



Kentucky Tax Alert



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Sales and Use Tax Reminder

All sales and use tax filers, whether monthly, quarterly, or annual, are reminded to completely and correctly report and remit Kentucky sales and use tax. To reduce the possibility of a tax underpayment or overpayment, KRC requests that you review the following tips for filing sales and use tax returns.

Retailers (Forms 51A102, 51A103)

- Include total receipts, including tax, in line 1.
- Make sure numerals are complete and legible in the appropriate dollars and cents boxes.
- Itemize deductions on lines 2 through 19 (codes 020 through 190) to equal the total deductions entered on line 20. (Total deductions on line 20 may not exceed total receipts on line 1.)
- Remember to compute taxable receipts on line 22 by dividing line 21 by 1.06 to remove the sales tax prior to calculation of the sales tax.
- Report total purchases subject to use tax on line 23a.
- Credits taken on line 28 can only be used if pre-approved by KRC.
- **Double-check** your math computations.
- To file a no activity return, write zero in lines 1, 20, and 23a and sign the signature block.

Consumers (Form 51A113)

- Make sure numerals are complete and legible in the appropriate boxes.
- **Double-check** your math computations.

Vendor Compensation

Effective July 1, 2003, through June 30, 2004, the amount paid to a vendor for the collection of sales tax is capped at \$1,500 for each reporting period. The change appeared on the July 2003 return that was due August 20, 2003.

Taxpayers Should Inform KRC of Address Changes

Taxpayers whose addresses changed during the past year should inform KRC of their new address so individual income tax forms are sent to the proper location.

Send address change notifications to Kentucky Revenue Cabinet, 1266 Louisville Road, Frankfort, KY 40601.

Transient Room Tax—Included in Gross Receipts Subject to Sales Tax

The transient room tax imposed under KRS 91A.390 authorizes local government authorities to impose a license tax that must be paid by motels, hotels, inns, and similar accommodations providers based upon a certain percentage (usually 3 percent) of the rent charged for accommodations. The intent of this license tax is to fund tourist and convention commissions and other related tourism activities. The transient room tax constitutes gross receipts subject to sales tax pursuant to KRS 139.050 and does not fall within the exclusion from gross receipts per KRS 139.050(3)(d). Motels, hotels, inns, and other similar accommodations providers that choose to pass this license tax on to their customers as a separate charge must be aware that the license tax charge is considered an increase in the room rate and is part of the business receipts subject to the Kentucky sales tax.

Forms Requisition Order Form Available in November

Form 40A727, Kentucky Income Tax Forms Requisition, will be published in the November issue of *Tax Alert*. This form is expected to be available from KRC's Online Taxpayer Service Center at www.revenue.ky.gov.

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Court Cases Update

Property Tax—In *Anson Stamping Company, LLC v. Revenue Cabinet*, K01-R-37, the Kentucky Board of Tax Appeals (KBTA) granted summary judgment on June 20, 2003, upholding KRC's intangible personal property tax assessment for the taxpayer's accounts receivable. The taxpayer had not listed the accounts receivable for ad valorem taxation, arguing that it should be allowed to offset the values of its accounts receivable with its accounts payable and that since the amount of the accounts payable exceeded the accounts receivable, the accounts receivable had no value.

The KBTA held that the Kentucky Constitution requires that all property be assessed for ad valorem purposes at its fair cash value, estimated as the price the property would bring at a fair voluntary sale. No reduction is permitted from fair cash value for outstanding debts, liens, or other encumbrances. The Kentucky Constitution makes no distinction between intangible property and other forms of property. The KBTA observed that “[r]educing the amount of an asset account by offsetting the amount of a liability account does not accurately reflect the fair cash value of the property any more than reducing a house's value by the amount of the mortgage would accurately reflect the value of the house.”

The KBTA's decision was not appealed and is therefore now final.

In an opinion and order entered on July 24, 2003, in *American Life & Accident Insurance Company of Kentucky, Inc. v. Revenue Cabinet*, 99-CI-2316, the Jefferson Circuit Court upheld KRC's denial of the taxpayer's refund claims for taxes paid pursuant to KRS 136.320, which relates to domestic life insurance companies. The refund claims were based upon the taxpayer's contention that all stock it owned should be excluded or deducted from its capital for purposes of arriving at the taxable capital subjected to taxation by KRS 136.320.

The legal basis of the taxpayer's contention was the prior ruling of the Kentucky courts in the *St. Ledger* case that KRS 136.030(1) was unconstitutional under the United States Constitution's Commerce Clause. That statute had exempted from the general ad valorem tax imposed by KRS 132.020(1) all stock in corporations that paid Kentucky property taxes on at least 75 percent of their property, wherever located. KRS 136.030(1) was incorporated into KRS 136.320 via its language providing for an exclusion or deduction from capital for “exempt intangible personal property.”

The circuit court ruled that none of the refund claims were timely under KRS 134.590, which provides a two-year time limitation for the submission of refund claims. The taxes imposed by KRS 136.320 were ad valorem taxes, the circuit court ruled, which rendered KRS 134.590 applicable. The taxpayer's refund claims were untimely and barred by KRS 134.590 because none of them had been submitted within two years of the payment of the taxes whose refund was sought.

The court noted that KRS 134.590 also applies to refunds of taxes paid under an unconstitutional statute. It further observed that the taxpayer's refund claims were based upon KRS 136.320's suffering from essentially the same constitutional flaw found to exist in *St. Ledger*.

Finally, the circuit court rejected the taxpayer's argument that it could use the doctrine of equitable recoupment and Revenue Policy 42P010 to apply these refund claims against its future years' tax liabilities. The court stated that the doctrine of equitable recoupment has not been expressly adopted by Kentucky courts in tax cases. The court further stated that states have not been unanimous in accepting the application of this doctrine to tax refund matters and of those states that have applied the doctrine, its use has been restricted to situations where a single item has been taxed twice on the basis of inconsistent legal theories, which was not the case here. Revenue Policy 42P010 did not apply to the taxpayer's refund claims because it related to individual *income taxes* and not the tax imposed by KRS 136.320.

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

Health Care Provider Tax—In *Lexington Fayette Urban-County Board of Health v. Revenue Cabinet*, 94-CI-00873, the Franklin Circuit Court held in an opinion and order entered on July 17, 2003, that the Lexington Fayette Urban-County Board of Health (“the Board”) was subject to the health care provider tax. The court observed that this tax was enacted by the General Assembly to be broad-based and to have uniform applicability unless an exception was specifically set forth in the statutes governing the tax.

The court was not convinced that the Board should be treated differently from county boards of health, which were subject to the tax. In any event, the health care provider tax statutes clearly impose the tax upon services provided by, among other entities, any “government unit or agency.”

This case is not yet final. The Board has appealed the circuit court's decision to the Court of Appeals.

In *Episcopal Church Home and Infirmary v. Revenue Cabinet*, K00-R-11 and K00-R-20, the KBTA upheld KRC's denials of health care provider tax refund claims. The taxpayer, a nursing home, was subject to tax because it was a “provider” of “nursing facility services” as those terms are defined by statute.

The KBTA rejected the taxpayer's argument that it was exempt from tax under Section 170 of the Kentucky Constitution as an institution of religion or purely public charity. As the Kentucky Supreme Court held in *Children's Psychiatric Hospital of Northern Kentucky v. Revenue Cabinet*, Ky., 989 S.W.2d 583 (1999), Ky. Const. §170 only applies to property taxes and not to the health care provider tax. The KBTA further held that the taxpayer was not an “institution of religion” under Ky. Const. §170.

The taxpayer has appealed the KBTA's decision to the Franklin Circuit Court.

Sales and Use Tax—In *Morton Buildings, Inc. v. Revenue Cabinet*, 2002-CA-1787, the Kentucky Court of Appeals ruled in an opinion rendered on July 25, 2003, that the taxpayer was subject to use tax for materials it purchased outside Kentucky and used to make building components that were eventually assembled into prefabricated buildings in Kentucky. The court rejected the taxpayer's arguments that the use tax could not apply because

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the materials were purchased and used in the manufacture of building components outside of Kentucky, without any specific intent on the taxpayer's part to use the materials in Kentucky.

The Court of Appeals observed that the purpose of the use tax is to act as a backstop to the sales tax by ensuring that transactions in other states are treated just as if they had taken place in this state and been subjected to the sales tax. The "use" triggering the use tax's application is broadly defined as "the exercise of any right or power over tangible personal property." In this case, the materials in question, in their altered form, were actually used in Kentucky when the taxpayer assembled the building components made up of the materials into prefabricated buildings.

The taxpayer did substantial business in Kentucky, maintaining Kentucky sales offices to sell the prefabricated buildings and constructing at least 700 buildings during the four-year period that was the subject of this case. It was not necessary that the taxpayer knew which particular items ("which two-by-four or bracket") would be used in constructing a building in Kentucky in order for the tax to apply.

Application of the use tax in this case was also supported by Regulation 103 KAR 26:070 §6. The Court of Appeals rejected the taxpayer's argument that this regulation unlawfully enlarged the scope of the taxing statute KRS 139.310, relying upon its previous opinion of *Pete Koenig Company v. Department of Revenue*, Ky. App., 655 S.W.2d 496 (1983). This regulation represents a proper and reasonable clarification of KRS 139.310, the court ruled. Thus, pursuant to KRS 139.310, as interpreted by Regulation 103 KAR 26:070 §6, the materials in question were used in Kentucky by virtue of their incorporation, as part of the building components, into realty located in Kentucky. Use tax therefore applied and KRC therefore acted properly in denying the taxpayer's claim for the refund of the use tax it had paid with respect to the materials in question.

The opinion of the Court of Appeals is not yet final. The taxpayer has filed a motion for discretionary review with the Kentucky Supreme Court.

In *United Parcel Service, Inc. v. Revenue Cabinet*, K99-R-40, at issue was the application of the exemption from sales and use tax provided in KRS 139.480(10) for "[a]ircraft, repair and replacement parts therefore, and supplies, except fuel, for the direct operation of aircraft in interstate commerce and used exclusively for the conveyance of property or passengers for hire." The taxpayer contended that this exemption extended to repair parts and supplies used to repair cargo containers.

These containers, known as unit load devices (ULDs), were used to contain and carry packages the taxpayer transported as part of its business as an air carrier. The ULDs were filled with packages, loaded onto the taxpayer's aircraft, and secured into place on the aircraft by a locking system. The ULDs were removed when the aircraft were converted into passenger planes by the taxpayer. The ULDs were also used to carry packages on trucks. They were also leased to other airlines and the U.S. Post Office.

The aircraft could be flown without the ULDs. The ULDs were therefore not an integral part of the taxpayer's aircraft.

The KBTA ruled that the exemption did not apply in this case. Exemptions from taxation are disfavored and must be strictly construed. For property to be exempt under KRS 139.480(19), the KBTA declared, it must be an aircraft, repair an aircraft, or replace part of an aircraft. The cargo containers in question, or ULDs, were not aircraft or parts of aircraft. The ULDs were used for distributing packages on trucks and moving packages in and out of the taxpayer's distribution center, as well as for storing packages on the taxpayer's aircraft. The fact that the ULDs were required equipment under federal law did not bring them within the terms of the exemption.

Accordingly, the KBTA upheld the assessment at issue in this case. This decision is now final.

In *United Parcel Service, Inc. v. Revenue Cabinet*, K99-R-39, the issue was whether a transaction was a taxable retail sale of tangible personal property or the nontaxable rendition of services.

The taxpayer, an air carrier providing interstate and international air transportation service, acquired dozens of aircraft from airlines around the world. The aircraft maintenance manuals received with the aircraft from the prior owners were "exceedingly voluminous, unwieldy and partially inapplicable" to the taxpayer's operation.

The taxpayer accordingly hired Jana, Inc. to consolidate and revise the manuals and customize them to the taxpayer's air operations. The consolidation and customization of the prior manuals to arrive at the final product involved a word-by-word, paragraph-by-paragraph review of the material by Jana employees consisting of mechanics with airframe and power plant licenses issued by the FAA, retired military personnel off the flight line, and other persons with experience in nearly all aspects of engineering, including knowledge of avionics, electronics and hydraulics.

Upon completion of the revision work, Jana, Inc. placed the revised manual information onto silver masters for delivery to the taxpayer. The silver masters consisted of reels of microfilm containing information to be used by the taxpayer's mechanics to maintain its aircraft in airworthy condition.

The information on each silver master was revised between two and four times a year. When revisions were made, the silver masters were discarded and replaced with new ones.

The KBTA ruled that the transaction between the taxpayer and Jana constituted the nontaxable rendition or provision of services. With a few limited exceptions not applicable to this case, the sales and use tax law is designed to tax sales or purchases (including leases) of tangible personal property and **not** services. The test employed by the KBTA to distinguish between the taxable sale of tangible personal property and the nontaxable performance of services was the "true object" or "essence of the transaction" test. See, e.g., Regulation 103 KAR 28:051 §(1).

The KBTA accordingly set aside the use tax assessment issued by KRC to the taxpayer. The KBTA's decision is final.



University of Kentucky 2003 Income Tax Seminar Schedule

Frankfort Seminar

Nov. 13 and 14
Best Western Parkside Inn
80 Chenault Drive
Frankfort, KY 40601

Grayson Seminar

Nov. 18 and 19
Grayson Conference Center
371 CW Stevens Blvd.
Grayson, KY 41143

Louisville Seminar

Nov. 18 and 19
The Executive Inn West
830 Phillips Lane
Louisville, KY 40209-1387

Lexington #1 Seminar

Nov. 20 and 21
Holiday Inn North
1950 Newtown Pike
Lexington, KY 40511

Hopkinsville Seminar

Nov. 20 and 21
Christian County Extension Center
2850-B Pembroke Rd.
Hopkinsville, KY 42240

Bardstown Seminar

Nov. 24 and 25
Best Western-General Nelson
411 West Stephen Foster Avenue
Nelson Room

Jenny Wiley Seminar

Nov. 24 and 25
Jenny Wiley State Park
75 Theatre Ct.
Prestonsburg, KY 41653

Owensboro Seminar

Dec. 1 and 2
Executive Inn Rivermont
One Executive Blvd.
Owensboro, KY 42301

Northern Kentucky Seminar

Dec. 2 and 3
Boone County Extension Office
6028 Camp Ernst Rd.
Burlington, KY 41005

Bowling Green Seminar

December 3 and 4
Carroll Knicely Conference Center
2355 Nashville Rd.
Bowling Green, KY 42101

Maysville Seminar

Dec. 4 and 5
Mason County Extension Center
800 U.S. Hwy. 68
Maysville, KY 41056

Paducah Seminar

Dec. 8 and 9
J.R.'s Executive Inn Riverfront
One Executive Blvd.
Paducah, KY 42001

Lexington #2 Seminar

Dec. 9 and 10
Holiday Inn North
1950 Newtown Pike
Lexington, KY 40511

Somerset Seminar

Dec. 11 and 12
Center for Rural Development
2292 South Hwy. 27
Somerset, KY 42501-2905

If you have questions or would like additional information, please contact *Carol Eads* at (859) 252-3769 or by e-mail at *ceads@uky.edu*. If you attended last year, you will automatically receive a registration packet in the mail.

Motor Fuels Tax Rates Are Set

For the quarter Oct. 1, 2003, through Dec. 31, 2003, the combined tax rate for the Kentucky variable motor fuels normal tax and "Supplemental Highway User Motor Fuel" is 15 cents per gallon on gasoline and liquefied petroleum gas. The rate is 12 cents per gallon on special fuels.

No adjustment to taxes due will be necessary for gasoline and special fuels held in bulk storage at the beginning of business Oct. 1, 2003.

New Manager at Louisville TSC

Monty Gray, a 28-year employee of KRC, has been named the district manager for the Louisville Taxpayer Service Center (TSC) effective September 1, 2003. Monty has served his entire tenure in this office, with seven of those years operating as supervisor of the field representative staff. He replaces Patrick Clark who retired effective August 31, 2003. The Louisville TSC may be reached at (502) 595-4512.

KRC Offices Closed for Veterans Day

Pursuant to KRS 18A.190, all KRC offices will be closed on Tuesday, Nov. 11, 2003, in observance of Veterans Day.

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Comments, suggestions and mailing list additions or corrections should be addressed to the Public Information and Communication Services Branch, Revenue Cabinet, Station 14, Frankfort, Kentucky 40620, (502) 564-4592.

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