

Kentucky Tax Alert

A REVENUE PUBLICATION FOR THE TAX PROFESSIONAL

November 2004 Vol. 23, No. 5

In This Issue

- 2005 Standard Deductions.....2
- Holiday schedule.....2
- Court Case Updates.....2-4
- Income Tax Forms Requisition.....5-6

Employers Encouraged to Release W-2/K-2s Early



In an effort to speed the issuance of individual income tax refunds, employers are encouraged to release Employee's Wage and Tax Statements, Forms W-2/K-2, at the earliest possible date.

This allows taxpayers to file their income tax returns earlier, thereby avoiding backlogs and delay of refunds. Fewer returns are filed at the beginning of the tax season than near the April 15 deadline. By increasing the number of tax returns filed early, refunds can be processed more efficiently.

Estimated Tax Payment Deadlines



Individual income taxpayers are reminded that final 2004 quarterly estimated tax payments are due on Jan. 17, 2005. Final 2004 estimated corporation income tax payments of 25 percent are due on Dec. 15, 2004.

Taxpayers who have not yet made their April 15, June 15, or Sept. 15, 2004 estimated payments should submit those payments on or before Jan. 17, 2005 to minimize underestimation penalties.

Importance of Using Correct Corporation Account Numbers

Using the correct **Kentucky corporation income and license account number**, along with the correct federal identification number, enables DOR to operate efficiently and minimizes unnecessary contacts with the taxpayer. Without the correct account number, document processing is delayed, payments are posted incorrectly and/or delinquency notices are generated. Also, during initial document processing, if the corporation cannot be properly identified, a new and separate **Kentucky corporation income and license account number** may be issued to the corporation, resulting in duplicate account numbers.



Upon registering with DOR, corporations receive correspondence notifying them of the specific tax account numbers (corporate, sales, withholding, etc.) issued to the corporation. The **Kentucky corporation income and license account number** should always be included on all documents related to corporation income and license tax that are submitted to DOR to ensure proper handling.

DOR Sets 2005 Tax Interest Rate At 5 Percent

Pursuant to KRS 131.183(1), the 2005 tax interest rate charged by the Kentucky Department of Revenue (DOR) on unpaid and delinquent taxes has been set at 5 percent. Where applicable, the same rate is paid on refunds issued by DOR.

The rate, effective Jan. 1, 2005, through Dec. 31, 2005, is based on the prime rate charged by Kentucky banks during October 2004. A recent survey of Kentucky banks showed that the average prime interest rate in October was 4.75 percent, which was rounded to the nearest whole percent, 5 percent.

2005 Tax Year Pension Exclusion, Standard Deduction Increased

Kentucky's individual income tax pension exclusion for the 2005 tax year is increasing to \$41,110. This exclusion applies to tax returns due April 15, 2006, and takes effect on January 1, 2005.

Retirees who make quarterly estimated Kentucky individual income tax payments should take this revised pension exclusion into effect when calculating their quarterly payments for 2005. The first payment is due on April 15, 2005.

For the 2004 tax year, for which returns are due on April 15, 2005, the pension exclusion is \$40,200.

The revision is made pursuant to KRS 141.0105, which requires DOR to adjust the exclusion annually for inflation.

Additionally, Kentucky's standard deduction for individual income tax increases from \$1,870 to \$1,910 for the 2005 tax year as authorized by KRS 141.081(2). Taxpayers who do not itemize deductions on their individual income tax return are entitled to claim the standard deduction.

The withholding tax tables effective for pay periods ending on or after Jan. 1, 2005, may be viewed at http://revenue.ky.gov/withholding_info.htm.

Kentucky Tax Alert is a bimonthly publication printed on recycled paper, the cost of which is paid from state funds. Comments, suggestions and mailing list additions or corrections should be addressed to the Office of Public Information, Finance Secretary's Office, Frankfort, Kentucky (502) 564-4240.

ERNIE FLETCHER, Governor

**ROBBIE RUDOLPH, Secretary
Finance and Administration Cabinet**

**MARK TREESH, Commissioner
Department of Revenue**

Editor *Jill Midkiff*
Production/Design *Jo Ann Smith*
Publications Coordinator *Sarah Gilkison*

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

The Department of Revenue can be found at www.revenue.ky.gov.

Court Case Updates



Income Tax—On Aug. 30, 2004, the Jefferson Circuit Court entered an order granting the DOR's motion for summary judgment in *Davis v. Revenue Cabinet*, 03-CI-03282. In this case, the plaintiffs asserted

that Kentucky's income taxation of the interest from bonds issued by other states and their obligations violated the Equal Protection and Commerce Clauses of the United States Constitution due to Kentucky's exemption from taxation of the interest from its bonds and bonds issued by its political subdivisions. The circuit court's Aug. 30, 2004, order agreed with the DOR that the provisions of the Kentucky income law challenged by the plaintiffs in this case are constitutional.

This decision is not yet final. The plaintiffs have appealed it to the Court of Appeals.

Property Tax—On Oct. 15, 2004, the Kentucky Court of Appeals ruled in *American Life & Accident Insurance Company of Kentucky, Inc. v. Revenue Cabinet*, 2003-CA-001802 that the DOR properly denied the



taxpayer's refund claims as untimely under KRS 134.590. These claims sought refunds of taxes paid by the taxpayer pursuant to KRS 136.320, which imposes an annual tax upon domestic life insurance companies based upon the fair cash value of their taxable capital and reserves.

The refund claims were based upon the taxpayer's contention that stock it owned in other corporations should be removed from its capital in the computation of its tax liability. This contention relied upon the Kentucky Supreme Court's *St. Ledger* decision, which held that Kentucky's general intangible ad valorem taxation of stock of companies that did not pay property tax on 75 percent or more of their property, while exempting the stock of companies that did, discriminated against interstate commerce in violation of the U.S. Constitution's Commerce Clause. The tax imposed by KRS 136.320 incorporated the same discriminatory exemption (KRS 136.030(1)) found to be unconstitutional in *St. Ledger*.

The Court of Appeals held that the refund statute KRS 134.590 applied to the taxpayer's re-

Court Case Updates (cont.)

fund claims because the tax imposed by KRS 136.320 is an ad valorem tax. Because it concluded that the tax in question is an ad valorem tax, the Court of Appeals did not need to address the question of whether KRS 134.590 applied because the refund claims were based upon the unconstitutionality of a statutory provision. KRS 134.590 requires that refund claims be submitted within two years of the payment of the taxes for which the refund was sought. None of the taxpayer's refund claims were timely under this statute and accordingly, the DOR correctly denied them.

The taxpayer nevertheless argued that it sought to equitably recoup or credit the amounts of these refund claims against its future years' tax liabilities. It relied upon an individual income tax policy, Revenue Policy 42P010, for this contention.

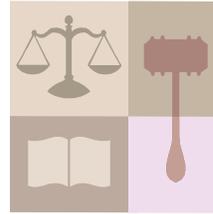
The Court of Appeals rejected this argument, holding that the case law was determinative of the question presented and not a revenue policy. This case law establishes that equitable recoupment, if it applies at all in Kentucky, is allowed only where the government has taxed a single transaction, item or taxable event under two inconsistent theories. This situation was not present in this case and therefore the doctrine of equitable recoupment was inapplicable.

This decision is not yet final. The taxpayer has petitioned the Court of Appeals for a rehearing.

In *Comcast Cablevision of the South v. Revenue Cabinet*, 2003-SC-001007, the Kentucky Supreme Court denied the taxpayer's motion for discretionary review on Nov. 10, 2004. In this case, the Court of Appeals had ruled that the DOR properly valued the taxpayer's operating property in making a public service corporation property tax assessment. The Court of Appeals rejected the taxpayer's argument that a portion of the value of this property could be carved out and characterized as nonoperating property. The DOR's assessment represented what a willing buyer would pay and a willing seller would accept for the operating property making up taxpayer's cable television system as of the relevant assessment dates. This operating property included both the taxpayer's tangible property and its franchise— i.e., the earning value ascribed to the taxpayer's capital by virtue of its operation as a cable television service provider. The taxpayer also did not report and did not identify any property that was

not used in its cable television system and thus could be considered nonoperating property.

By virtue of the denial of the taxpayer's motion for discretionary review, the Court of Appeals' decision is now final.



On Nov. 10, 2004, the Kentucky Supreme Court denied the taxpayer's motion for discretionary review in *Pipefitters Joint Educational and Training Fund v. Revenue Cabinet*, 2004-SC-000282. In this case,

the Court of Appeals had upheld the DOR's denial of the taxpayer's claim that it was exempt from property tax as an "institution of education not used or employed for gain by any person or corporation, and the income of which is devoted solely to the cause of education." The Court of Appeals ruled that the institution operated by the taxpayer was geared toward the pipefitters trade and primarily intended to promote union membership. Thus, the taxpayer did not satisfy the requirements set forth by this state's highest court in *Kesselring v. Bonnycastle Club*, 299 Ky. 585, 186 S.W.2d 402 (1945) that to be exempt as an educational institution, an organization must provide a benefit to the public and not be used or employed for gain and give systematic instruction in any or all of the useful branches of learning by methods common to schools and institutions of learning.

By virtue of the Supreme Court's denial of the taxpayer's motion for discretionary review, the Court of Appeals' decision is now final.

Sales and Use Tax—The Campbell Circuit Court entered an order on Aug. 3, 2004, in *Griffin Industries, Inc. v. Revenue Cabinet*, 04-CI-0002, affirming a Kentucky Board of Tax Appeals decision in the DOR's favor. The circuit court upheld a sales and use tax assessment of \$99,648.31, rejecting the taxpayer's assertion of the exemption contained in KRS 139.480(23) for "[m]achinery or equipment purchased or leased by a business, industry or organization in order to collect, source, separate, compress, bale, shred, or otherwise handle waste materials if the machinery is primarily used for recycling purposes."

The circuit court determined that the "[t]he record reflected that there was sufficient evidence

Court Case Updates

for the KBTA to find that [the taxpayer] act[ed] in separate capacities as both a recycler and a manufacturer.” Specifically, the taxpayer “act[ed] as a recycler in its collection of waste material and its delivery of this waste material to its plant” and it “act[ed] as a manufacturer when it [took] the waste material, process[ed] it, add[ed] other materials to the processed waste and produce[d] a final finished product that [was] marketed and sold to consumers.” The court noted the parties’ agreement that the taxpayer’s “purchases of equipment or machinery used in the **collection** of waste materials, [and] separating, compressing, bailing or shredding of the waste material are not taxed since they are exempt” under the recycling exemption provided by KRS 139.480(23).

To be exempt under KRS 139.480(23), the machinery in question must be “primarily used for recycling purposes.” Before the KBTA, “[t]here was testimony that once the waste material arrives at the [taxpayer’s] rendering plants it becomes a raw material which is acted upon by [the taxpayer in] producing a final finished product.” The circuit court therefore held that there was sufficient evidence to support the KBTA’s determination that the machinery at the taxpayer’s rendering plant was used for manufacturing, not recycling, and that the KBTA accordingly applied the law correctly in ruling that the exemption did not apply.

The circuit court further held that the KBTA was correct in ruling that the exemption in question did not apply to repair and replacement parts for machinery used in its collection of waste materials. The court ruled that “a repair or replacement part is not a ‘machine’ and does not fall within the meaning of KRS 139.480(23) or the common understanding of the term ‘machine.’”

This decision is not yet final. The taxpayer has appealed to the Court of Appeals.

On Sept. 9, 2004, the Franklin Circuit Court entered an opinion and order in *Revenue Cabinet v. King Drugs, Inc.*, 03-CI-00550, reversing a KBTA decision that had set aside a sales and use tax assessment for purchases of various medical supplies. These medical supplies included C-Paps, TENS devices, heating pads, mattresses, trapeze bars, commode chairs, humidifier, nebulizers, canes, ventilators, suction machines, pressure pads, CPM

machines, C-Pap supplies, catheters, IV pumps, IV poles, bandages, a milk bag, cups, ileostomy supplies, masks, containers and urostomy supplies.

The taxpayer successfully argued before the KBTA that these medical supplies were exempt under KRS 139.472 as prosthetic devices and physical aids merely because they were artificial devices prescribed by a licensed physician. The circuit court’s Sept. 9, 2004 opinion and order rejects this interpretation. The court rules that reading KRS 139.472 narrowly and as a whole, as the law requires, the exemption this statute provides extends only to artificial devices prescribed by a licensed physician solely for the use of a particular crippled person so as to become a brace, support, supplement, correction or substitute for the bodily structure, including the extremities.

This decision is not yet final. The taxpayer has appealed it to the Court of Appeals.

In *Open MRI, LLC v. Revenue Cabinet*, 03-CI-1413, the Franklin Circuit Court entered an opinion and order on Sept. 20, 2004 that affirmed an earlier KBTA decision in the DOR’s favor. The taxpayer contended that the production of detailed images of the human body by its magnetic resonance imaging (MRI) equipment constituted manufacturing that entitled it to take advantage of 1) the sales and use tax exemption for machinery for new and expanded industry (KRS 139.480(10) and 139.170); and 2) the ad valorem exemption from local taxation and reduced state tax rate for “machinery actually engaged in manufacturing” (KRS 132.200(4) and 132.020(10)). The circuit court agreed with the KBTA that the taxpayer was engaged in the rendition of a professional medical diagnostic service and not manufacturing.

This decision is now final. The taxpayer did not appeal further.

DOR Offices Closed for Holidays

Pursuant to KRS 18A.190, all DOR offices will be closed Thursday and Friday, Nov. 25 and 26, in observance of Thanksgiving; Friday and Monday, Dec. 24 and 27, in observance of Christmas; and Friday and Monday, Dec. 31 and Jan. 3, in observance of New Year’s Day. Normal hours will resume on Tuesday, Jan. 4, 2005.

**KENTUCKY INCOME TAX
FORMS REQUISITION**

**FROM: Department of Revenue
Frankfort, KY 40620**

The label at right will be used to mail your forms. **Do not detach.**
Please prepare a duplicate address below for our files.

Name _____
Street _____
City, State _____
and ZIP _____
Phone (____) _____
Date Ordered _____

TO: Name _____
Street _____
City, State _____
and ZIP Code _____

Check one: Individual Attorney CPA Tax Practitioner Other _____

Package K (contains all individual, fiduciary, partnership, corporation and S corporation income tax forms, schedules and instructions) Quantity **▶**

FORMS	I	N	C	S	ISSUANCE NO.	QUANTITY
740—Kentucky Individual Income Tax Return					42A740	*
740/740-EZ—Instructions					42A740-S11	
740-EZ—Kentucky Individual Income Tax Return					42A740-EZ	*
740-X—Amended Kentucky Individual Income Tax Return					42A740-X	
740-NP—Nonresident or Part-Year Resident Income Tax Return					42A740-S9	
Schedules A & ME (740-NP)—Itemized Deductions/Moving Expense and Reimbursement					42A740-S9 (A & ME)	
740-NP Packet					42A740-S10	
740-NP-R—Nonresident Income Tax Return—Reciprocal State					42A740-S9-R	
740-ES—2005 Estimated Tax Voucher					42A740-ES	*
740-ES—Instructions					42A740-S4	
Schedule A (740)—Itemized Deductions					Schedule A	*
Schedule J—Kentucky Farm Income Averaging					42A740-J	*
Schedule M—Kentucky Federal Adjusted Gross Income Modifications					42A740-M	*
Schedule P—Pension Income Exclusion					42A740-P	*
Schedule TC—Tax Computation Schedule					42A740-TC	*
Schedule UTC—Unemployment Tax Credit					42A740-UTC	*
1045-K—Kentucky Net Operating Loss Application for Income Tax Refund					42A740-S20	*
1045-K—Instructions					42A740-S20(I)	
2210-K—Underpayment of Estimated Tax by Individuals					42A740-S1	*
4972-K—Kentucky Tax on Lump-Sum Distributions					42A740-S21	*
8453-K—Kentucky Individual Income Tax Declaration for Electronic Filing					42A740-S22	
740-V—Kentucky Electronic Payment Voucher					42A740-S23	
8582-K—Kentucky Passive Activity Loss Limitations					42A740-S18	*
Application for Extension of Time to File Return (Individual, Partnership, Fiduciary)					40A102	

**Forms shaded and marked with an asterisk(*) are provided at no charge.*

Total Forms—Page 1	
Total Forms—Page 2	
Total Forms Provided at No Charge	-
Total Forms	▶

Package K _____ x \$6.00 (each additional \$5.00)

Total Forms _____ x \$ _____ each (see Forms Cost Schedule below) .

Envelopes _____ x \$3.50 per group of 100

Subtotal

Sales Tax (6%) (Kentucky residents only)

TOTAL **▶**

1 – 24	NC
25 – 74	\$.09 each
75 – 100	.07
101 – 200	.06
201 – 500	.05
over 500	.04

Make check payable to: Kentucky State Treasurer
Mail order form and check to: Kentucky Department of Revenue
FORMS
P.O. Box 518
Frankfort, Kentucky 40602-0518

FORMS	ISSUANCE NO.	QUANTITY
Kentucky Individual Income Tax Installment Agreement Request	12A200	
741—Kentucky Fiduciary Income Tax Return	42A741	
741—Instructions	42A741(I)	
741-D—Capital Gains and Losses	42A741-D	
Schedule K-1 (741)—Beneficiary's Share of Income, Deductions, Credits, etc.	42A741 (K-1)	
765—Kentucky Partnership Income Return	42A765	
765—Instructions	42A765(I)	
Schedule K-1 (765)—Partner's Share of Income, Credits, Deductions, etc.	42A765 (K-1)	
720—Kentucky Corporation Income and License Tax Return	41A720	*
720—Instructions	41A720(I)	
720S—Kentucky S Corporation Income and License Tax Return	41A720S	*
720S—Instructions	41A720S(I)	
Schedule K-1 (720S)—Shareholder's Share of Income, Credit, Deductions, etc.	41A720S (K-1)	*
720X—Amended Kentucky Corporation Income Tax and Corporation License Tax Return	41A720X	
720ES—Corporation Estimated Income Tax Voucher	41A720ES	*
720ES—Instructions	41A720-S4	
Schedule A (720)—Apportionment and Allocation	41A720A	*
Application for Extension of Time to File KY Corporation Income and License Tax Return	41A720SL	*
Schedule EZC—Kentucky Enterprise Zone Tax Credit	41A720EZC	*
Schedule HH—Housing for Homeless Families Deduction	41A720HH	*
Schedule QR—Qualified Research Facility Tax Credit	41A720QR	*
Schedule QR (K-1)—Pro Rata/Distributive Share of Approved Qualified Research Facility Tax Credit	41A720QR (K-1)	*
Schedule RC—Application for Income Tax Credit for Recycling and/or Composting Equipment	41A720RC	*
Schedule RC(C)—Continuation Sheet for Schedule RC	41A720RC(C)	*
Schedule RC (K-1)—Pro Rata/Distributive Share of Recycling Equipment Tax Credit	41A720RC (K-1)	*
722—Election to File Consolidated Kentucky Corporation Income Tax Return	41A722	*
851-K—Kentucky Affiliations and Payment Schedule	41A851-K	*
PTE-WH—Kentucky Nonresident Income Tax Withholding on Net Income Distributive Share Income	40A200	
740NP-WH—Kentucky Nonresident Income Tax Withholding on Net Distributive Share Income Transmittal Report	40A201	
Total Forms—Page 2 (enter here and on page 1)		➤
ENVELOPES (Available in groups of 100 only)		
Refund 6" x 9" Blue —Enter number of groups here and on page 1		➤
Payment 6" x 9" Yellow—Enter number of groups here and on page 1		➤

**Forms shaded and marked with an asterisk(*) are provided at no charge.*

 <p>KENTUCKY IRS e file CLICK, ZIP, FAST ROUND TRIP</p>	<p><i>Have you seen our Web page?</i></p> <ul style="list-style-type: none"> ➤ Forms ➤ Instructions ➤ and a Whole Lot More! <p style="text-align: center;">www.revenue.ky.gov</p>
<p>Electronic Filing—It's to your advantage! Choose one of these easy methods!</p> <ul style="list-style-type: none"> ➤ Federal/State Electronic Filing ➤ Federal/State Online Filing 	