	-0.5

Table 2
Tax Receipts
(millions of dollars)

	FY02	FY01	Percent Change
General Fund	\$6,292.0	\$6,377.9	-1.3
Road Fund	1,052.8	992.1	6.1
Combined	\$7,344.8	\$7,370.0	-0.3

Table 3
Nontax Receipts
(millions of dollars)

	FY02	FY01	Percent Change
General Fund	\$268.2	\$276.0	-2.8
Road Fund	66.2	72.1	-8.2
Total	\$334.4	\$348.1	-3.9

General Fund

General Fund receipts for the year decreased by 1.4 percent over those reported in Fiscal Year 2000-01. Total General Fund receipts of \$6,560.2 million compare to \$6,653.9 million collected in Fiscal Year 2000-01.

While the sales tax growth rate continues to decrease from previous years, it also continues to be the most consistent performer of the large taxes. The growth rate for Fiscal Year 2001-02 was 2.3 percent, and compares to the growth rate for Fiscal Year 2000-01 of 3.5 percent. Receipts of \$2,300.0 million compare to prior year receipts of \$2,248.5 million.

Performance in the individual income tax dropped significantly from the small growth rate posted in Fiscal Year 2000-01. The growth rate for Fiscal Year 2001-02 was a negative 2.7 percent, compared to 2.8 percent positive growth in Fiscal Year 2000-01. Receipts totaled \$2,702.5 million and compare to \$2,778.5 million collected last year.

The corporate income tax declined by 28.5 percent for the year. Receipts of \$207.4 million compared to \$289.9 million collected in Fiscal Year 2000-01. Fiscal Year 2000-01 receipts had decreased 5.4 percent from Fiscal Year 1999-2000 collections.

Coal severance tax collections reversed a long trend by posting a 13.1 percent increase for the year. Receipts totaled \$160.2 million and compare to \$141.6 million collected during the prior fiscal year. The increase in coal severance tax receipts is primarily due to significant fluctuations in energy prices, which resulted in significantly increased demand for coal. However, energy prices are now stabilizing and the demand for coal has decreased significantly in recent months, so the increase in coal severance tax is not expected to continue.

Total property taxes experienced an increase of 6.3 percent during this fiscal year. Receipts totaled \$433.0 million compared to \$407.5 million collected in Fiscal Year 2000-01. Part of this increase is due to a delay in distributions of certain property tax collections. There is normally a pay-out from the tangible property tax accounts to local governments during June of each year. This payment was not made in June 2002. Consequently, receipts are overstated by approximately \$11 million for Fiscal Year 2001-02.

The growth in lottery receipts increased significantly from the previous year. Receipts of \$169.0 million grew by 7.6 percent over the \$157.0 million remitted to the state last fiscal year.

Revenue Receipts

The “all other” category finished the year with a decrease of 6.8 percent. Receipts of \$587.8 million compare to \$630.9 million collected in Fiscal Year 2000-01.

Table 4 compares the growth rates in major General Fund categories and the fund as a whole for the entire year and the four individual quarters.

Table 4
General Fund Growth Rates
for the Four Quarters and Full Year, FY02

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY01
Total					
Receipts	0.8%	2.1%	-5.5%	-3.0%	-1.4%
Sales & Use	3.6	2.4	0.2	3.0	2.3
Individual					
Income	0.3	2.7	-6.3	-6.7	-2.7
Corporate					
Income	-16.8	-16.9	*	-13.7	-28.5
Coal					
Severance	21.1	20.8	15.9	-3.1	13.1
Property	3.5	9.9	-7.7	29.4	6.3
Lottery	-3.8	24.1	2.6	7.7	7.6
All Other	-1.6	-17.1	-2.8	-7.1	-6.8

Road Fund

Total Road Fund receipts increased by 5.2 percent during Fiscal Year 2001-02. Total receipts of \$1,119.0 million compare to \$1,064.2 million collected in this fund during Fiscal Year 2000-01.

The motor fuels taxes growth of 5.1 percent compares to a decline of 3.6 percent during Fiscal Year 2000-01. Receipts of \$429.8 million compare to \$408.8 million collected during the previous fiscal year.

Motor vehicle usage tax receipts of \$429.3 million percent increased by 8.2 percent over the \$396.8 million collected in Fiscal Year 2000-01. This compares to a decline of 3.1 percent experienced last year.

The performance of the weight distance tax was almost flat for the year and finished with a growth of 0.1 percent. Receipts totaled \$75.3 million for this year and \$75.2 million for the last fiscal year.

The “all other” category increased slightly by 0.7 percent over the previous year. Total receipts in this category were \$184.7 million, which compares to \$183.4 million collected in Fiscal Year 2000-01.

Table 5 displays the growth rates for the Road Fund and its major tax categories for the year as a whole and the four individual quarters.

Table 5
Road Fund Growth Rates
for the Four Quarters and Full Year, FY02

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY01
Total					
Receipts	-2.5%	12.1%	8.6%	3.2%	5.2%
Motor Fuels	-0.8	3.9	12.8	5.5	5.1
Motor					
Vehicle					
Usage	-2.0	19.7	12.9	4.1	8.2
Weight					
Distance	-1.5	0.6	1.0	0.5	0.1
All Other	-9.0	21.8	-4.9	-1.4	0.7

EMPOWER Kentucky

The *EMPOWER Kentucky* revenue enhancement initiatives have continued during Fiscal Year 2001-02. Collections during the fiscal year are shown in Table 6. *EMPOWER Kentucky* is a program that funds, among other things, specific procedures within the Revenue Cabinet. These procedures are designed to collect certain revenues that are owed to the commonwealth but are not voluntarily paid.

Table 6
EMPOWER Kentucky Collections During FY02
(millions of dollars)

Type Tax	Collections During FY02
Individual Income	\$27.6
Corporation Income	2.5
Sales and Use Tax	19.0
Property Tax	17.9
Other	3.5
Total	\$70.5

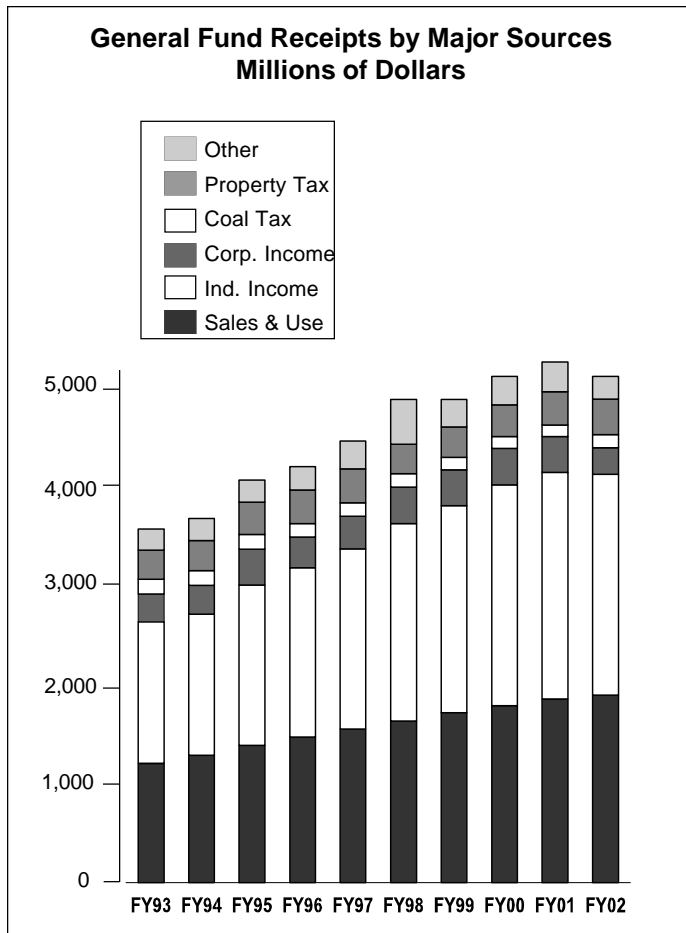
Revenue Receipts

GENERAL FUND

GENERAL FUND TOTAL RECEIPTS		
Fiscal Year	Receipts	Percent Change
2001-02	\$6,560,216,551	-1.4
2000-01	6,653,897,653	2.7
1999-00	6,478,385,032	4.5
1998-99	6,198,387,525	3.1
1997-98	6,011,806,561	6.1
1996-97	5,663,553,289	6.1
1995-96	5,336,883,824	3.5
1994-95	5,154,077,980	10.9
1993-94	4,647,078,322	3.0
1992-93	4,511,721,822	3.5

ALCOHOLIC BEVERAGE TAXES

Malt Beverage		
Fiscal Year	Receipts	Percent Change
2001-02	\$40,883,326	5.2
2000-01	38,854,920	1.2
1999-00	38,385,890	4.1
1998-99	36,870,323	2.6
1997-98	35,937,878	3.2
1996-97	34,830,419	1.0
1995-96	34,489,349	2.0
1994-95	33,812,169	3.9
1993-94	32,553,876	4.4
1992-93	31,172,541	2.5



Distilled Spirits

Fiscal Year	Receipts	Percent Change
2001-02	\$23,477,073	1.7
2000-01	23,077,057	3.3
1999-00	22,349,780	4.3
1998-99	21,432,736	2.2
1997-98	20,979,849	2.1
1996-97	20,548,503	0.3
1995-96	20,493,441	3.0
1994-95	19,897,599	-0.3
1993-94	19,960,515	0.2
1992-93	19,923,344	2.2

Wine

Fiscal Year	Receipts	Percent Change
2001-02	\$8,183,587	4.3
2000-01	7,846,391	2.3
1999-00	7,672,648	8.8
1998-99	7,049,136	7.6
1997-98	6,551,316	7.6
1996-97	6,085,828	8.5
1995-96	5,610,308	15.7
1994-95	4,847,726 ¹	7.9
1993-94	4,492,841	0.9
1992-93	4,454,161	4.2

¹Adjusted for small math error.

Revenue Receipts

CIGARETTE TAX¹

Fiscal Year	Receipts	Percent Change
2001-02	\$13,943,208	-0.5
2000-01	14,007,582	-1.2
1999-00	14,184,888	-3.3
1998-99	14,673,839	-3.0
1997-98	15,130,443	-5.7
1996-97	16,044,967	2.3
1995-96	15,680,704	3.7
1994-95	15,126,270	5.9
1993-94	14,285,746	2.1
1992-93	13,994,590	-0.4

¹The cigarette tax is levied at the rate of 3 cents per pack. These totals reflect the 2.5 cents per pack that are deposited into the General Fund. The remaining 0.5 cent per pack is dedicated to tobacco research and is deposited in the Tobacco Research Trust Fund.

CORPORATION LICENSE TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$117,500,770	-20.3
2000-01	147,515,402	6.0
1999-00	139,127,819	10.5
1998-99	125,912,523	11.7
1997-98	112,763,161	4.9
1996-97	107,498,746	18.8
1995-96	90,515,391 ²	-7.1
1994-95	97,449,950 ¹	18.8
1993-94	82,031,324 ¹	-5.8
1992-93	87,061,523	6.3

¹Adjusted for small math error

²Corrected for posting error.

COAL SEVERANCE TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$160,160,116	13.1
2000-01	141,553,087	-2.5
1999-00	145,139,909	-6.0
1998-99	154,476,772	-5.7
1997-98	163,731,038	0.1
1996-97	163,545,844	-5.3
1995-96	166,101,045	-7.3
1994-95	179,116,944	-0.4
1993-94	179,844,327	-0.2
1992-93	180,117,668	-2.7

INDIVIDUAL INCOME TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$2,702,510,022	-2.7
2000-01	2,778,541,444	2.8
1999-00	2,701,613,908	6.7
1998-99	2,532,005,348	4.7
1997-98	2,418,144,438	9.7
1996-97	2,205,022,964	6.3
1995-96	2,074,572,167	5.6
1994-95	1,964,843,490	13.6
1993-94	1,729,182,293	-0.2
1992-93	1,733,415,059	3.3

CORPORATION INCOME TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$207,353,777	-28.5
2000-01	289,931,017	-5.4
1999-00	306,442,050	-1.8
1998-99	312,066,675	-6.5
1997-98	333,666,393	14.0
1996-97	292,753,126	2.8
1995-96	284,732,573	-16.5
1994-95	340,912,408	26.7
1993-94	269,067,231	5.6
1992-93	254,775,357	-6.0

INHERITANCE AND ESTATE TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$ 83,359,872	-0.1
2000-01	83,461,499	12.0
1999-00	74,489,981	-8.5
1998-99	81,483,083	-22.8
1997-98	105,538,130	10.8
1996-97	95,287,282	17.0
1995-96	81,441,427 ¹	2.4
1994-95	79,511,634	4.4
1993-94	76,135,351	7.3
1992-93	70,965,470	-8.3

¹Phase-in of Class A beneficiary exemption began July 1, 1995.

Revenue Receipts

INSURANCE PREMIUMS TAX

Foreign Life Insurance Companies		
Fiscal Year	Receipts	Percent Change
2001-02	\$36,058,437	3.7
2000-01	34,775,487	-3.2
1999-00	35,909,807	8.5
1998-99	33,085,292	-5.8
1997-98	35,116,933	6.1
1996-97	33,086,032	-8.5
1995-96	36,165,049	6.5
1994-95	33,966,941	-10.7
1993-94	38,057,960	11.1
1992-93	34,268,972	1.7

Insurance Companies Other than Life

Fiscal Year	Receipts	Percent Change
2001-02	\$65,899,201	11.5
2000-01	59,118,323	3.7
1999-00	57,000,964	4.7
1998-99	54,431,503	3.5
1997-98	52,600,230	4.5
1996-97	50,318,931	3.4
1995-96	48,687,419	7.0
1994-95	45,515,163	6.5
1993-94	42,720,970	5.1
1992-93	40,631,761	2.1

LOTTERY RECEIPTS

Fiscal Year	Receipts	Percent Change
2001-02	\$169,000,000	7.6
2000-01	157,030,000	0.5
1999-00	156,300,000	1.6
1998-99	153,800,000	0.5
1997-98	153,000,000	1.3
1996-97	151,000,000	2.7
1995-96	147,000,000	8.1
1994-95	136,000,000	19.3
1993-94	114,000,000	14.0
1992-93	100,000,000	0.0

MINERALS AND NATURAL GAS TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$24,656,955	-17.9
2000-01	30,030,552	34.2
1999-00	22,369,419	18.0
1998-99	18,954,883	-6.1
1997-98	20,192,086	0.7
1996-97	20,051,609	15.4
1995-96	17,378,785	17.6
1994-95	14,783,614	-11.6
1993-94	16,718,727	8.1
1992-93	15,463,902	18.0

OIL PRODUCTION TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$2,590,722	-22.9
2000-01	3,358,036	13.2
1999-00	2,967,395	120.6
1998-99	1,344,942	-37.0
1997-98	2,135,211	-29.9
1996-97	3,044,497	15.1
1995-96	2,644,656	-5.0
1994-95	2,784,562	3.2
1993-94	2,697,560	-38.9
1992-93	4,413,136	-7.2

PARI-MUTUEL TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$5,179,952	-16.2
2000-01	6,182,083	-7.0
1999-00	6,645,098	-7.4
1998-99	7,179,163	48.1
1997-98	4,845,921	-18.0
1996-97	5,911,958	-17.3
1995-96	7,148,951	-1.5
1994-95	7,256,986	18.3
1993-94	6,134,317	-1.8
1992-93	6,247,368	-8.8

Revenue Receipts

PROPERTY TAXES—REAL ESTATE

Fiscal Year	Receipts	Percent Change
2001-02	\$179,678,050	4.8
2000-01	171,524,695	2.5
1999-00	167,326,472	3.5
1998-99	161,723,137	4.8
1997-98	154,245,453	-9.3
1996-97	170,063,059 ¹	19.2
1995-96	142,728,406	7.2
1994-95	133,200,108	0.8
1993-94	132,125,477	4.6
1992-93	126,333,184	3.4

¹Some tangible property tax receipts were erroneously credited to real property receipts accounts.

PROPERTY TAXES—TANGIBLE

Fiscal Year	Receipts	Percent Change
2001-02	\$151,308,795	7.7
2000-01	140,466,295	7.3
1999-00	130,960,896	4.3
1998-99	125,564,658	-0.2
1997-98	125,753,465	0.9
1996-97	124,637,468 ¹	-9.6
1995-96	137,812,773	20.8
1994-95	114,122,717	9.2
1993-94	104,501,822	10.8
1992-93	94,346,047	4.5

¹Some tangible property tax receipts were erroneously credited to real property receipts accounts.

PROPERTY TAXES—INTANGIBLE

Fiscal Year	Receipts	Percent Change
2001-02	\$23,113,567	2.5
2000-01	22,551,153	-0.8
1999-00	22,721,743	25.5
1998-99	18,103,920	-14.3
1997-98	21,129,328 ¹	-54.7
1996-97	46,631,437 ¹	-29.9
1995-96	66,489,089	-20.4
1994-95	83,479,482	7.9
1993-94	77,393,521	-0.5
1992-93	77,751,342	11.1

¹Shares of stock were exempted from property tax.

SALES AND USE TAX

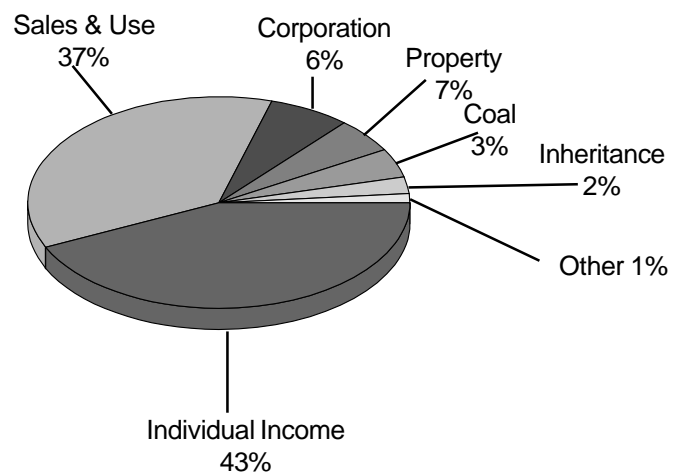
Fiscal Year	Receipts	Percent Change
2001-02	\$2,299,990,621	2.3
2000-01	2,248,471,100	3.5
1999-00	2,171,397,969	4.1
1998-99	2,085,899,677	5.3
1997-98	1,981,297,580	5.2
1996-97	1,882,681,995	5.5
1995-96	1,783,881,316	6.2
1994-95	1,680,520,815	7.7
1993-94	1,560,085,519	6.7
1992-93	1,462,251,261	7.2

BANK FRANCHISE TAX¹

Fiscal Year	Receipts	Percent Change
2001-02	\$50,549,168	1.9
2000-01	49,610,220	-6.5
1999-00	53,061,789	12.8
1998-99	47,059,959	34.2
1997-98	35,059,801	-14.2
1996-97	40,878,664	-----

¹Kentucky's bank franchise tax was instituted in July 1996.

Makeup of FY02 General Fund



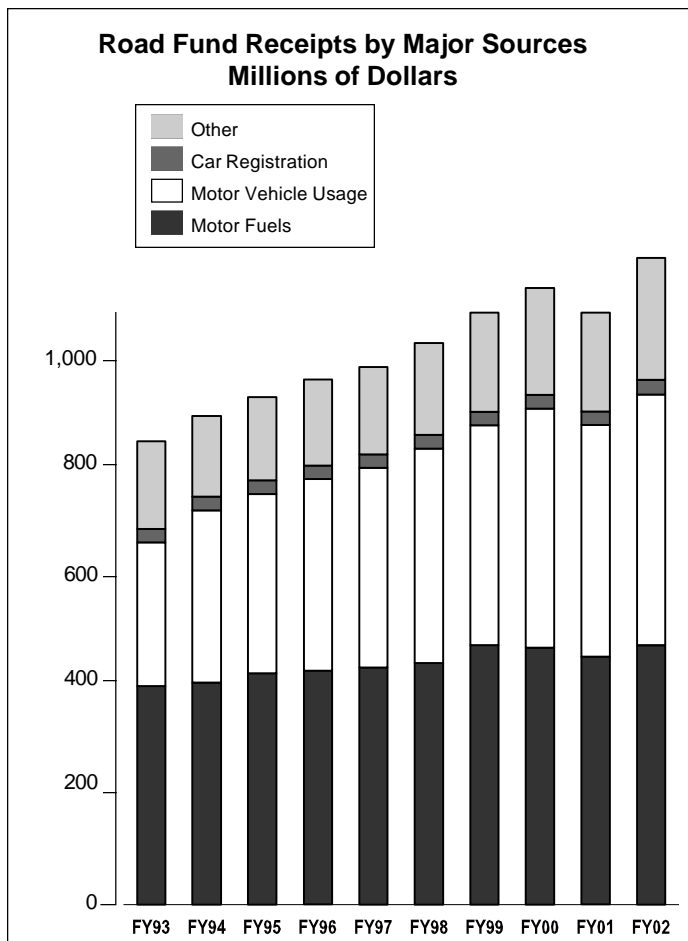
Revenue Receipts

ROAD FUND

Fiscal Year	ROAD FUND TOTAL RECEIPTS	
	Receipts	Percent Change
2001-02	\$1,119,005,317	5.2
2000-01	1,064,181,565	-2.4
1999-00	1,090,777,822	3.2
1998-99	1,056,596,153	4.4
1997-98	1,011,789,675	5.4
1996-97	960,183,780	2.2
1995-96	939,910,490	4.4
1994-95	900,619,387	4.4
1993-94	862,826,425	5.2
1992-93	820,411,480	4.9

MOTOR FUELS TAXES

Fiscal Year	Motor Fuels Normal	
	Receipts	Percent Change
2001-02	\$429,812,296	5.1
2000-01	408,801,115	-3.6
1999-00	423,876,351	-0.9
1998-99	427,848,100	8.0
1997-98	396,123,781	1.4
1996-97	390,688,336	3.3
1995-96	378,142,941	1.3
1994-95	373,316,977	4.2
1993-94	358,435,307	1.4
1992-93	353,651,330	4.5



Motor Fuels Normal Use and Surtax

Fiscal Year	Receipts	Percent Change
2001-02	\$14,124,035	-8.8
2000-01	15,492,738	-2.6
1999-00	15,905,613	-5.6
1998-99	16,853,163	-3.6
1997-98	17,473,744	14.1
1996-97	15,316,702	-32.1
1995-96	22,554,473	-2.2
1994-95	23,052,951	7.7
1993-94	21,399,126	3.9
1992-93	20,591,812	-1.9

MOTOR VEHICLE OPERATOR'S LICENSE

Fiscal Year	Receipts	Percent Change
2001-02	\$5,564,009	-0.5
2000-01	5,592,769	-1.7
1999-00	5,689,329	5.3
1998-99	5,400,685	3.0
1997-98	5,241,595	-2.1
1996-97	5,355,648	4.8
1995-96	5,110,387	-1.2
1994-95	5,170,423	-3.5
1993-94	5,358,710	6.7
1992-93	5,020,733	-3.8

Revenue Receipts

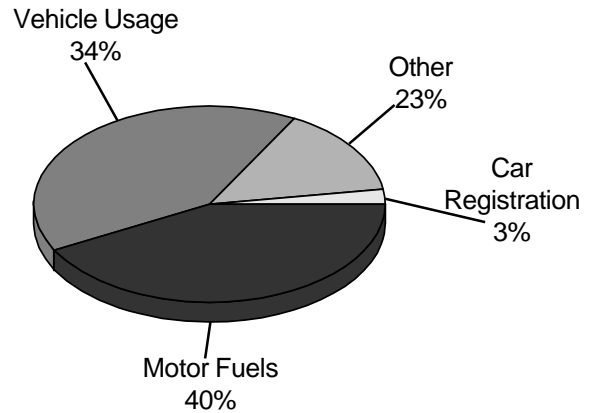
MOTOR VEHICLE REGISTRATIONS

Passenger Car Registration		
Fiscal Year	Receipts	Percent Change
2001-02	\$25,355,086	9.5
2000-01	23,162,962	-1.4
1999-00	23,485,625	0.6
1998-99	23,356,526	-1.1
1997-98	23,604,679	1.4
1996-97	23,276,395	-0.5
1995-96	23,389,132	0.0
1994-95	23,398,303	-0.3
1993-94	23,473,690	1.7
1992-93	23,083,164	0.8

MOTOR VEHICLE RENTAL USAGE TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$47,840,871	-7.3
2000-01	51,619,167	3.3
1999-00	49,957,851	12.4
1998-99	44,465,916	7.3
1997-98	41,450,720	13.3
1996-97	36,593,748	25.9
1995-96	29,054,964	26.5
1994-95	22,966,441	34.7
1993-94	17,055,319	40.7
1992-93	12,124,476	33.2

Makeup of FY02 Road Fund



MOTOR VEHICLE USAGE TAX

Fiscal Year	Receipts	Percent Change
2001-02	\$381,398,176	10.5
2000-01	345,120,799	-4.0
1999-00	359,437,723	8.5
1998-99	331,187,817	1.8
1997-98	325,308,554	6.7
1996-97	304,868,491	2.1
1995-96	298,585,859	5.2
1994-95	283,820,829	2.0
1993-94	278,157,347	19.1
1992-93	233,527,651	11.4



Accomplishments

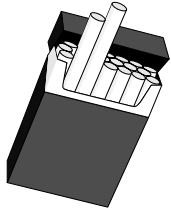

Major KRC Accomplishments in Fiscal Year 2001-02

Accomplishments during Fiscal Year 2001-02 reflect employees' commitment to KRC's goals. These accomplishments emphasize the Cabinet's mission—to provide courteous, accurate and efficient services for the benefit of the commonwealth and administer Kentucky tax laws in a fair and impartial manner.

Major accomplishments are highlighted in individual narratives in this report. Other specific accomplishments that underscore major progress toward KRC's goals are as follows:

Taxpayer Service

- Offered extended office hours in April 2002 to accommodate taxpayers with questions regarding individual income tax returns, withholding, and sales and use taxes.
- Continued the partnership with the University of Kentucky and the IRS in presenting up-to-date individual income tax information to approximately 1,400 Kentucky tax practitioners, CPAs, attorneys, insurance adjusters, realtors, and other interested persons.
- Processed 1,195,440 timely and correctly filed individual income tax returns requesting refunds by June 7, 2002. 
- Issued 187,466 direct deposit refunds for individual income tax returns.
- Processed 730,780 returns filed through electronic media representing an increase of 22 percent over the previous processing cycle.
- Continued to participate in the University of Louisville's Louis A. Grief Tax Institute by presenting up-to-date individual income tax information to approximately 200 tax practitioners, CPAs, attorneys, and other interested persons. 
- Served as the main answering point (taxpayer assistance group) for individual, withholding, and sales tax telephone inquiries. A total of 90,847 inquiries were received for the fiscal year.
- Increased voluntary electronic submission of wage and tax statements due to educational campaign performed in Withholding Tax Section.

- Created quarterly cigarette tax newsletter to advise and notify all registered cigarette wholesalers of ongoing changes in cigarette tax laws, policies, and procedures. 
- Designed a "Cigarette Licensing and Taxing Requirements Handbook" for use by law enforcement and other state tobacco regulatory and monitoring agencies.
- Joined IRS on November 3 for a joint problem solving day. Taxpayers received assistance in resolving either state or federal tax issues with one-stop assistance.
- Continued partnerships with the IRS to provide education and training for volunteers participating in community-based partnerships that provide free tax preparation and electronic filing for the elderly and low-income taxpayers.
- Participated in a statewide effort to identify available resources to assist taxpayers who work and/or live in Kentucky who have limited English speaking skills, identified as Limited English-Speaking Persons (LEP), and have a need to communicate with government. The goals were to: define the languages where the most critical needs occur; identify resources available to government and LEPs; determine the need for written vs. verbal skills; define response times for interpreters; and to identify potential markets that can provide translation services.
- Established a foreign and sign language directory for KRC employees to better assist taxpayers who are unable or limited in speaking English.
- Extended the income tax filing deadline until May 4, 2002, for victims of storms and floods in 24 Kentucky counties declared eligible for federal disaster assistance. 
- Withdrew the requirement for Form 8453-K to be signed and submitted to KRC when an income tax return was electronically filed, making electronically filing truly *paperless*.

Collection of Tax Revenues

- Implemented a vehicle loaner/rental program to collect fees from sales and/or repair companies which either loan or rent vehicles to the public (HB 325).
- Joined in cooperative effort with Transportation Cabinet to identify and assess motor fuels tax violators.

Accomplishments

Business Practices

- Processed more than five million documents, deposited more than \$7.3 billion in receipts, and made timely deposits into all funds.
- Instituted the use of two-dimensional (2-D) bar code technology to improve the efficiency of processing paper returns. KRC used the 2-D technology to process 262,345 paper returns. KRC processed 200,949 *no-money* (refund, returns without payment) returns and 61,396 *money* (returns with payment) returns. Basically the 2-D technology is incorporated into software packages offered by various software vendors. The 2-D process is faster, has a lower error rate, and requires less human resources than the normal paper process. The obvious benefit to taxpayers is the reduction in the time required to issue refunds.
- Continued and expanded KRC workshops to provide improved assistance. There were 22 workshops covering nine different topics with 368 attendees. Since the KRC Tax Workshop program began in September 2000, 49 workshops have been conducted, covering 16 topics for 1,000 attendees.




Technological Advances

- Networked the Central Kentucky and Corbin Taxpayer Service Centers (TSC). All TSCs now have Wide Area Network (WAN) connections.
- Increased sales and use tax audits performed using computer-assisted auditing by 2 percent. This percentage should continue to rise next fiscal year. The audit staff also completed sales and use tax audits using random sampling.
- Continued work on streamlined sales tax project (SSTP).
- Began research and review of implementing an online sales tax filing system; also initial stages of preparing a system to handle *no pay* sales tax returns via the telephone (IVR).
- Began work in the Motor Fuels Tax Section on two new systems. One system will replace an old data-input and



licensing system to Windows-based program with additional capabilities. This system will be more adaptable to changes in the tax laws, provide search capabilities presently not available, streamline data entry, create reports that are currently done by hand, and be user friendly. Another will allow gasoline and special fuels licensed dealers to remit their taxes and the corresponding petroleum assurance tank fees by electronic funds transfer (EFT) payment.

- Processed \$2.7 billion in EFT payments for sales, withholding, and bank franchise taxes. 
- Completed the development of KRC's Tax Amnesty System. This system allowed taxpayer's accounts to be centralized into one area which processes their application, tax returns, and any payments associated with the Amnesty request. The system provides extensive reporting capability and reconciliation of Amnesty accounts.
- Implemented a new KRC public Web site which provides user friendly features to assist taxpayers. The site contains downloadable forms, news stories, links to related tax organizations, and KRC contact information.
- Implemented a pilot public Web site that allowed taxpayers to pay their timely individual income tax due by credit card. This site was not advertised by KRC, however, it still received 173 credit card payments totaling \$74,600 by April 15.
- Implemented an application giving KRC employees the ability to accept credit card payments for the payment of delinquent taxes.
- Implemented the Revenue Electronic Timekeeping System (RETS), a Web-based timekeeping application. RETS sends the data to the commonwealth's Payroll, Time, and Leave (PTL) system automatically. RETS eliminated unnecessary duplication of effort for over 100 timekeepers within KRC. Several commonwealth agencies have requested the ability to obtain a copy of the system for their employee's timesheet functions.
- Connected the last of KRC's TSC offices to the Kentucky Information Highway (KIH), making it easier for these offices to share information with the central office and taxpayers. This allows field service employees to utilize high-speed Internet access and e-mail services. Connected

Accomplishments

two dozen more PVA sites to the KIH, bringing the total number of counties connected to 60.

- Modified the EFT system to allow the acceptance of motor fuels taxes.
- Modified the electronic filing system to accept individual income tax return data that was received through scannable bar codes. Worked with the tax software providers to develop a bar code that would contain the data needed to more easily and accurately process a tax return.
- Implemented the PVA support system that processes electronic personnel information regarding county PVA employees. By generating reports, letters, and requests for personnel actions, it assists in the administration and maintenance of employee personnel matters. It also assists in budgeting functions of personnel expenditures.
- Developed and implemented the W-2 reconciliation system which automates the processing of electronic wage records. This system retrieves W-2 and other tax return information from electronic and paper records. It also retrieves records from KRC's accounts receivable system (CARS) and then electronically reconciles the taxpayer's account. Discrepancies are put on a work list for employees to resolve. The system includes correspondence and report capabilities which enhance the productivity of the program area.
- Participated in the development and implementation of the second iteration of the Revenue Evaluation and Decision Support (READS) system, KRC's data warehouse. This iteration involved the development of the OSCAR data mart which will allow KRC to identify the most effective collection techniques through the evaluation of historical information.
- Continued migration of KRC's tax system reports to the electronic Report Delivery System (RDS). These reports were being printed and distributed on a daily, weekly, and monthly basis. RDS improves the timeliness and accessibility the reports which are viewed online.
- Implemented a Storage Area Network (SAN) allowing KRC servers' high-speed access to a centralized storage pool. This allows for better storage management and controlled storage growth. SAN has helped server consolidation effort, allowing for the removal of eight servers from the network.
- Implemented a number of network security features including moving to private Internet Protocol (IP) addresses, the establishment of a De-militarized Zone

(DMZ), and the use of Virtual Private Network (VPN) for secure remote connections to the network. Worked with Governors Office of Technology (GOT) on the design and have started to implement a complete VPN solution to allow secure internal communications between all KRC sites.

- Continued the lease refresh of KRC's desktops and laptops, staying with a three-year lease refresh cycle. Started the installation of systems with the Windows 2000 operating system.

Use of Electronic Filing Increases

- Reported that the use of electronic filing methods for 2001 individual income tax returns increased over the 2000 filing season. Electronic returns fall into one of three categories: TeleFile (telephone filing), online (Internet filing), or electronic (typically tax preparers). By the end of Fiscal Year 2001-02, 606,084 returns had been filed electronically compared to 495,921 returns in 2000.
- Reported that the number of returns filed electronically by preparers for Fiscal Year 2001-02 increased to 481,388 compared to 401,864 in 2000. In its third year of offering TeleFile, KRC accepted 50,577 returns filed by phone. The number of taxpayers filing online in 2001 increased to 74,119 compared to 45,698 filed in 2000.

Compliance Initiatives

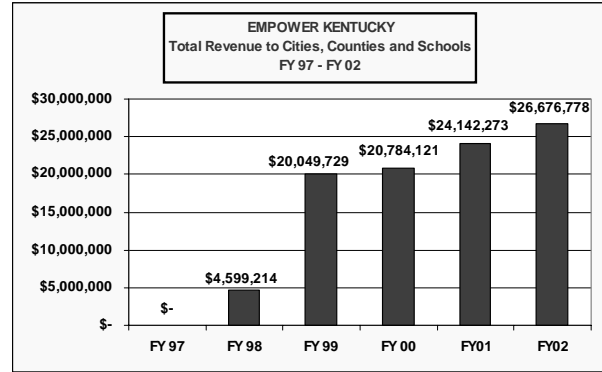
- Commenced a new taxpayer follow-up program to ensure proper filing of sales and use tax returns by recently registered taxpayers.
- Enabling legislation was signed into law on March 21, 2001, to allow Kentucky to participate in multi-state Streamlined Sales and Use Tax Project. Participated with 34 other states and the District of Columbia in the project to reach an agreement to simplify and modernize the sales and use tax structures across the nation; and minimize the tax collection burden on remote and main street sellers. Provided leadership through the Project's steering Committee.
- Matched the withholding data provided by employers with the withholding data provided on individual income tax returns to ensure compliance.
- Reconciled data provided by employers to ensure proper remittance of tax withheld from employees.
- Educated taxpayers and enforced use tax compliance on out-of-state purchases by Kentucky residents.
- Reviewed third party data to ensure business entities are registered and paying the correct taxes.

EMPOWER Kentucky

\$300 Million and Counting

KRC's *EMPOWER Kentucky* programs, first begun in Fiscal Year 1996-97, continued to prove extremely effective in closing the gap between taxes rightfully due and taxes actually paid. In the fiscal year just ended, the total state revenue realized from the programs was \$70,461,137. An additional \$26,676,778 was collected from property tax programs for local taxing jurisdictions. Since Fiscal Year 1997, the total additional state and local revenue collected from KRC's *EMPOWER* program is \$341,337,192.

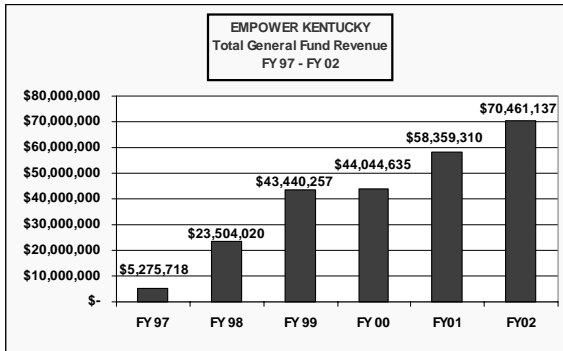
In January 1997, KRC received authorization and funding from the *EMPOWER Kentucky* trust fund to initiate process reengineering and improvements through an initiative entitled Simplified Revenue Systems. The overarching goal for Simplified Revenue Systems is greater equity and fairness in tax administration while improving service and efficiency. The various tax gap programs are designed for better detection of nonfilers and a reduction in the level of underreporting. Various efficiency improvements have been realized in KRC's collections processes as a result of employees participating in the *EMPOWER* process re-design and reengineering initiatives.



State Budget Deficit Impact on *EMPOWER*

The convergence of two key factors during Fiscal Year 2001-02 led to the consolidation of Simplified Revenue Systems and cancellation of some system integration plans. As the state budget deficit grew during Fiscal Year 2002, the timeline, cost, and complexity of developing a new Master Tax Index (MTI) system also grew beyond original estimates. Consequently, a fund transfer was effected in order to use unexpended *EMPOWER Kentucky* trust funds to help balance the state budget and the MTI project, a key component if KRC's long-term strategy for technological improvements, was cancelled. MTI was intended as a simplified registration system. KRC is pursuing alternative approaches in order to achieve the original goals of this project.

With the remaining *EMPOWER* funds available to KRC, the design and development of other technological improvements continues to unfold. Online filing of sales and withholding taxes is under development. Once completed, taxpayers will be able to view their account filing status for the previous 12 months and file returns via the Internet. KRC employees will be able to see the same information as taxpayers and thereby provide faster telephone assistance. Taxpayers will also see greater opportunity to use electronic payment options for tax liabilities. Credit card Web payments, direct debit, e-checks, and electronic funds transfer (EFT) payment options will all be available with the completion of the online filing project. Sales and use and withholding taxpayers will have the ability to file no tax due returns by calling a toll-free number and using an assigned personal identification number. These and other improvements will be completed during the *EMPOWER* program.



Kentucky Cities, Counties, and Schools Benefit

KRC's property tax compliance programs have an added benefit. In addition to the new state revenue generated from improved discovery and auditing programs, cities, counties, and schools throughout the commonwealth are the recipients of the local portion of property taxes. Since 1997, the local portion of revenues from *EMPOWER Kentucky* has totaled \$96,252,115. That figure represents a very sizable recovery of taxes that otherwise would have gone undetected and uncollected.

Strategic Plan

Revenue Cabinet Strategic Plan—Fiscal Years 2003–06 Receives Approval

The Revenue Cabinet Strategic Plan—Fiscal Years 2003–06 was approved by the Office of State Budget Director for implementation. The comprehensive business plan was developed over several months by numerous employees throughout KRC. While not the first strategic plan written in KRC, it does represent the first such plan as mandated by House Bill 502 (the Appropriations Bill) in the 2000 Regular Session. The mandate for developing strategic plans has since been codified in KRS 48.810. KRC's experience in the strategic planning process proved invaluable to managers during development of the new plan.

The plan is based upon the principle that the majority of citizens voluntarily pay their fair share of taxes to support government. Rightfully, with that willingness comes certain expectations of government, foremost of which is accountability. The basic goals of KRC, explained below, are premised upon accountability to stakeholders and equity and fairness in tax administration.

Mission

The mission of the Kentucky Revenue Cabinet is to provide courteous, accurate and efficient services for the benefit of the Commonwealth and administer Kentucky tax laws in a fair and impartial manner.

Goal 1: Provide quality service to customers and stakeholders.

Government derives its legitimacy from citizens. However, citizens are not only stakeholders in the government they created. Many times they are also customers demanding products and services. Incorporating what customers tell us into our overall strategies will ensure that programs focus on meeting customer expectations.



KRC consistently provides high levels of service to its various customers and stakeholders—individual taxpayers, large and small businesses, tax practitioners, local officials, the governor and the legislature. This first goal in the strategic plan is established as the primary aim of KRC to maintain that high level of service by constantly seeking new ways to deliver timely and accurate service designed to address specific needs.

Objective 1.1 Conduct recurring, periodic seminars for local officials over the next four years.

During the course of developing the Revenue Cabinet Strategic Plan Fiscal Years 2003–06, various local officials were surveyed. Those surveyed included PVAs, county judge-executives, county attorneys, county clerks, sheriffs, school superintendents, city managers, and mayors. This important group of stakeholders was asked what they thought this agency is doing right and what they thought this agency could do better. Local

taxing jurisdictions have a stake in the property valuations and property tax compliance and collection programs. A large majority of this group requested that we meet with them to review tax law changes and the impact those changes might have on their jurisdictions.

Output measures:

- Number of attendees at KRC sponsored seminars
- Number of seminars conducted annually

Outcome measure:

- Attendee satisfaction measured through seminar evaluations and surveys

Objective 1.2 Establish and implement a strategy and marketing plan to increase KRC's e-government initiatives.

Consumers are turning more and more to the Internet for information, products, and services. Access to information and services 24 hours a day, seven days a week is rapidly becoming an expectation. Citizens are no longer willing to use valuable time to visit courthouses and other government offices if they can conduct the same business online. It is incumbent upon a responsive government to offer more services online, in a secure environment. E-government in KRC refers to **Everyday Government**. That term implies information and services are available everyday, regardless of whether offices are actually open. KRC seeks to provide online services when possible. To maximize the efficiencies of online services, citizens must know what information is available and where to find it on the Internet. This objective addresses the need to develop a marketing strategy.

Input measures:

- Dollars invested in paid advertising
- Number of services available from Web site

Outcome measures:

- Increase in the number of voluntary electronic filers
- Increase in number of Web site information packets available
- Percentage of dollars received via EFT

Objective 1.3 Reduce telephone time, effort, and caller anxiety by redesigning KRC's automated attendant system to be more user friendly.

KRC receives thousands of telephone calls each year from citizens needing information or assistance with their tax obligations. A telephone system that provides lengthy and confusing instructions to callers can increase anxiety levels and frustrate taxpayers. Contacting KRC by telephone need not be an unpleasant experience.



Strategic Plan

Output measures:

- Reduced wait time as determined from telephone Automated Call Distribution (ACD) reports
- Reduced the number of abandoned calls as determined from ACD reports

Outcome measure:

- Increase in taxpayer satisfaction ratings as determined by surveys

Objective 1.4 Explore cross-agency opportunities within state government to address multi-ethnic service delivery during the next four years.

Kentucky is expected to gain 175,000 non-English speaking people through international migration between 1995 and 2025, mainly Asians and Hispanics. In order to meet the needs of new citizens, who may have not yet gained a working use of the English language, KRC will have translators available for taxpayer assistance. One purpose is to minimize the anxiety level new citizens may have in dealing with unfamiliar systems of taxation. By taking a proactive approach to meeting these needs, KRC hopes to help new citizens understand their responsibilities and avoid unintentional noncompliance with Kentucky's tax laws.

Output measures:

- Use of multi-lingual options on telephone automated attendant system
- Directory or database of multi-lingual state employees available for translation service

Objective 1.5 Implement improved security and privacy measures that meet public expectations for IT systems and online transactions.

KRC continues to place the highest priority on the security of taxpayer information and implements policies to protect taxpayer privacy. KRC educates employees about the importance of maintaining confidentiality while allowing necessary electronic access in order to provide accurate and effective taxpayer services. A heightened awareness of the importance of security at all levels of the organization has precipitated multiple technology initiatives with respect to physical security, network security, and application security. By taking a proactive multi-pronged approach, KRC will provide a secure environment to house important electronic government applications.

Output measures:

- Number of attempted intrusions successfully stopped
- Development of privacy statement

Objective 1.6 Improve the quality and timeliness of information available to policy makers and citizens over the next four years.

Policy makers in both the Executive and Legislative Branches need timely and accurate information when addressing tax fairness and adequacy of the state's revenue base. KRC is often called upon to research the impact of legislative proposals. To improve the analysis of data and turn that data into information (knowledge), KRC developed a data warehouse which links key databases. This warehouse technology is being employed to analyze proposals. The warehouse also provides information to management that can be helpful in determining how best to allocate resources.

Output Measures:

- Focused education, compliance, and assistance efforts based upon customer demographics
- Number of customers and stakeholders opting to receive online press releases

Outcome Measures:

- Improved analysis of policy alternatives
- Better informed taxpayers and a more fair and efficient administration of state programs

Goal 2: Ensure KRC maintains a highly skilled and motivated work force.

To effectively meet the demands of customers and stakeholders, KRC must maintain a highly skilled and motivated workforce. Employees must provide accurate and timely information on complex tax questions, know how to navigate through various computer systems, analyze complex data using the latest technologies, research legal issues, and communicate with citizens at all levels of understanding. It is incumbent to provide the necessary staff training and support to ensure that work force skills are adequate to meet the expectations of our customers.

Objective 2.1 Assess professional and leadership development needs and establish departmental training plans for each of the next four years.

KRC is developing a training strategy that will ensure that all employees have the requisite skills to do their jobs. KRC conducted two day-long workshops with Senior Staff in January and February 2002 to determine the current state of training and to discuss future training needs of the work force. Currently, a Training Strategies Team is preparing recommendations for Senior Staff and these will be presented for discussion by the end of August 2002. Next steps will come from these recommendations.

Input measure:

- Completion of skills assessment of work force

Strategic Plan

Output measures:

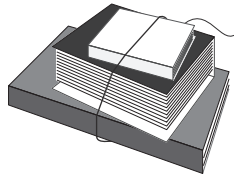
- Annual training plans
- Number of people trained
- Number of classroom training hours provided to work force

Outcome measure:

- Improvement in tax practitioners' perception that information is reliable and employees are knowledgeable

Objective 2.2 Explore and implement new strategies for leveraging technology to improve training delivery.

Traditional classroom settings for training and development can be augmented by distance learning techniques. Video-conferencing, videotapes, online courses and online forums are examples of such techniques. The training that is most effective is that which provides theory, demonstration, practice and feedback. A traditional classroom setting is most conducive to meeting all of those characteristics. However, distance learning techniques can be employed to some extent to meet the needs of staff at greatly reduced costs. Using the Internet, it is possible to deliver training programs to various geographic regions of the commonwealth and accommodate the varied needs of its employees. Online training forums, in conjunction with videotapes and other resources hold promise for improved training delivery.



Output measure:

- Increased use of distance learning techniques

Objective 2.3 Work with the Personnel Cabinet to improve career paths for KRC employees.

In the 2001 survey of employees, a need was identified to improve career paths for certain classifications. KRC, working with the Personnel Cabinet, must examine those classifications to determine what changes may be appropriate. Changes might include more steps in some classification series. In some classifications, there is a need to correct pay scales that offer no incentive to move from a non-supervisory to a supervisory position.

Output measure:

- An improvement strategy developed with Personnel Cabinet

Outcome measures:

- Increased employee retention rate
- Improved employee satisfaction as measured by surveys

Objective 2.4 Enhance the KRC's Intranet to improve communication and training.

KRC surveyed employees in 2001. Responses to the survey indicate that employees want primarily two improvements in this

agency. First, they want better communication about what is happening. Second, they want a career path to chart their future. To improve communication, KRC is turning more and more to its Intranet site as a vehicle for communicating up-to-date information. The Intranet site has also become the central point for keeping up with training opportunities and scheduling.

Input measure:

- Increase the number of PVAs with access to KRC's Intranet
- Increase the number of publications available on KRC's Intranet

Output measure:

- Increased Intranet usage

Outcome measures:

- Increased cross training
- Improvement in employees' perception of Cabinet-wide communications
- Less reliance on printed publications and manuals

KRC's Strategic Plan is based upon the principle that citizens voluntarily pay their fair share of taxes to support government services. Therefore, it is important to make the voluntary compliance process easy to use and cost efficient for both taxpayers and the government. This goal recognizes that *compliance* encompasses both voluntary and enforced compliance. Moreover, it recognizes that compliance and assistance go together. Accurate and timely assistance will translate into higher voluntary compliance rates.



Goal 3: Promote balanced, cost effective compliance and taxpayer assistance programs.

Objective 3.1 Develop more strategies to improve compliance and taxpayer assistance.

Experience indicates that some taxpayers fail to comply with their tax obligations because they do not understand what is required or do not understand how to comply. Providing adequate levels of taxpayer service translates into higher levels of voluntary compliance. Public awareness is the cornerstone of the voluntary compliance effort. KRC constantly seeks new ways to reach taxpayers with information about Kentucky taxes. This approach is intended to decrease unintentional noncompliance.

Output measure:

- A plan to cross-train employees in multiple tax types, linked to annual training plans

Efficiency measures:

- Total revenue collected per full-time employee
- Total compliance revenue collected per total Cabinet budget

Strategic Plan

Outcome measures:

- Improved service for taxpayers as measured by surveys
- Increased public perception of knowledgeable staff as measured by surveys
- Increased registration of nonfilers

Objective 3.2 Leverage technology to improve compliance.

With technological advancements come changes in how data is processed. New opportunities are created to transform data into knowledge. With more knowledge about the cause and effect of taxpayer behavior such as intentional or unintentional noncompliance, KRC has greater opportunities to undertake corrective action. Compliance programs no longer revolve solely around processing paper documents. Data received in electronic format can be analyzed electronically at speeds and volumes that dwarf traditional methods. Scanning, imaging, electronic filing, telephonic-filing, bar codes, and computer tapes all lend themselves to unique processing and analytical techniques. This objective is directed at focusing resources that will lead to improved compliance rates.



Outcome measures:

- Reduction in number of common filing errors
- Reduction in collection cycle time
- Reduction in number of and dollar amount of uncollectable tax bills issued

Objective 3.3 Improve registration processes to simplify interaction between taxpayers and KRC.

The need to register a new business often brings taxpayers into direct contact with KRC for the first time. There are a myriad of questions and concerns about how to correctly start a business and obtain the necessary permits and licenses from federal, state, and local governments. A simple registration process that is easy to understand can go a long way toward eliminating anxiety among taxpayers. This objective is directed at focusing resources to make that achievable.

Output measure:

- Implementation of a new registration system

Outcome measures:

- Simplified registration processes
- Improved customer satisfaction as measured by surveys

Objective 3.4 Improve KRC's public education efforts.

KRC seeks the highest level of voluntary compliance with the tax laws of the commonwealth as is possible. That objective requires a never-ending public education effort. There are new taxpayers coming of age and entering the work force each year. There are new businesses starting operations in Kentucky each year. There are immigrants moving to Kentucky each year. There

are tax law changes almost every year. There are changes in business practices each year. There are tax law changes each year as a result of court cases. These and other reasons require the vigilance to constantly update customers and stakeholders about their rights and responsibilities as taxpaying citizens of Kentucky.

Output measures:

- More Web-based information to support public education
- Customized e-mail announcements

Outcome measure:

- Better informed public regarding tax responsibilities and developments

Goal 4: Strengthen the efficiency and operations of KRC.

Goal Number 4 in KRC's Strategic Plan is directly tied to Governor Patton's strategic initiative to strengthen the efficiency and operations of state government. Included in this goal are initiatives that will reduce costs, eliminate redundancies, maximize the legislative process in order to simplify tax laws, streamline the compliance and assistance processes, and improve research services.

Objective 4.1 Maximize legislative opportunities to support accomplishment of strategic goals.

Each year the Division of Tax Policy solicits legislative proposals from employees throughout KRC. Those proposals are considered by a committee and a determination is made on which proposals will become initiatives. The goal is to seek legislative solutions to administrative difficulties encountered by taxpayers as well as our own staff, and to seek legislative enactments or changes which support the overall mission of KRC.

Output measures:

- Number of KRC legislative proposals enacted

Objective 4.2 Implement strategies designed to reduce costs while maintaining and improving quality service.

Saving money is everyone's responsibility in KRC. The responsibility to identify cost savings opportunities is not limited solely to managers, but each employee as well. Quite often, the person with the greatest insight about inefficiencies is the frontline employee. Therefore, managers are encouraged to not only use reports for managing and decision-making but to also solicit ideas from their employees. This objective recognizes that everyone has the opportunity to make significant contributions in fulfilling KRC's mission.



Efficiency Measure:

- Total revenue collected per total dollar spent

Strategic Plan

Objective 4.3 Instill continuous quality improvement principles.

This objective is an outgrowth of participation by state agencies in the Center for Quality Management (CQM). During Fiscal Year 2001, several agencies sent representatives to a six-day course on integrated management systems sponsored by the CQM. The course focused on developing knowledge and skills to effectively implement improvement strategies to achieve customer satisfaction. CQM concepts include:

- focus on customers,
- continuous improvement,
- fundamentals of data analysis, and
- total participation.

Output measures:

- Number of quality improvement workshops conducted
- Number of personnel trained in quality improvement principles

Objective 4.4 Develop and implement strategies to improve all channels of internal and external communication.

During strategic planning, a great deal of attention was focused on the importance of communications with customers and stakeholders. The success of programs aimed at improving voluntary compliance is heavily dependent upon accurate information being provided to taxpayers. Only when taxpayers understand their obligations is voluntary compliance achievable. Taxpayers are dependent upon KRC for the necessary information. Consequently, management must constantly seek ways to improve the flow of information, first to its employees and then to customers and stakeholders.



Output measures:

- Plan to improve internal communication
- Plan to improve external communication
- Improved employee satisfaction as measured by surveys

Objective 4.5 Validate organization structure.

During strategic planning it became apparent that a need existed to examine the current organizational structure as it relates to the goals and objectives of the plan. This step is necessary to ensure that there are no institutional barriers that would create impediments to successfully achieving the goals. This objective addresses that concern and also brings into discussion the need to redesign programs and processes that may be necessitated by retirements. KRC lost more than 8 percent of its work force to retirements during Fiscal Year 2001 and Fiscal Year 2002. That represents a major loss of experienced personnel.

Output measure:

- Revised organization chart

Outcome measure:

- Improved alignment of programs and functions

Objective 4.6 Establish a Cabinet-wide operational planning and reporting system to implement the strategic plan.

KRC's operational planning and reporting system ensures that the strategic plan becomes a working document. The operational plan includes developing and maintaining a project portfolio. Only those projects that directly support the strategic plan will be undertaken, unless otherwise mandated by law or executive order. The projects undertaken in support of the strategic plan goals and objectives are approved by senior leadership. Priorities are set for the various projects in order to allocate resources. Project benefits are determined, timelines established, resources assigned and progress reports submitted once the project is underway.

Output measure:

- Project portfolio that documents KRC strategies
- Action plans
- Periodic progress reports

Outcome measure:

- Achievement of KRC's vision for the future

Taxpayer Service

Office of Taxpayer Ombudsman

The Office of Taxpayer Ombudsman serves as the taxpayers' rights advocate when taxpayers or practitioners contact the Ombudsman for assistance in the resolution of complaints and problems. It is the responsibility of the Ombudsman Office to coordinate a fair and equitable resolution with the taxpayer and KRC.



Referrals on behalf of taxpayers are also received from fellow KRC employees, local officials, and other state or federal agencies. The Office also serves as liaison to both the executive and legislative branches of government, and routinely works with the Offices of Constituent Services in the Governor's Office and the Legislative Research Commission to coordinate responses to correspondence and inquiries received regarding tax matters.

The staff worked on a variety of issues this year which included:

- coordinated the settlement of delinquent property tax bills with local officials and KRC staff;
- obtained waiver of civil penalties when reasonable cause for waiver was demonstrated;
- coordinated the reduction or removal of wage and bank levies and assisted in obtainment of payment agreements when the taxpayer would have suffered significant hardship as a result of the levy;
- coordinated release and removal of tax liens from taxpayer records when just cause was presented;
- assisted taxpayers with the resolution of a tax bill or pending refund;
- assisted taxpayers in their requests for a payment plan;
- assisted taxpayers in the Offer in Settlement program;
- assisted taxpayers in resolving issues regarding vendor offsets.

As the advocate for the taxpayer, the staff of the Ombudsman Office serves on various KRC committees to provide input on forms, legislation, and training and educational programs.



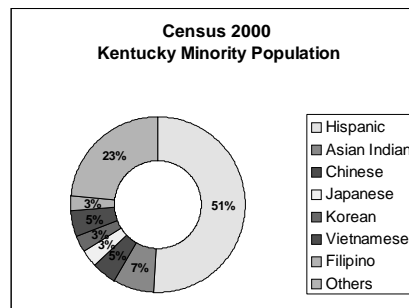
Expanding Taxpayer Services to Limited English-Speaking Persons

KRC participated in a statewide effort to identify available resources to assist people who work and/or live in Kentucky who have limited English speaking skills, identified as Limited English-Speaking Persons (LEP), and have a need to communicate with government. The goals were to:

- define the languages where the most critical needs occur;
- identify resources available to government and LEPs;
- determine the need for written vs. verbal skills;
- define response times for interpreters, and;
- identify potential markets that can provide translation services.

KRC has determined that Spanish translation services are needed more often than other languages and that our bilingual employees are our most valuable resource for providing expanded service to LEP taxpayers. Several KRC employees have been identified and agreed to assist with translation. Another identified resource is a Foreign Language Interpreter Database and a Language Identification Form that employees can use to help a limited English-speaking person identify which language they speak by looking at the card and pointing to the language that they understand. The Language Identification Form has 35 different languages that say "Please point to the language you understand." The database and the identification form are very helpful and valuable resources. The Foreign Language Interpreter Database and the Language Identification Form were sent to KRC Manager E-mail Group for distribution. KRC is also considering the use of a service known as Language Line, an interpreter service accessed by dialing an 800 number.

See chart below for statistics on percentages of languages spoken in the commonwealth. Access <http://factfinder.census.gov> to obtain statistical information on Kentucky.



2002 General Assembly

A Review of Tax Law Changes Enacted by the 2002 General Assembly

(This legislative summary was compiled by the staff of KRC's Division of Tax Policy)

NOTE: This summary of legislation enacted by the 2002 General Assembly is intended to present only general information concerning the major provisions of the legislation and should not be construed to represent a complete analysis or specific interpretations of the law changes. Information that is more specific will be provided to taxpayers as the legislative changes are implemented. Full text of enacted bills is available on the legislative home page <http://www.lrc.state.ky.us>.

The 2002 Kentucky General Assembly created, amended, or repealed numerous statutes. A total of 1,169 bills and 574 resolutions were introduced. Of this total, 368 bills became law for an enactment rate of 26.86 percent.

Thirty-three bills and resolutions had substantive tax implications. The tax portion of each bill is described in this review. Effective dates are shown when specifically stated in the legislation. Otherwise, the changes are effective July 15, 2002.

Tax Amnesty

When—A Tax Amnesty Program will be offered during the fiscal year ending June 30, 2003, for a period of not less than 60 nor more than 120 days. KRC plans to conduct the program during the fall of 2002.

Who—All taxpayers who pay their taxes directly to KRC qualify for tax amnesty except those on notice of a criminal investigation or who are the subject of any criminal litigation for nonpayment, delinquency, evasion, or fraud in relation to any federal or state taxes.

Taxes Included—All taxes under the direct administrative jurisdiction of KRC except ad valorem taxes levied on most real property, motor vehicles, and motorboats (collected by the county clerk), and personal property payable to local officials (i.e., furniture and fixtures, inventory).

Tax Periods Included—All tax periods beginning on or after December 1, 1987, and ending prior to December 1, 2001. (Prior amnesty covered periods ending prior to December 1, 1987.)

Amnesty Incentives

- All eligible taxpayers will pay only the tax due for all eligible tax periods.
- All interest will be waived.
- All penalties and cost of collection fees will be waived.

After Amnesty

- The current 20 percent Cost of Collection Fee will be increased to 25 percent.
- KRC will be authorized to publish a list of delinquent taxpayers. This list may be published on the Internet or through any medium available. This would be similar to the list of delinquent real property taxpayers which is already required by law to be published in the newspaper.

- Corporate officers will be individually liable for the payment of gasoline and special fuels taxes collected from their customers. This legal liability is already in place for sales and use, withholding taxes, health care providers, and coal severance taxes.
- Individual liability will be imposed on the responsible members and partners of limited liability companies (LLCs) and limited liability partnerships (LLPs) for gasoline and special fuels, sales and use, and withholding taxes, each of which is collected by the business entity for remittance to the commonwealth. This provision will be effective retroactive to July 15, 1994.
- A \$100 minimum failure to file penalty will be imposed for those taxpayers who fail to file returns after they have been requested by KRC. (**HB 614**)

General Administration

Collection of Delinquent Child Support Obligations—

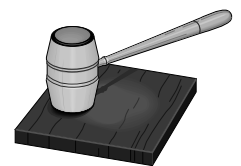
Amends KRS 131.130 to permit KRC to enter into an annual memoranda of agreement with the Cabinet for Families and Children to collect support obligations for up to five years. This legislation also permits KRC to use the same powers, rights, duties, and authority for the collection, refund, and administration of support obligations as is used by KRC for delinquent taxes under KRS Chapters 131, 134, and 135, and as used by the Cabinet for Families and Children for support obligations under KRS Chapters 205 and 405. (**SB 133**)

CPAs and Attorneys May Act as Agents for Kentucky

Permits and Taxes

Creates a new section of KRS Chapter 352 to allow licensed certified public accountants and licensed attorneys to act as agents for their clients and complete, sign, and submit applications for seller's permits for Kentucky use tax collections, general business licenses, and employer's withholding tax, corporation income tax, and corporation license tax registration numbers. It also amends KRS 139.240 to allow the "agents" to sign an application for a seller's permit on behalf of the owner or business entity, and amends KRS 143.030 to permit the application for a certificate of registration on behalf of an individual or business entity. (**HB 273**)

Tax Increment Financing (TIF)—This legislation amends KRS Chapter 65 to include new definitions related to the Kentucky Tax Increment Financing Act. It also provides procedures for determining the state's portion of the incremental state revenue that may be returned to the local development area in order to promote economic development. This bill requires Kentucky Economic Development Finance Authority (KEDFA) approval



2002 General Assembly

of industrial revenue bonds if state property taxes are to be reduced. *(HB 372)*

Taxpayer Information—Requires KRC to provide an electronic copy of the names and addresses of all persons filing Kentucky resident individual income tax returns by county to the Administrative Office of the Courts for a potential jury pool. The information is subject to the confidentiality provisions of KRS 131.190. *(HB 781)*

Income Tax

Filing Extension for National Guard Members and Reserve Members—National Guard and Reserve members on active duty, and who serve in an area designated as a combat zone by presidential proclamation, are entitled to an extension to file and pay Kentucky income taxes that become due during the period of service. The extension is for 12 months after the expiration of the service in the combat zone. *(SB 178)*

Skills Training Investment Credit and Other Economic Development Incentives—KRS 154.12-2084 was amended regarding eligibility criteria for the Bluegrass State Skills training investment tax credit. This change establishes minimum wage and benefit requirements at 150 percent of the federal minimum wage plus benefits of 15 percent of the applicable base hourly wage for 90 percent of the participants if the business is located in a county with an unemployment rate of 15 percent or greater. Also, KRS 154.20-170 was amended to provide that the KEDFA give priority consideration to economic development initiatives in counties with an unemployment rate of 15 percent or greater. *(HB 166)*

Vouchers for Purchase of Health Insurance—KRS 141.010 is amended to exclude from income tax any amount paid to provide vouchers for the purchase of health insurance. Employers may deduct the cost of vouchers or similar instruments that provide health insurance coverage to employees or their families. Employees may exclude from gross income the value of any voucher or similar instrument used to provide health insurance. The provisions of HB 280 are effective for taxable years beginning after December 31, 2000. *(HB 280)*



Economic Development Modernization—This legislation updates the current economic development tax incentive programs of Kentucky Rural Economic Development Act (KREDA), Kentucky Industrial Development Act (KIDA), Kentucky Jobs Development Act (KJDA), and Kentucky Economic Opportunity Zone (KEOZ). All of these programs were changed to establish wage and benefit thresholds for eligible companies by requiring that within six months after the activation date the approved company shall compensate at least 90 percent of its full-time employees whose jobs were created as a result of the approved project with base hourly wages equal to 75 percent of county or state wages, but no less than 150 percent of federal minimum wages. In addition to the base hourly wage, the approved company

must provide employee benefits equal to at least 15 percent of the base hourly wage or provide hourly compensation equal to 115 percent of the base hourly wages. The following specific changes were also made to these programs:

KREDA—Added a third eligibility standard for counties to qualify for KREDA benefits which will result in 11 additional counties qualifying;

KREDA, KEOZ, and KIDA—Changed the limitation on tax incentives from debt service to approved costs;

KREDA, KJDA, and KIDA—Allow, with KEDFA approval, approved companies or their affiliates to impose wage assessments; and

KJDA—Reduce minimum jobs for eligibility from 25 to 15 jobs to attract “New Economy” businesses. *(HB 372)*

Internal Revenue Code Reference Update—The Internal Revenue Code (IRC) reference date in KRS 141.010(3) is changed to the code in effect on December 31, 2001, for taxable years beginning on or after January 1, 2002. The provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) are included and in effect for 2002 Kentucky returns. HBs 243 and 812 amended KRS 141.050 to provide that changes to federal income tax law made after the IRC reference date contained in KRS 141.010(3) shall not apply for purposes of KRS Chapter 141 unless adopted by the General Assembly.

Not included in the code update are the provisions of the “Victims of Terrorism Tax Relief Act of 2001” signed by President Bush on January 23, 2002, and the “Job Creation and Worker Assistance Act of 2002” signed by President Bush on March 9, 2002. *(HB 457)*

Credit for Qualified Research—A new section of KRS Chapter 141 was created to allow a credit against individual and corporation income taxes equal to 5 percent of the cost of constructing and equipping new facilities or expanding existing facilities in Kentucky for “qualified research.” “Qualified research” is defined to mean qualified research as defined in Section 41 of the IRC. *(HB 525)*

Revisions to Kentucky Investment Fund Act (KIFA)—Various sections of KRS 154.20-250 to 154.20-284 were repealed and new sections were created to make the following changes:

1. allow this credit to apply to insurance taxes imposed by KRS 136.320, 136.330, and 304.3-270, and taxes imposed on financial institutions by KRS 136.300 and 136.310 (savings and loan associations) and KRS 136.505 (bank franchise tax) in addition to the current credit against individual and corporation income tax and corporation license tax;
2. changes the time the credit is granted from the time of making the investment in the fund to when the fund has made an investment in a qualified business;



2002 General Assembly

3. provides that the investor may not claim the credit until the tax year following the year in which the credit is granted; and
4. establishes \$3 million as the maximum amount of KIFA credits that may be approved during each of the fiscal years ended 2003 and 2004. *(HB 525)*

Nonresident Partners of Qualified Investment Partnerships—KRS 141.206 was amended to exempt nonresident individuals from taxation on distributive share income from a “qualified investment partnership.” “Qualified investment partnership” is defined to mean a partnership formed to hold only investments that produce income that would not be taxable to the nonresident individual if held or owned individually. *(HB 525)*

Motor Vehicle Usage Tax

Loaner or Rental Motor Vehicles—KRS 138.4605 was amended to modify the taxation of motor vehicles loaned or rented by an automobile dealer to a customer with a vehicle in the dealer’s service or repair facility. Such vehicles registered under the program will be subject to a flat \$25 per month tax. This replaces the previous taxation system where tax was based on 6 percent of gross receipts. Administration of the tax is moved from the Transportation Cabinet to KRC. Motor vehicles no longer covered under the loaner permit program will be taxed as all other motor vehicles under KRS 138.450(12). *(HB 325)*

Property Tax

Agricultural Exemptions—This bill expands the definition of agricultural land to include any parcel of at least five acres used for aquaculture (similar to the five acre horticultural qualification) thereby allowing the property to be assessed based upon its agricultural value. *(SB 179)*

Training Units/Incentives for County Officials—Amends KRS 132.590(3)(c) regarding the issuance of annual training incentive payments for PVAs. This bill will allow the PVA, once reaching four incentive payments, to have the opportunity to remain at this level of payment until departure from the office, and never to exceed four checks per year. This bill provides that PVAs are subject to the same requirements as county officials with regard to attainment of training units and incentive payments. This bill becomes effective July 15, 2002. *(HB 120)*

Unmined Minerals Property Tax—This bill provides relief to farmers who hold fee simple interest in their properties, or have retained the mineral rights as well as the surface rights. Currently, unmined minerals (including coal) are severed from the surface estate for many parcels and are assessed separately in all cases. Under HB 243, individuals will not receive an unmined minerals property tax bill if they own the surface real estate and the unmined minerals, they are not engaged in or affiliated with the business of mining, and the property is being actively farmed or managed for timber production. These changes become effective January 1, 2003. *(HB 243)*

Omnibus Housekeeping Bill—Updates and clarifies property tax language in several statutes and extends several due dates to the benefit of the taxpayer. All provisions in this bill become effective July 15, 2002, except Section 6, which will become effective January 1, 2003. This KRC initiative accomplishes the following:

1. removes obsolete agency references;
2. extends filing dates for public service companies and financial institutions;
3. removes a conflicting penalty provision for distilled spirits tax;
4. synchronizes dates on which unlisted tangible personal property becomes omitted;
5. extends the protest period for omitted personal property from 30 to 45 days;
6. the amendment to KRS 132.290 makes the property tax interest statute consistent with that of other taxes by requiring interest to accrue on omitted property tax bills to the date the bill is paid. *(HB 448)*

Fire Department Fees—This bill specifies that if a fire department collects membership charges or subscriber fees, a fiscal court may adopt an ordinance to add these charges or fees to the property tax bill. It requires the county clerk to add the charge or fee amount to the tax bills of the affected property owners, and requires sheriffs to collect the charges or fees in the same manner as other taxes on the bill. Unpaid charges or fees will bear the same penalty as general state and county taxes, and will result in liens being placed on property for nonpayment. *(HB 483)*



Foreign Trade Zones—Amends KRS 132.020 and 132.200 to clarify that favorable property tax rates and exemptions for foreign trade zones (FTZ) are limited only to zones that are established and activated in accordance with U.S. Customs and Foreign Trade Zones Board regulations. HB 715 clarifies the General Assembly’s intent to reserve FTZ benefits for businesses that bring foreign commerce through Kentucky. This bill becomes effective July 15, 2002. *(HB 715)*

Motor Vehicle Ownership—Amends KRS 186.021, 134.805, and 134.810 to clarify that the owner as defined in KRS 186.101(7)(a) and (c) on January 1 of any year is liable for the property taxes on motor vehicles. The buyer in possession of the vehicle on January 1 is the legal owner for tax purposes, even if the title hasn’t been “officially” transferred. Effective January 1, 2003. *(HB 812)*

Sales and Use Tax

Unenriched and Enriched Uranium—Effective August 1, 2002, an amendment to KRS 139.470 provides that receipts from the sale of unenriched and enriched uranium purchased for ultimate storage, use, or other consumption outside this state and delivered to a common carrier for shipment outside this state will not be subject to Kentucky sales tax. This exemption applies

2002 General Assembly

regardless of whether the carrier is selected by the buyer or seller or an agent or representative of the buyer or seller, or whether the F.O.B. is seller's shipping point or buyer's destination. **(SB 193)**

Tourism Attraction Projects—The 1996 Tourism Development Act provided sales tax inducements for a "tourism attraction project" that enters into an agreement with the Tourism Development Finance Authority on or before June 30, 2002. Effective April 11, 2002, an amendment to KRS 148.851 has removed the June 30 deadline of the original legislation. This bill also expands the type of lodging facilities that can be part of a "tourism attraction project." Full service lodging facilities with a minimum of 500 guest rooms that have reconstruction, restoration, rehabilitation, or upgrade costs of more than \$10 million may now qualify as part of a "tourism attraction project." **(HB 372)**

Cervid Exemption—Effective July 1, 2002, an amendment to KRS 139.480 codifies a provision originally included in the 2000 budget bill. Members of the genus cervidae (deer and elk) used in an agricultural pursuit for the production of hides, breeding stock, meat and cervid by-products will be exempt from sales and use tax. Water, feed and feed additives, insecticides, fungicides, herbicides, rodenticides, and other chemicals used in this pursuit, equipment, machinery, attachments, repair and replacement parts, and any materials incorporated into the construction, renovation, or repair of the on-site facilities will be exempt from the sales and use tax. **(HB 517)**



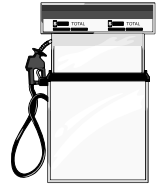
Mobile Telecommunications Services—Effective for customer service bills after August 1, 2002, an amendment to KRS 139.100 conforms the taxation of mobile telecommunications services billed in Kentucky to the Federal Mobile Telecommunications Act which Congress passed on July 28, 2000. All states are conforming to this language to ensure that more than one state will not impose a sales tax on the same mobile telecommunications services. At the effective date, mobile phone service charged to a customer with a primary service address in this state will be subject to Kentucky sales tax regardless of where the call originates or terminates. **(HB 634)**



Miscellaneous Taxes

Insurance Premium Surcharge—SB 187 provides that the Department of Insurance shall provide KRC with a list of all Kentucky-licensed property and casualty insurers and the amount of premium collected. KRC shall estimate the premium surcharge due and compare the results of the estimate with the surcharge paid the preceding year and report to the Legislative Research Commission, the Commission on Fire Protection Personnel Standards and Education, the Kentucky Law Enforcement Council, and the Department of Insurance. **(SB 187)**

Agricultural Gasoline Excise Taxes—Replaces the current refund system for agricultural gasoline excise taxes with an exemption for this fuel. Agricultural special fuels are already exempt from the tax. However, purchasers of gasoline used in watercraft, aviation, city and suburban buses, taxicabs, and senior citizen transportation must continue to pay the tax and apply for a refund. **(HB 43)**



Waste Tire Fee—Extends the "waste tire" fee (which was scheduled to end on July 31, 2002) to July 31, 2006. **(HB 422)**

Mineral Severance Tax—Deletes the exemption of tar sands from the mineral severance tax. It provides that the severance tax from tar sands is to be distributed to counties and is to be used for economic development purposes as approved by the Department of Local Government. **(HB 457)**

Bank Franchise Code Update—The current IRC reference date for bank franchise tax is updated from December 31, 1997, to December 31, 2001. This amendment will not change the amount of tax owed by a financial institution. Effective for the bank franchise tax return filed for the calendar year ending December 31, 2002. **(HB 531)**

Dyed Diesel Fuel/Motor Fuel Bonding Requirements—Amends the definition of "special fuels" to include dyed diesel fuel to allow better tracking of fuel use. The bill also provides that motor fuel dealers may elect to file a financial agreement with KRC not to exceed two months estimated tax liability or \$5,000, whichever is greater, provided that they meet certain reporting and payment requirements. Otherwise, they would continue to file a financial agreement with KRC not to exceed three months estimated tax liability or \$5,000, whichever is greater. **(HB 662)**

Interim Studies

Individual Development Accounts—This resolution directs the Department of Financial Institutions to conduct a study of the establishment of an individual development accounts program in Kentucky. Findings and recommendations must be presented to the Legislative Research Commission (LRC) by October 30, 2003. **(SJR 153)**

Kentucky Enterprise Zone Program—The Interim Joint Committee on Appropriations and Revenue will study the Kentucky Enterprise Zone Program and present findings to LRC by December 1, 2002. **(HCR 13)**

Forest Management—LRC will study and report to the 2003 General Assembly on state and federal inheritance, property, and income tax policies that discourage good forest management practices. In addition, the study shall identify incentives that would encourage good forest management. **(HCR 13)**



Legal Issues

Legal Developments and Court Decisions

During this past year, the Division of Legal Services handled a substantial caseload involving a variety of tax and other issues at all levels of the court system and in administrative proceedings. A number of these cases have a potential substantial fiscal impact or resulted in decisions having significant precedential value or effect.

The division's attorneys also participated in the legislative process through such activities as the formulation and drafting of legislative proposals, the review of proposed legislation and service on KRC in-house legislative committees. In addition, the division reviewed and prepared regulations and documents expressing or explaining KRC policies and positions and assisted with the implementation of enacted legislation.

The Division of Legal Services handles a substantial number of cases presenting a variety of issues arising under or relating to Kentucky's tax laws. The division continues to experience an increase in both the complexity of the issues and amounts of money at stake in these cases.

The division represents KRC in all cases and appeals other than personnel, bankruptcy, collection, and criminal cases. In performing this function, the division's attorneys appear before the Kentucky Board of Tax Appeals (KBTA) and other administrative tribunals of this state and before the state and federal courts. This representation of KRC embraces the handling of all phases and levels of the litigation process, including discovery, trials, motion practice, hearings, and appeals.

The cases handled by the Division of Legal Services address issues, or have resulted in precedents, of great importance and interest to taxpayers and the commonwealth. A number of these cases are discussed below.

Revenue Cabinet v. O'Daniel, 2001-SC-01032, Kentucky Supreme Court and Curtsinger v. Revenue Cabinet, 2002-SC-00204, Kentucky Supreme Court

In *O'Daniel*, the taxpayers purchased an automobile (a Lincoln Town Car) in December 1994. They took physical possession but the vehicle was not officially registered and titled until January 19, 1995. No property tax was paid on the automobile for the 1995 tax year.

KRC issued the taxpayers an assessment for the 1995 property tax. The taxpayers protested, arguing they were not responsible for the tax because they were not the registered owners until after January 1, 1995, the relevant assessment date. KRC responded that the taxpayers were equitable owners of the automobile in December 1994 and thus were liable for the 1995 property tax on that motor vehicle.

The KBTA agreed but the Marion Circuit Court reversed. KRC appealed to the Kentucky Court of Appeals.

In an opinion rendered on November 9, 2001, the Court of Appeals affirmed the ruling of the circuit court. The Court reasoned that liability for property taxes on motor vehicles was premised upon record ownership, relying upon KRS 186.021(2), 186.025(2), 134.805(5)(a) and 134.810(4) and (5). In this case, the taxpayers did not become the owners of record of the Lincoln Town Car until they registered it on January 19, 1995, the Court of Appeals held. Accordingly, they were not owners of record of the automobile on January 1, 1995, the relevant assessment date, and thus were not liable for the 1995 property taxes on that vehicle.

KRC has filed a motion for discretionary review of the Court of Appeals' opinion with the Kentucky Supreme Court. The Supreme Court has granted this motion and proceedings are now underway before that Court.

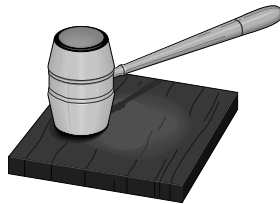
In the *Curtsinger* case, the taxpayers' situation was factually similar to that of the taxpayers in *O'Daniel*. Instead of pursuing their administrative remedies, however, the taxpayers in *Curtsinger* brought an original action in the Franklin Circuit Court seeking declaratory and injunctive relief with respect to their assessment.

The circuit court denied KRC's motion to dismiss this case for lack of jurisdiction due to the taxpayers' failure to exhaust administrative remedies; however, the circuit court rendered a decision on the merits in KRC's favor in ruling on motions for summary judgment filed by both sides. The circuit court reasoned that the Kentucky Constitution required all property to be assessed for ad valorem taxation unless specifically exempted by the Kentucky Constitution. No exemption from taxation has been enacted for motor vehicles. Moreover, liability for the motor vehicle property tax rested upon ownership, KRS 132.020(1), and in this case, the taxpayers were owners of the automobile in question once they took physical possession of it pursuant to a bona fide sale, as provided in KRS 186A.010(7)(a).

The taxpayers appealed the Franklin Circuit Court's decision to the Court of Appeals. This appeal has been transferred to the Kentucky Supreme Court, where proceedings are now underway.

Revenue Cabinet v. LWD, Inc., 2002-SC-00329-SC, Kentucky Supreme Court

At issue in this sales and use tax case was the application of the occasional sale exemption provided in KRS 139.470(4) and 139.070(1)(b) for "[a]ny transfer of all or substantially all the property held or used by person in the course of such activity [i.e., an activity for which he is required to hold a seller's permit, see KRS 139.070(1)(a)] when after such transfer the real or ultimate ownership of such property is substantially similar to that which existed before such transfer."



Legal Issues

The facts of this case were as follows: LWD Equipment, Inc. was a wholly owned subsidiary of LWD Holding, Inc. LWD Equipment's sole business activity consisted of leasing business equipment and it accordingly held a seller's permit as required by Kentucky sales and use tax law to engage in this activity.

LWD Equipment would buy a variety of business equipment, which it would immediately lease to a dozen sister corporations, all of which were 100 percent owned by LWD Holding. LWD Equipment neither sold tangible personal property nor leased equipment to parties other than its sister corporations. LWD Equipment's leasing activities to its sister corporations were multiple, continuous, and ongoing.

LWD Equipment did not report and remit sales tax on these leases as required by such provisions of the sales and use tax law as Regulation 103 KAR 28:051. KRC accordingly issued LWD Equipment a sales tax assessment, which was upheld by the KBTA. The Franklin Circuit Court reversed the KBTA, however, and KRC appealed that decision to the Kentucky Court of Appeals.

In an opinion rendered on November 30, 2001, the Court of Appeals agreed with KRC that the occasional sale exemption provided for in KRS 139.470(4) and 139.070(1)(b) did not apply in this case. This exemption did not embrace transactions that occur frequently and continuously for several years, the Court held. Application of the exemption to LWD Equipment's multiple, continuous, and ongoing leasing activities would be contrary to the General Assembly's intent in enacting an "occasional" sale exemption in the first place.

In this case, KRC had also argued that LWD Equipment's appeal of the KBTA decision to the Franklin Circuit Court was procedurally deficient and should have been dismissed due to that appeal's failure to name the KBTA as an indispensable party. The Court of Appeals rejected this argument, holding that LWD Equipment had complied with the governing statute KRS 13B.140(1) by naming the KBTA in the petition initiating the appeal and serving the KBTA with a copy of the petition.

LWD Equipment has filed a motion for discretionary review of the Court of Appeals' opinion with the Kentucky Supreme Court.

Revenue Cabinet v. State Dock, Inc. and Popplewell's Alligator Dock No. 1, Inc., 2001-SC-0439 and Popplewell's Alligator Dock Inc. v. Revenue Cabinet, 2001-SC-0434, Kentucky Supreme Court

The substantive issue in this sales and use tax case concerns the application of the exemption provided in KRS 139.483 for "supplies and fuel consumed in the operation of, and supplies consumed by crew members aboard such ships and vessels which are used principally in the transportation of property or in the conveyance of persons for hire."

Popplewell's Alligator Dock No. 1, Inc. ("Alligator") operated a marina in Kentucky. As part of its business, it leased luxury houseboats to the public. Alligator collected and remitted sales tax on the rental of the houseboats but not on the sale of gasoline used to power the leased houseboats.

Alligator contended that the sale of gasoline was exempt from tax under KRS 139.483. KRC disagreed and assessed tax accordingly. The KBTA upheld the assessment and the Franklin Circuit Court affirmed the KBTA's decision.

Alligator appealed to the Kentucky Court of Appeals. In an opinion rendered on February 23, 2001, the Court of Appeals affirmed the Franklin Circuit Court's decision. The Court held that the exemption provided in KRS 139.483 did not apply because the houseboat lessees' *principal use* of the houseboats was *not* the transportation of property or the conveyance of persons for hire. Therefore, Alligator's sale of gasoline was subject to sales and use tax.

Alligator filed a motion for discretionary review of the Court of Appeals' opinion with the Kentucky Supreme Court. That motion was granted on April 17, 2002.

Alligator and State Dock, Inc. also filed an original action in the Franklin Circuit Court seeking declaratory and injunctive relief with respect to the application of KRS 139.483 to the sale of gasoline to power the houseboats and the rental of the houseboats themselves. The circuit court dismissed this action for lack of jurisdiction due to the failure of State Dock and Alligator Dock to exhaust their administrative remedies.

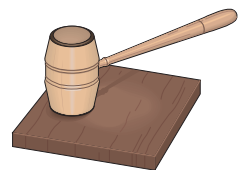
Alligator and State Dock appealed the dismissal to the Kentucky Court of Appeals. In the same February 23, 2001, opinion referred to above, the Court of Appeals vacated the circuit court's dismissal and remanded the case to the circuit court for a decision on the merits. The Court held that exhaustion of administrative remedies was not required where there were no factual questions to be resolved and only a legal question—the proper construction and application of KRS 139.483—remained to be decided.

KRC filed a motion for discretionary review of this facet of the Court of Appeals' opinion with the Kentucky Supreme Court. On April 17, 2002, the Court granted this motion. Proceedings are now underway before the Supreme Court in this case.

Woodward, Hobson & Fulton, L.L.P. v. Revenue Cabinet, Ky. App., 69 S.W.3d 476 (2002)

The taxpayer in this case, a law firm, purchased copies of medical records from physicians, hospitals, and other health care providers located outside Kentucky. The taxpayer then used these copies in the prosecution or defense of lawsuits relating to the person whose treatment was reflected in these records.

KRC assessed use tax for these transactions. KRC's position was that the copies were being purchased for use, storage, or other consumption in this state by a professional service provider (a law firm) in the rendition of its professional service. Accordingly, tax applied by virtue of such provisions of the sales and use tax law as Regulations 103 KAR 27:020 § 1, 103 KAR 27:130 § 1 and 103 KAR 26:010 § 1 and 3.



Legal Issues

The KBTA upheld the use tax assessment and the Jefferson Circuit Court affirmed the KBTA's determination. However, the Kentucky Court of Appeals reversed the circuit court's decision in an opinion rendered on February 22, 2002.

The Court of Appeals reasoned that the out-of-state health care providers' provision of the medical record copies for a charge to the taxpayer was part of their professional medical service and was *not* a purchase of those copies by the taxpayer subject to use tax. The Court reasoned as follows:

We are persuaded by Woodward's argument that providing copies of medical records is merely incidental to the service rendered. A patient's medical records do not exist independently of the medical service rendered. The records cannot be released without the patient's consent. The records, themselves, have no intrinsic value. In essence, their only value is evidence of the services rendered—diagnosis and treatment—the product of the medical provider's skill.

In arriving at its decision, the Court of Appeals also pointed to recent Kentucky Attorney General opinions (98-ORD-88 and 99-ORD-102) concluding that sales tax did not apply to charges for the provision of copies of public records pursuant to Open Records Act requests. In these opinions, the Attorney General ruled that a public agency's discharge of the duty imposed by the Open Records Act to provide copies of agency public records could not be treated as a sale subject to sales tax.

In addition, the Court of Appeals' opinion refers to various statutory provisions governing medical records and includes as follows:

We do not believe that our Legislature intended for medical providers furnishing copies of patient records in compliance with a statute to be equated with retailers, nor do we believe that applicants for such medical records should be equated with consumers.

No further review was sought in this case. This case is therefore now final.

Western Kentucky Coca-Cola Bottling Company, Inc. v. Revenue Cabinet, Ky. App., 80 S.W.3d 787 (2002)

At issue in this case is a sales tax assessment for sales of canned soft drinks from vending machines on the Fort Campbell military base.

The sales were made pursuant to a contract the taxpayer held with the Army and Air Force Exchange Service (AAFES). Under this contract, title to the soft drinks vested in AAFES upon

their placement in the machines. AAFES also set the price of the drinks and directed where the machines were to be placed. On the other hand, the taxpayer owned the machines and performed all functions relating to the operation of the machines and the removal and disposition of the sale proceeds. Keys were necessary to the operation of the machines and only the taxpayer had the keys. Moreover, the vending machines were not monitored nor was access to the machines restricted.



On these facts, KRC asserted that the taxpayer was liable for the sales tax on the sales of canned soft drinks from the vending machines based upon the "factor and agent" and vending machine Regulations 103 KAR 25:050 and 103 KAR 27:180. Moreover, the imposition of tax was specifically authorized by the federal Buck Act.

The KBTA set aside the assessment. The Franklin Circuit Court reversed the KBTA's ruling.

In an opinion rendered on December 21, 2001, the Kentucky Court of Appeals reversed the circuit court's decision. The Court held that the assessment should be set aside because the transfer of title to the canned soft drink to AAFES was immune from taxation under the principle of law, rooted in the United States Constitution's Supremacy Clause, that prevents the legal incidence of state taxes from falling upon instrumentalities of the federal government.

KRC filed a motion for discretionary review of this opinion with the Kentucky Supreme Court. Among other things, KRC contended that the Court of Appeals' opinion did not address the transactions for which the assessment in question was made—the sales of the soft drinks from the vending machines. These sales were not immune under the Supremacy Clause or the Buck Act, as the legal incidence of the tax fell upon the purchasers, who were not federal instrumentalities and the sales were not made at the post exchange or commissary to persons authorized by Army regulations to make purchases there.

On August 14, 2002, the Kentucky Supreme Court denied KRC's motion for discretionary review.

KRC Administration

KRC Administrative Expenditures

KRC administrative expenditures for Fiscal Year 2001-2002 totaled \$67,386,632. The types of appropriated funds that support ongoing operations include General, Road, Restricted, and Federal funds.

Personnel costs represented 54 percent, or \$36,353,771, of the total administrative expenditures for Fiscal Year 2001-2002.

ADMINISTRATIVE COSTS, FISCAL YEAR 2002

(Excluding PVA, EMPOWER Kentucky and Capital Construction Costs)

	General Fund	Agency Fund	Federal Fund	Road Fund	Total
Salaries full-time	\$34,390,771	\$1,122,900	\$15,100	\$ 825,000	\$36,353,771
Fringe benefits	7,746,768	0	0	0	7,746,768
Seasonal employees	641,594	0	0	0	641,594
Overtime/block 50s	194,383	0	0	0	194,383
Training and tuition assistance	58,145	0	0	0	58,145
Worker compensation insurance	138,000	0	0	0	138,000
Unemployment insurance	60,764	0	0	0	60,764
Legal/audit services/consultants	592,064	0	0	0	592,064
Janitorial services	272,920	0	0	0	272,920
Data entry/temporary services	41,440	66,700	0	0	108,140
Security	165,635	0	0	0	165,635
Total Personnel	\$44,302,484	\$1,189,600	\$15,100	\$ 825,000	\$46,332,184
Carpool (state motor pool)	\$ 46,767	\$ 0	\$ 0	\$ 0	\$ 46,767
Utilities	294,229	7,500	0	6,000	307,729
Rent/rentals	3,012,369	35,000	0	55,000	3,102,369
Maintenance and repairs	1,094,661	0	0	0	1,094,661
Postage	2,287,576	236,682	0	301,716	2,825,974
Printing/other services	781,741	709,996	0	12,812	1,504,549
Information technology (includes GOT costs)	8,673,374	535,950	0	161,450	9,370,774
Computer equipment	487,906	0	0	0	487,906
Supplies	663,545	839	0	0	664,384
Commodities/furniture	13,950	0	0	0	13,950
Software/telephone equipment	43,424	25,580	0	0	69,004
Travel	772,704	51,133	0	0	823,837
Filing/lien/collection fees	32	125,786	0	0	125,818
Dues/subscriptions services	379,412	71,818	0	54,550	505,780
Total Operating	\$18,551,690	\$1,800,284	\$ 0	\$ 591,527	\$20,943,502
Computer equipment over \$5,000	\$ 110,946	\$ 0	\$ 0	\$ 0	\$ 110,946
Total Capital Outlay	\$ 110,946	\$ 0	\$ 0	\$ 0	\$ 110,946
Total Administrative Costs	\$62,965,120	\$2,989,884	\$15,100	\$1,416,527	\$67,386,632

KRC Administration

KRC Departments, Divisions, and Their Duties

KRC consists of 13 divisions, headed by the Office of the Secretary. The divisions are organized into four departments—Information Technology, Law, Property Valuation, and Tax Administration.

Office of the Secretary

The Secretary of the Revenue Cabinet is the agency's top administrative official. The Office of the Secretary is established under Chapter 131 of the Kentucky Revised Statutes. The Secretary of the Revenue Cabinet is authorized under the statute to appoint assistants and personnel as necessary to perform functions of the office.

The Office of the Secretary includes the offices of Financial and Administrative Services, General Counsel, Internal Audit, PVA Administrative Support Branch, Strategic Planning/Program Review, and Taxpayer Ombudsman.

The **Financial and Administrative Services** office assists KRC in personnel and fiscal services and training and development. It provides office supplies and equipment, educational, budget and fiscal, and personnel services for KRC.

The **Internal Audit** office is responsible for auditing the accounting, control, and custodial activities of KRC to ensure compliance with applicable federal and state laws, administrative regulations, policies, and procedures. In addition, the Disclosure Branch, responsible for approving and regulating the disclosure of confidential state and federal information, reports to the Internal Audit office.

The **Strategic Planning/Program Review** office directs and coordinates the long-term planning of KRC and recommends strategies to achieve goals and objectives. The planner also coordinates work of the commissioners with respect to long-term planning and is responsible for guiding plan implementation throughout KRC.

The **Taxpayer Ombudsman** office is responsible for coordinating the resolution of taxpayer complaints and problems if requested by taxpayers or their representatives; recommending publications and education programs to improve voluntary compliance with Kentucky's tax laws; and otherwise ensuring the rights of taxpayers under KRS 131.041-131.081, the Kentucky Taxpayers' Bill of Rights.

The **PVA Administrative Support Branch** provides budget, fiscal, personnel, and payroll administration for all 120 PVAs and more than 680 deputies throughout the commonwealth.

This branch also coordinates open enrollment for health and life insurance and directs property tax educational KY-Courses. It conducts workshops at summer and fall PVA conferences and area meetings.

Department of Information Technology

The Department of Information Technology consists of two divisions, the Division of Technology Infrastructure Support and the Division of Systems Planning and Development. It provides strategic planning for the development of information resource policies and offers overall support for information technologies available within KRC. The focus is on efficient delivery of information services in support of KRC's mission and objectives.

The **Division of Systems Planning and Development** is responsible for application development support services, including electronic commerce, Web development, and end-user support and production control.

The **Division of Technology Infrastructure Support** provides network support service, KRC technology procurement support, and computer operations support.



Department of Law

The Department of Law administers KRC's collection efforts, communication efforts, tax policy, and legal services; resolves protested issues; and performs tax research studies. It consists of the Division of Collections, the Division of Legal Services, the Division of Protest Resolution, the Division of Research, and the Division of Tax Policy, as well as the Public Information and Communication Services Branch, which is attached to the commissioner's office.

The **Division of Collections** is responsible for the collection of delinquent taxes and the administration of collection-related compliance programs including Voluntary Disclosure and Offers in Settlement. The division is also responsible for administering the Criminal Referral program.

The **Division of Legal Services** represents KRC in administrative proceedings before the Kentucky Board of Tax Appeals (KBTA) and Board of Claims and in legal actions involving tax and a variety of other issues at every level of the state and federal court system. The division also performs a wide range of other services and functions which include rendering advice and written legal opinions concerning the state's tax laws to KRC personnel, other state government personnel, and taxpayers; reviewing and drafting proposed statutes and regulations; analyzing tax laws and assisting with their implementation and administration; assisting with the preparation of KRC



KRC Administration

informational publications; and providing assistance and advice in connection with audits, protest conferences, and other stages of the enforcement and administration of the tax laws.

During this past year, the division handled a substantial caseload involving a variety of tax and other issues at all levels of the court system and in administrative proceedings. A number of these cases have a potential substantial fiscal impact or resulted in decisions having significant precedential value or effect.

The **Division of Protest Resolution** reviews and bills tax audits completed by field auditors in KRC's 11 taxpayer service centers. The division is also responsible for responding to and resolving taxpayers' protests of the assessments which may result from both field audits and office audits. In addressing protests, the division reviews the information submitted by the taxpayer in support of a protest and conducts taxpayer conferences. When a protest cannot be resolved, the division issues final rulings which may be appealed by the taxpayer to the KBTA.

The **Division of Research** is responsible for providing analyses of tax-related issues and fiscal impact studies of legislative proposals, administrative changes, and court decisions; gathering and maintaining data to assist the Governor's Office of Economic Analysis and the Governor's Office of Policy Research in revenue forecasting; performing internal studies of administrative practices and procedures to improve efficiency of tax administration; responding to external requests for tax-related information or analysis; and assisting in the design of tax forms, returns, and related instructions.

The **Division of Tax Policy** is responsible for providing oral and written technical advice on Kentucky tax law; drafting proposed tax legislation and regulations; testifying before legislative committees on tax matters; analyzing tax legislation; reviewing and revising tax returns and forms; drafting and reviewing articles and publications; reviewing and approving final ruling letters; providing expert witnesses in tax litigation; providing consultation and assistance in protested tax cases; and conducting training and education programs.

The **Public Information and Communication Services Branch** is responsible for KRC publications, forms, and printing.

Department of Tax Administration

The Department of Tax Administration administers KRC's taxpayer assistance, general tax administration, field operations, and tax processing efforts. It consists of the Division of Compliance and Taxpayer Assistance, the Division of Field Operations, and the Division of Revenue Operations.

The **Division of Compliance and Taxpayer Assistance** is responsible for providing taxpayer assistance, administering taxes levied under the Kentucky Revised Statutes, managing compliance programs, and conducting office audits.

The **Division of Field Operations** is responsible for providing services to all 120 counties from 11 taxpayer service

centers located throughout the state. These services include taxpayer assistance and education, the preparation of tax returns, the distribution of forms, the collection of delinquent taxes, and the performance of audits. This division also provides instructors, develops training materials, and coordinates training for KRC employees and outside groups.

The **Division of Revenue Operations** is responsible for receiving and processing revenues for deposit into the state treasury, registering firms for business taxes, processing tax returns, and making additional assessments or refunds. This division also has responsibility for records management.

Department of Property Valuation

The Department of Property Valuation administers all property taxation matters. It is composed of the Division of Local Valuation, the Division of State Valuation, and the Division of Technical Support.

The **Division of Local Valuation** is responsible for certifying property valuations submitted by PVAs, coordinating property tax collection, and providing technical and administrative support to PVAs, county clerks, sheriffs, county attorneys, and local taxing districts.

The **Division of State Valuation** is responsible for overseeing the assessment of intangible and tangible personal property, motor vehicles, apportioned vehicles, public service company property, omitted personal property, and other taxes on property.

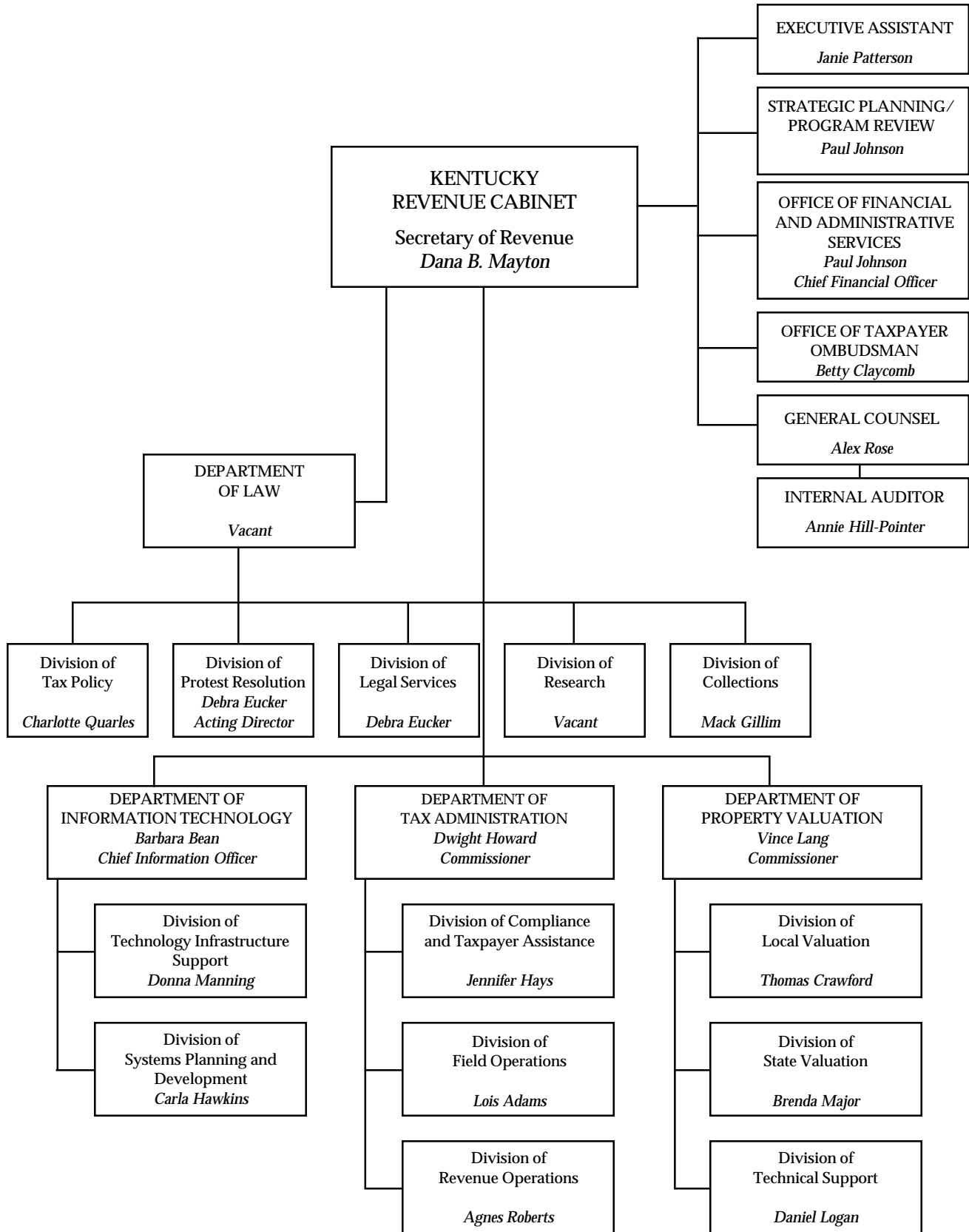
The **Division of Technical Support** is responsible for providing assistance to the 120 PVAs in the areas of mapping projects, mineral valuation and compliance, and computer technology.

KRC Management Appointments

On Aug. 16, 2001, David Gabbard was promoted to assistant director for the Division of Technical Support. Previously, he was a branch manager of the Mineral Assessment Compliance Branch. Gabbard is an 11-year veteran of KRC. Prior to that he worked 17 years as a coal mine manager/operator. He has a bachelor of arts degree in political science from the University of Kentucky. He is also a Vietnam veteran.

On March 1, 2002, Jerry Brown was promoted to revenue district manager of the Central Kentucky Taxpayer Service Center. Previously, he was a revenue field representative supervisor. Brown has nearly 20 years of service with KRC, five and one-half years as a tax examiner, four and one-half years as a unit supervisor, eight years as a field representative supervisor, and one year as district manager of the Owensboro Taxpayer Service Center. Prior to his KRC career, he worked for 11 years as an assembler and production supervisor for Ford Motor Company—Kentucky Truck Plant. He has a bachelor of arts degree in history and government.

MANAGEMENT—KENTUCKY REVENUE CABINET
 JUNE 30, 2002





Secretary D. Mayton



L. Adams



B. Bean



B. Claycomb



T. Crawford



D. Eucker



M. Gillim



C. Hawkins



J. Hays



A. Hill-Pointer



D. Howard



P. Johnson



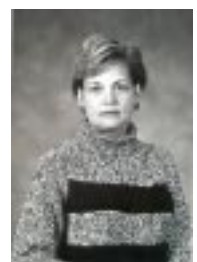
V. Lang



D. Logan



B. Major



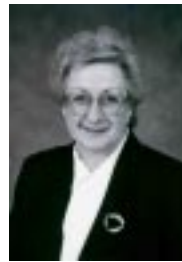
D. Manning



J. Patterson



C. Quarles



A. Roberts



A. Rose

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 2002)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Alcoholic Beverage Wholesale Sales Tax	KRS 243.884	9 percent of wholesale sales of distilled spirits, wine and malt beverages.	A wholesale sales tax on alcoholic beverage wholesalers/distributors to be reported monthly. There are statutory exemptions.
Bank Franchise Tax	KRS 136.500 et seq.	1.1 percent of net capital. Minimum tax is \$300 per year.	Tax is imposed on every financial institution regularly engaged in business in Kentucky at any time during the calendar year. A financial institution is presumed to be regularly engaged in business in Kentucky if during any taxable year it obtains or solicits business with 20 or more persons within Kentucky, or if receipts attributable to sources in Kentucky equal or exceed \$100,000. Tax is in lieu of all city, county and local taxes except for the real estate transfer taxes, real property and tangible personal property taxes upon users of utility services and the local deposit franchise tax.
Beer Consumer Tax	KRS 243.720 et seq.	\$2.50 per barrel of 31 gallons.	An excise tax imposed on distributors or retailers of malt beverages who purchase malt beverages directly from a brewer. There are statutory exemptions and credits. There is a 50 percent discount for domestic brewers up to 300,000 barrels per annum.
Cigarette Enforcement and Administration Fee	KRS 365.390	.001 cent per pack (rate subject to change annually).	Fee paid by cigarette wholesalers and unclassified acquirers to provide for the expenses of the Revenue Cabinet in administering the Cigarette Tax Law.
Cigarette Licenses	KRS 138.195	Resident wholesaler \$500 Nonresident wholesaler \$500 Subjobber \$500 Vending machine operator \$ 25 Transporter \$ 50 Unclassified acquirer \$ 50	Annual license fee imposed upon various dealers and handlers of cigarettes. More than one license may be required by the Revenue Cabinet for any dealer or handler depending upon the diversity of his business and the number of established places of business.
Cigarette Tax	KRS 138.130 et seq.	3 cents per 20 cigarettes, proportioned for other quantities.	An excise tax on cigarettes paid by resident and nonresident wholesalers and unclassified acquirers. The tax is paid by purchasing stamps within 48 hours after cigarettes are received by a resident wholesaler and within 24 hours after cigarettes are received by an unclassified acquirer. A nonresident wholesaler must affix the tax stamps prior to importing them into Kentucky.
Coal Tax	KRS 143.010, 143.020 et seq.	50 cents per ton minimum or 4.5 percent of gross value. (The minimum tax shall not apply to a taxpayer who only processes coal.)	Tax is based on the gross value of coal severed and/or processed in Kentucky. Partial or whole exemptions from the tax may apply to newly permitted production from "thin seams."
Corporation Income Tax	KRS 141.010 et seq., 155.170	First \$25,000 4 percent Next \$25,000 5 percent Next \$50,000 6 percent Next \$150,000 7 percent All Over \$250,000 8.25 percent Business Development Corporations 4.5 percent	Annual tax on the entire net income of the corporation apportioned and allocated to Kentucky. Corporations whose estimated tax liability will exceed \$5,000 must file a declaration of estimated tax due and pay the estimated tax in three installments. Financial institutions as defined in KRS 136.500, except bankers banks organized under KRS 287.135, insurance companies; savings and loan associations; corporations exempted by Internal Revenue Code (IRC) Section 501; and religious, educational, charitable and like corporations not conducted for profit are exempt from corporate income tax. An "electing small business corporation," (S corporation) as defined in Section 1361(a) of the IRC, is recognized as being exempt from Kentucky corporation income tax except for tax on net capital gain of such corporation as provided in KRS 141.040(5). "A filing requirement will apply to a corporation that only has a partnership interest in Kentucky, under KRS 141.206." A limited liability company (LLC) is treated for Kentucky income tax purposes in the same manner as its tax treatment for federal income purposes under KRS 141.208. For taxable years ending on or after December 31, 1995, KRS 141.200 allows an affiliated group to elect to file a consolidated Kentucky income tax return with the election binding for 96 consecutive calendar months. KRS 141.120 prohibits affiliated groups from filing a combined Kentucky corporation income tax return using the unitary business concept.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 2002)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Inheritance and Estate Taxes	KRS 140.010 et seq.	Inheritance tax 4–16 percent Estate tax an amount by which the state death tax credit allowable under the federal tax law exceeds the inheritance tax.	The Kentucky inheritance tax is a tax on the right to receive property upon the death of another person. The rate of tax and the exemptions allowed depend on the legal relationship of the beneficiary to the decedent. If the date of death is after June 30, 1998, the following list of beneficiaries are exempt from paying inheritance tax: (1) Surviving spouse, parent; (2) Child (adult or infant)—child by blood, stepchild, child adopted during infancy, or a child adopted during adulthood who was reared by the decedent during infancy; (3) Grandchild—issue of child by blood, stepchild, child adopted during infancy, or of a child adopted during adulthood who was reared by decedent during infancy; (4) Brother, sister (whole or half). The Kentucky estate tax is the amount which the allowable federal estate death tax credit exceeds the Kentucky inheritance tax.
Insurance Premium Surcharge	KRS 136.392	1.5 percent of premiums.	An insurance premium surcharge on insured Kentucky risks. There are statutory exemptions.
Insurance Premium Taxes	KRS 136.330 to 136.390, 299.530, 304.3-270, 304.4-030	All domestic and foreign life companies 1.7 percent tax rate for calendar year 2002. The tax rate is being lowered by 0.1 percent per year until the rate reaches 1.5 percent. Annuities are exempt from tax. All other insurance companies 2 percent tax rate for calendar year 2002. Fire insurance* 0.75 percent *Represents additional tax on applicable premiums.	Annual tax imposed on insurance companies and risk retention groups based upon premium receipts on business done. There are statutory exemptions.
Legal Process Taxes	KRS 142.010 et seq.	Conveyances of real property (deeds) \$3.00 Mortgages, financial statements and security agreements \$3.00 Marriage licenses* \$3.50 Powers of attorney to convey real or personal property \$3.00 Lien or conveyance of coal, oil, gas or other mineral right or privilege \$3.00	Taxes imposed on the filing of an instrument subject to tax or the issuance of a marriage license. Collected by county clerk. *A \$10 Spouse Abuse Shelter Fund fee levied on marriage licenses by KRS 209.160 is, by agreement between the Revenue Cabinet and the Cabinet for Families and Children, also reported and paid to the Revenue Cabinet by county clerks as part of the monthly report of legal process taxes due.
Marijuana and Controlled Substance Tax	KRS 138.870 et seq.	\$3.50 per gram on marijuana, loose. \$1,000 per marijuana plant. \$200 per gram controlled substance by weight. \$2,000 per 50 dosage units of controlled substance.	Growers, sellers, dealers, buyers and manufacturers must obtain a tax stamp to affix to the product. Commonwealth's or county attorneys who obtain a conviction of, or guilty or Alford plea from an offender must notify the Revenue Cabinet if the product which was the subject of the conviction or plea does not bear the tax stamp.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 2002)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Motor Fuels Tax—Gasoline	KRS 138.210 et seq.	9 percent of average wholesale price of gasoline, but not less than 10 cents per gallon. Rate determined quarterly. A 5 cent per gallon "Supplemental Highway User Motor Fuel Tax" also applies.	An excise tax paid by licensed dealers on all gasoline received in this state. There are statutory provisions for partial or full tax refunds for designated users.
Motor Fuels Tax—Liquefied Petroleum Gas	KRS 234.310 to 234.440	Variable rate same as gasoline. The 5 cent per gallon supplemental tax also applies to liquefied petroleum gas.	An excise tax paid by licensed dealers on all liquefied petroleum motor fuel withdrawn to propel motor vehicles on the public highways, unless the carburetion system has been approved by the Natural Resources and Environmental Protection Cabinet.
Motor Fuels Tax—Petroleum Storage Tank Environmental Assurance Fee	KRS 224.60-145	1.4 cents per gallon.	A petroleum storage tank environmental assurance fee is levied on all taxable gasoline and special fuel reported in this state by licensed dealers. There are provisions for exemptions or refunds for qualifying gasoline or special fuels not to be used on the public highways.
Motor Fuels Tax—Special Fuels	KRS 138.210 et seq.	Variable rate same as gasoline. A 2 cent per gallon "Supplemental Highway User Motor Fuel Tax" also applies.	An excise tax is levied on all special fuels received in this state by licensed dealers. There are statutory provisions for tax credits and partial or full tax refunds for designated users.
Motor Vehicle Usage Tax	KRS 138.450 et seq.	6 percent of the consideration given or retail value as defined in KRS 138.450. Value is dependent on the type of transaction. Optional tax payment method available for U-Drive-It operators based on 6 percent of the gross rental or lease charges.	Tax imposed on new and used motor vehicles when registered for the first time in this state and when ownership is transferred. There are statutory exemptions and credits. Regular usage tax payments are made to the county clerk and forwarded to the Revenue Cabinet. U-Drive-It usage tax payments are made directly to the Transportation Cabinet on a monthly basis.
Natural Resources Severance and Processing Taxes (Minerals, Natural Gas and Natural Gas Liquids)	KRS 143A.010, 143A.020 et seq.	4.5 percent of gross value. 12 cents per ton (clay production). Limestone used in the manufacturer of cement by an integrated miner and manufacturer of cement shall be limited to 14 cents per ton of limestone mined in Kentucky.	Tax of 4.5 percent of the gross value is imposed on every taxpayer engaged in the business of severing and/or processing minerals (including natural gas and natural gas liquids) in Kentucky with the exception of clay. Clay production is taxed at 12 cents per ton. A credit equal to the tax of 12 cents per ton is granted to those taxpayers who sever or process clay sold to and used as a component of landfill construction by an approved waste disposal facility within this state. Also, no tax is imposed on the processing of ball clay. This tax does not apply to fluorspar, lead, zinc, and barite severed for any purposes; or to rock, limestone, or gravel used for privately maintained but publicly dedicated roads; or limestone when sold or used by the taxpayer for agricultural purposes so as to qualify for exemption from sales and use tax. A credit equal to the tax is allowed on the gross value of limestone which is severed or processed within this state and sold to a purchaser outside this state. This credit is extended only to taxpayers who sever or process limestone through the rip-rap construction aggregate of agricultural limestone stages, and who sell in interstate commerce not less than 60 percent of such stone. The credit shall not be allowed to a taxpayer who processes the limestone beyond the agricultural limestone stages. A gas well, which has been plugged and abandoned for a consecutive two-year period that resumes producing, qualifies for the Recovered Inactive Well Tax Credit equal to 4.5 percent of the gross value.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 2002)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Oil Production Tax	KRS 137.120 et seq.	4.5 percent of market value of crude petroleum produced in Kentucky.	Tax on the production of crude petroleum is attached when the crude petroleum is first transported from the tanks or other receptacle located at the place of production. Transporter of crude petroleum, as agent, pays tax for all persons owning any interest in such oil. An oil well, which has been plugged and abandoned for a consecutive two-year period that resumes producing, qualifies for the Recovered Inactive Well Tax Credit equal to 4.5 percent of the gross value.
Property Taxes: Agricultural Products In hands of producer or agent Tobacco not at manufacturer's plant (Storage) Other agricultural products not at manufacturer's plant (Storage)	KRS 132.020(1), 132.200(6) KRS 132.020(1), 132.200(6) KRS 132.020(1), 132.200(6)	1.5 cents (per \$100 of assessment). 1.5 cents (per \$100 of assessment). 1.5 cents (per \$100 of assessment).	State rate only. Also subject to county and city rates. Also subject to county and city rates.
Aircraft	KRS 132.020(12), KRS 132.200(19)	1.5 cents (per \$100 of assessment).	Local option.
Annuities or Rights to Receive Income	KRS 132.215(2)	0.1 cent (per \$100 of assessment).	State rate only.
Bank Deposits Domestic and Out-of-State	KRS 132.030(1)	0.1 cent (per \$100 of assessment).	Tax is based on deposits as of January 1 and is paid by the institution on behalf of the depositors. State rate only.
Brokers' Accounts Receivable (Also see Margin Accounts)	KRS 132.050	10 cents (per \$100 of assessment).	State rate only.
Car Lines (Private)	KRS 136.120(4), 136.180(3)	Subject to annual adjustment.	Subject to annual adjustment. Local tax collected and distributed by the Revenue Cabinet effective January 1, 1994.
Distilled Spirits	KRS 132.020(10)	5 cents (per \$100 of assessment).	Subject to full local rates.
Farm Machinery Used in Farming	KRS 132.020(1), 132.200(1)	0.1 cent (per \$100 of assessment).	State rate only.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 2002)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Goods Held for Sale in the Regular Course of Business	KRS 132.020(10)	5 cents (per \$100 of assessment).	Subject to local rates.
Intangible Property of Banks	KRS 132.020(2)	0.1 cent (per \$100 of assessment).	State rate only.
Intangibles Money in hand, notes, bonds, accounts and other credits, except those arising from out-of-state business, or intercompany accounts between parent and subsidiary, and other not specified elsewhere. Accounts receivable, notes, bonds, credits, nondomestic bank deposits and other intangibles arising from out-of-state business, and intercompany accounts between parent and subsidiary, patents and copyrights, and tobacco base allotments.	KRS 132.020(1), 136.120(1) KRS 132.020(2), 132.120(2)	25 cents (per \$100 of assessment). 1.5 cents (per \$100 of assessment).	State rate only. State rate only.
Leasehold Interest (Owned by tax-exempt governmental unit)	KRS 132.020(1)	1.5 cents (per \$100 of assessment).	State rate only.
Life Insurance Companies (Domestic) Capital Reserves Policy Proceeds on Deposit (Individual)	KRS 136.320 KRS 132.216	28 cents (per \$100 of assessment). 0.1 cent (per \$100 of assessment). 25 cents (per \$100 of assessment).	Also subject to county and city rates. State rate only. State rate only.
Livestock and Poultry	KRS 132.020(1)	0.1 cent (per \$100 of assessment).	State rate only.
Local Government Franchise Taxes on Bank Deposits	KRS 136.575	No state rate. Tax due the following January 31. Based on June 30 deposits.	Tax is imposed on financial institutions measured by deposits in the institutions located within the jurisdiction of the county, city or urban county government at a rate not to exceed twenty-five thousandths of one percent (0.025%) of the deposits if imposed by counties and cities and at a rate not to exceed fifty thousandths of one percent (0.050%) of the deposits imposed by urban county governments.
Manufacturing Machinery	KRS 132.020(1), 132.200(4)	15 cents (per \$100 of assessment).	State rate only.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 2002)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Margin Accounts (See Brokers' Accounts Receivable)	KRS 132.060–KRS 132.090	25 cents (per \$100 of assessment).	State rate only.
Mobile Homes (Real Property)	KRS 132.751	Subject to annual adjustment. Taxed at real estate rate.	Subject to full local rates.
Motor Vehicles	KRS 132.487	45 cents (per \$100 of assessment).	Full local rates. Collected upon registration.
Historic Motor Vehicles	KRS 132.020	25 cents (per \$100 of assessment)	State rate only.
Pollution Control Facilities	KRS 132.020(1), 132.200(9)	15 cents (per \$100 of assessment).	State rate only.
Public Warehouses Goods held for sale except goods in transit Goods in transit to an out-of-state destination within six months	KRS 132.020(10) KRS 132.097	5 cents (per \$100 of assessment). Exempt.	Full local rates. Special taxing districts only.
Radio, Television and Telephonic Equipment	KRS 132.020(1), 132.200(5)	15 cents (per \$100 of assessment).	State rate only.
Railroads (Intrastate)	KRS 132.020(11)	10 cents (per \$100 of assessment both real and tangible).	Multiplier applied to local rates. Multiplier subject to annual adjustment.
Raw Materials and Products in Course of Manufacture	KRS 132.020(10), 132.200(4)	5 cents (per \$100 of assessment).	State rate only.
Real Estate not Elsewhere Specified	KRS 132.020(1)	Adjusted annually (by July 1) per KRS 132.020(8). The state real estate rate was 15.3 cents for 1998, 14.8 cents for 1999, 14.1 cents for 2000, 13.6 cents for 2001, and 13.5 cents (per \$100 assessment) for 2002.	Full local rates.
Recreational Vehicles	KRS 132.730, 132.751	Classification depends on permanency of location. 45 cents (per \$100 of assessment).	Subject to full local rates.
Recycling Machinery	KRS 132.020(1), 132.200(16)	45 cents (per \$100 of assessment).	State rate only.
Retirement Plan or Profit-Sharing Plan Tax	KRS 132.043	0.1 cent (per \$100 of assessment).	State rate only. Taxable to individual participant.
Savings and Loan Associations (Domestic) (Foreign included effective January 1, 1990)	KRS 136.300(1), KRS 136.310(1)	10 cents (per \$100 of assessment).	State rate only.

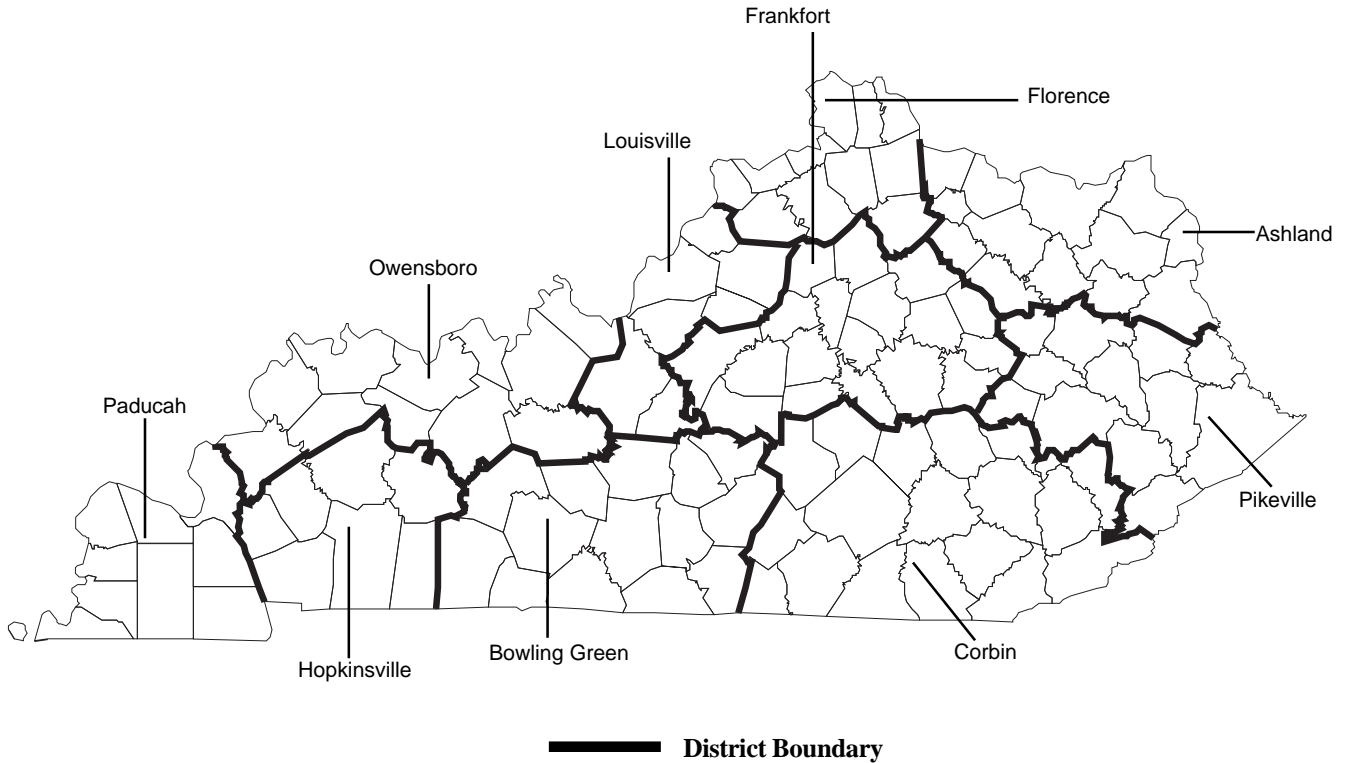
TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 2002)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION																
Tangible Property not Elsewhere Specified	KRS 132.020(1)	45 cents (per \$100 of assessment).	Full local rates.																
Trucks, Tractors, Trailers, Semi-Trailers and Buses (Interstate)	KRS 136.183	Subject to annual adjustment.	Local tax collected and distributed by the Revenue Cabinet effective January 1, 1993.																
Unmined Coal, Oil and Gas Reserves, and Other Mineral or Energy Resources Held Separately from Surface Real Property	KRS 132.820	Real estate rate: 15.3 cents for 1998, 14.8 cents for 1999, 14.1 cents for 2000, 13.6 cents for 2001, and 13.5 cents (per \$100 assessment) for 2002. Subject to annual adjustment.	Full local rates.																
Watercraft Commercial Individual Federally Documented	KRS 136.181 KRS 132.020(1), 132.488 KRS 132.020(13) KRS 132.200(20)	45 cents (per \$100 of assessment). 45 cents (per \$100 of assessment). 1.5 cents (per \$100 of assessment).	Full local rates. Full local rates. Local option.																
Public Service Commission Assessment	KRS 278.130 et seq.	Maximum assessment 2.0 mills Minimum assessment \$50	Assessment imposed annually on utility companies under the jurisdiction of the Public Service Commission based on proportionate share of gross intrastate revenues by each company.																
Public Service Company Property Taxes	KRS 136.115 et seq.	Property of public service corporations taxed at the same rate as property owned by any individual or corporation (see rates under Property Taxes).	Property of public service corporations taxed at the same rate as property owned by any individual or corporation (see rates under Property Taxes).																
Racing Taxes: (1) License Tax	(1) KRS 137.170 et seq.	(1) Per day of races. <table style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th style="text-align: center;">Average Daily Mutuel Handle (for preceding year)</th> <th style="text-align: center;">Tax Rate Per Day</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">\$ 0 — \$ 25,000</td> <td style="text-align: center;">\$ 0</td> </tr> <tr> <td style="text-align: center;">25,001 — 250,000</td> <td style="text-align: center;">175</td> </tr> <tr> <td style="text-align: center;">250,001 — 450,000</td> <td style="text-align: center;">500</td> </tr> <tr> <td style="text-align: center;">450,001 — 700,000</td> <td style="text-align: center;">1,000</td> </tr> <tr> <td style="text-align: center;">700,001 — 800,000</td> <td style="text-align: center;">1,500</td> </tr> <tr> <td style="text-align: center;">800,001 — 900,000</td> <td style="text-align: center;">2,000</td> </tr> <tr> <td style="text-align: center;">900,001 and above</td> <td style="text-align: center;">2,500</td> </tr> </tbody> </table>	Average Daily Mutuel Handle (for preceding year)	Tax Rate Per Day	\$ 0 — \$ 25,000	\$ 0	25,001 — 250,000	175	250,001 — 450,000	500	450,001 — 700,000	1,000	700,001 — 800,000	1,500	800,001 — 900,000	2,000	900,001 and above	2,500	(1) License tax imposed upon the operation of a track at which horse races are run under the jurisdiction of the Kentucky Racing Commission. Reported and paid within 30 days of end of each race meeting. An annual recapitulation report is due on or before December 31 each year for the race year ended November 30.
Average Daily Mutuel Handle (for preceding year)	Tax Rate Per Day																		
\$ 0 — \$ 25,000	\$ 0																		
25,001 — 250,000	175																		
250,001 — 450,000	500																		
450,001 — 700,000	1,000																		
700,001 — 800,000	1,500																		
800,001 — 900,000	2,000																		
900,001 and above	2,500																		
(2) Admission Tax	(2) KRS 138.480 et seq., 139.100(2)(c)	(2) Tracks under jurisdiction of the Kentucky Racing Commission 15 cents/person	(2) Excise tax on each paid admission to race track. There are statutory exemptions. Reported and paid within 30 days of end of each race meeting. Race track admission tax is in lieu of sales tax.																

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 2002)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
<p>Racing Taxes: (continued)</p> <p>(3) Pari-Mutuel Tax</p>	<p>(3) KRS 138.510 et seq.</p>	<p>(3) 3.5 percent of total wagered at all thoroughbred tracks under Kentucky Racing Commission jurisdiction with average daily handle of \$1.2 million or more; 1.5 percent if average daily handle is less than \$1.2 million.</p> <p>3.75 percent of total wagered at all standardbred tracks under Kentucky Racing Commission jurisdiction with average daily handle of \$1.2 million or more; 1.75 percent if average daily handle is less than \$1.2 million.</p> <p>3 percent of telephone account wagering and the total wagered at "receiving" tracks.</p> <p>For fiscal year ending 6/30/2002, tracks with an average daily handle of \$1,200,000 or more are allowed a tax credit of \$12,000 per racing day.</p> <p>For fiscal year ending 6/30/2002, tracks with a total handle on live racing of \$250,000 or less pay 2 percent on telephone account wagering, intertrack wagering, and simulcasts.</p>	<p>(3) Excise tax is imposed on every person, corporation or association which operates a horse race track at which betting is conducted.</p> <p>Excise tax is also imposed on receiving tracks participating in intertrack wagering on simulcast races.</p> <p>Average daily handle is computed from the amount wagered at the host track, excluding money wagered at receiving tracks and all telephone account wagering.</p> <p>A portion of the pari-mutuel tax is allocated to the following:</p> <ul style="list-style-type: none"> • Equine Drug Research • Equine Industry Program • Higher Education Equine Trust and Revolving Fund • Thoroughbred Development Fund • Standardbred, Quarterhorse, Appaloosa and Arabian Development Fund <p>Reported and paid weekly.</p>
<p>Rural Cooperative Annual Tax</p>	<p>KRS 279.200, 279.530</p>	<p>\$10.</p>	<p>Annual payment by corporations (RECCs and RTCCs) formed under KRS Chapter 279 in lieu of certain taxes.</p>
<p>Sales and Use Taxes</p>	<p>KRS 139.010 et seq.</p>	<p>Sales tax 6 percent</p> <p>Use tax 6 percent</p>	<p>Sales tax is imposed on the retailer for the privilege of making retail sales of tangible personal property or taxable services within Kentucky.</p> <p>Use tax is imposed on the use, storage or other consumption in the state of tangible personal property purchased for use, storage or other consumption in this state.</p> <p>Use tax is imposed on construction machinery and equipment brought into this state for the purpose of making improvements to real property.</p> <p>There are statutory exemptions.</p>
<p>Waste Tire Fee</p>	<p>KRS 224.50-868</p>	<p>\$1 per tire sold at retail.</p>	<p>Applies to the retail sale of new motor vehicle tires sold in Kentucky. Does not apply to new cars brought into the state for sale or use. Sales of recapped tires are exempt from the fee.</p>
<p>Withholding (Individual Income Tax)</p>	<p>KRS 141.010 et seq.</p>	<p>Deduction from salaries or wages based upon formula or tax tables.</p>	<p>Employers are required to withhold individual income tax from payment of wages or salaries each pay period. Withholding tables and formulas are provided for common pay periods.</p>

KENTUCKY TAXPAYER SERVICE CENTERS



Ashland, 41101-7670

134 Sixteenth Street
Telephone: (606) 920-2037
Fax: (606) 920-2039

Bowling Green, 42104-3278

201 West Professional Park Court
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Central Kentucky

200 Fair Oaks Lane, First Floor
Frankfort, 40620
Fax: (502) 564-8946

Corbin, 40701-6188

15100 North US25E
Suite 2
Telephone: (606) 528-3322
Fax: (606) 523-1972

Frankfort, 40620

200 Fair Oaks Lane, Second Floor
Taxpayer Assistance Branch
Telephone: (502) 564-4581
Fax: (502) 564-3685

Hopkinsville, 42240

181 Hammond Drive
Telephone: (270) 889-6521
Fax: (270) 889-6563

Louisville, 40202-2446

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Suite 102
Telephone: (502) 595-4512
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Turfway Ridge Office Park
7310 Turfway Rd., Suite 190
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Fax: (270) 687-7244

Paducah, 42001-4024

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Clark Business Complex, Suite G
Telephone: (270) 575-7148
Fax: (270) 575-7027

Pikeville, 41501-1275

Uniplex Center, 126 Trivette Drive, Suite 203
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Fax: (606) 433-7679