STREAMLINING KENTUCKY’S SALES TAX CODE–PART III

This issue is the third in a series highlighting the upcoming changes to Kentucky’s sales and use tax law resulting from the Streamlined Sales and Use Tax Act. Previous editions of Kentucky Sales Tax Facts in April and May 2004 covered additional aspects of this historic legislation. You may access all three of these articles as well as other materials regarding the Streamlined Sales Tax Project (SSTP) at www.revenue.ky.gov. The SSTP was organized in March of 2000 with a wide range of participation from state and local tax administrators, state and local government representatives, and private industry groups. On November 12, 2002, 30 states, including Kentucky and the District of Columbia approved the Streamlined Sales Tax Agreement (SSTA). During the 2003 legislative session, the Kentucky General Assembly enacted HB 293 to conform to the uniform standards of the SSTA. The goal of this project is to simplify and modernize sales and use tax collection and administration so that Main Street merchants as well as remote sellers can more easily comply with the multiple tax requirements of various states. There are now 42 states actively participating in this effort. We anticipate full implementation of the SSTA in early 2005. The changes in Kentucky law discussed below will take effect July 1, 2004.

Delivery Charge Transition Rules

Beginning July 1, 2004, the meaning of sales price under KRS 139.050 will change to include all delivery charges that are part of a retail sale (see Kentucky Sales Tax Facts, April 2004, for general discussion). Under the amended statute, delivery charges means charges by the retailer for the preparation and delivery to a location designated by the purchaser including transportation, shipping, postage, handling, crating, and packaging. Any delivery charges made by or on behalf of the seller of taxable tangible personal property will be taxable regardless of how the delivery charges are billed.

In order to ease the implementation of this new law, the Department of Revenue offers the following transitional rule for sales of construction materials made to contractors who have entered into a bona fide written lump-sum or fixed-price construction contract that meets the requirements described above.

To qualify for this transitional treatment, contractors must provide their suppliers with a signed statement indicating the following:

- The contractor’s name, address, and Kentucky consumer’s use tax account number (if number is assigned).
- The name and address of the party contracting for the construction project.
- The name and location of the project, the contract number, and the date of the contract.
- A statement that the materials are for use by the contractor under a lump-sum or fixed-price construction contract that does not provide for allocation of future taxes.

Vendors must retain this documentation as proof of an exempt delivery transaction on the same basis as other sales records according to the provisions of KRS 139.720. When filing their sales tax returns for tax periods on or after July 1, 2004, vendors must not claim the freight and delivery deduction. This deduction is no longer valid because of the statute change. To claim a deduction for delivery charges for construction materials purchased by contractors to fulfill qualifying contracts described above, vendors should place the delivery charge on line 19 of the worksheet and use code 190 for the deduction on the return. Vendors should designate the code 190 deduction as delivery transition rule.

Delivery Charge Examples

To understand these examples, remember that under current law shipping charges are generally taxable if the actual seller of the taxable product makes the delivery. Beginning July 1, 2004, shipping charges for taxable products for which the seller is responsible are taxable regardless of who performs or bills for the delivery. Any delivery charges for which the seller is responsible are a condition of the sale and part of the sales price as defined in the amended version of KRS 139.050. Also, keep in mind that delivery charges for nontaxable items are not taxable.

1. A furniture store sells a sofa and hires a common carrier to deliver the product to the customer. The delivery charges billed to the purchaser of the sofa on July 1, 2004, forward become taxable as part of the sales price.

2. A business buys new office equipment. The buyer independently hires a third-party trucking company to pick up and deliver the office furniture to the Kentucky location. The trucking company
bills the equipment buyer directly. The delivery charges in this transaction are exempt because they are not part of the sales price.

3. A supplier of construction materials delivers its products to customers in its own trucks. In most cases, these delivery charges are currently taxable, and they will continue to be taxed after July 1, 2004. If the construction material supplier forms a separate transportation company to deliver its products, the delivery charges of the transportation company to the customer may still be part of the taxable sales price. For the delivery charges from the transportation company to be exempt, the customer must exercise the option to directly hire the transportation service of its choice. If the newly formed transportation company has exclusive rights to deliver its related party’s products, then its delivery charges are considered a condition of the sale of construction materials and part of the sales price.

4. A grocery store sells and delivers food and nonfood items to a customer. If there is one delivery charge covering a transaction that includes the sale of taxable and nontaxable products, then the entire delivery charge is taxable. There is no provision within the definition of sales price to exclude any portion of the bundled delivery charge covering both taxable and nontaxable products. Of course, if the charge is only for delivery of nontaxable food items, then the delivery charge is also exempt.

5. Examples of a seller’s nontaxable delivery charges include the following charges for delivery of:
   a. products to customers outside Kentucky unless the customer takes possession of the property in this state prior to delivery out of state;
   b. products covered under a valid exemption or resale certificate;
   c. exempt property such as prescription drugs, prosthetic devices, school textbooks, etc.;
   d. property purchased under the terms of a direct pay permit as provided in Regulation 103 KAR 31:030.

Please note that taxable delivery charges must be included when the direct pay holder reports taxable purchases and remits the applicable tax.

Sourcing Issues

The May 2004 edition of Kentucky Sales Tax Facts provided a general discussion of sourcing rules that provide guidelines so that retailers can determine the correct state’s tax to charge. The sourcing of a sale to Kentucky generally depends upon the purchaser taking possession of the product in this state. Under current provisions of the law, transactions are not exempt sales in interstate commerce if an out-of-state buyer arranges for the delivery of products purchased from a Kentucky vendor to an out-of-state location. In these types of arrangements, the delivery company hired by the out-of-state purchaser is considered the purchaser’s representative. When the shipping company as the purchaser’s representative receives the product in Kentucky, the transaction is consummated here and sales tax is applied accordingly. The only exceptions to this rule are those provided by statute. For example, under KRS 139.470(13) there is an exemption for the sale of newspaper inserts and catalogs to an out-of-state buyer even when the buyer hires the common carrier to make delivery of the product out of state.

However, with the adoption of the new SSTA sourcing rules on July 1, 2004, receiving the product in Kentucky will not include possession by a shipping company on behalf of the purchaser located out of state. For example, if a shipping company on behalf of an out-of-state purchaser takes possession of the product and delivers the product to the purchaser out of state for use, the product will not be considered as received in Kentucky. However, note that this change does not affect transactions where the purchaser or purchaser’s representative makes the purchase in Kentucky before arranging for delivery to an out-of-state location. If the purchaser or his representative buys the product at the seller’s location, then the transaction will be sourced as an over-the-counter sale taxable in Kentucky.

Prepared Food Definition

For a general overview of the food definitions that become effective on July 1, 2004, under the Streamlined Sales Tax Act, see the May 2004 edition of the Kentucky Sales Tax Facts. Excluded from the definition of food and food ingredients is the taxable category of prepared food. Under the revised version of KRS 139.482, items sold with eating utensils provided by the seller, sold in a heated state or heated by the seller, or two or more food ingredients mixed or combined by the seller for sale as a single item are taxable as prepared food. However, meats or other food that the seller only slices, repackages, or pasteurizes and that generally require cooking before eating are not taxable prepared foods unless sold with eating utensils provided by the seller.

Based upon the prepared food definition, food sold by businesses that sell meals such as restaurants, caterers, sandwich shops, snack bars, concession stands, coffee shops, and other eating establishments are taxable. However, the definition excludes bakery items such as bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, danishes, cakes, tortes, pies, tarts, muffins, bars, cookies, and tortillas unless sold with eating utensils provided by the seller. All of these items sold as a meal are taxable regardless of where the customer eats.

In order for eating establishments that sell food suitable for consumption on or off the premises to claim the food exemption for bakery goods, the seller must maintain adequate accounting records to distinguish sales of bakery goods with eating utensils and sales of bakery goods without eating utensils. These businesses must also provide information on invoices, cash register receipts, or sales tickets that clearly show that a sale was for food items that are not served with eating utensils. For example, the burden of proof will be upon the restaurant to distinguish the sale of a taxable piece of pie from the sale of an entire pie. The first item is generally served with eating utensils while the whole pie is not.

Review the changes to the Kentucky tax code as discussed in this series of articles to determine how the new laws will affect your business. Make any adjustments necessary in your accounting and other business practices to conform to the requirements that take effect July 1, 2004. If you need further assistance with any of these topics, contact the Department of Revenue, Sales and Use Tax Branch at (502) 564-5170 or via e-mail at KRCWebResponseSalesTax@ky.gov.

This newsletter is intended to provide practical information to assist persons in fulfilling their sales and use tax obligations to the commonwealth. To submit additional questions or suggestions for future topics, please write to: Kentucky Sales Tax Facts, Sales and Use Tax, Station 53, P.O. Box 181, Frankfort, KY 40602-0181 or call (502) 564-5170, fax (502) 564-2041, Web site www.revenue.ky.gov.

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