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## ***EXECUTIVE SUMMARY***

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The purpose of a Tax Expenditure Analysis is to quantify and catalog specific tax reductions that have been granted in statute. An item is determined to be a tax expenditure if the tax revenue associated with that item is reduced because of a specific statute.

Direct budgetary expenditures are made by distributing funds actually collected by the Commonwealth, while tax expenditures are made by granting preferential tax treatment that allows the targeted recipient to retain tax dollars that would otherwise be paid in taxes to the Commonwealth.

Direct expenditures are evaluated during each budget cycle, and are approved, adjusted, or rejected during the budget process. Tax expenditures, however, are evaluated and approved only when a statutory adjustment is made. There is no process to revisit or re-evaluate tax expenditures once they are passed and placed within statute without the creation of a Tax Expenditure Analysis.

This report itemizes tax expenditures using multiple displays and assists in a biennial review of the expenditures. The report briefly explains each tax containing tax expenditures and quantifies the amount of potential tax revenue that is foregone because of the statutory implementation of these expenditures.

Tax expenditures function in different ways to accomplish the intended goals. A sales tax exemption almost always results in some product being sold without the sales tax or transaction tax being assessed and collected. The lack of this collection results in a lower net cost to the purchaser and lower revenues to the Commonwealth. An individual income tax exemption will usually result in lower amounts of tax withheld from employees and a correspondingly lower remittance to the Commonwealth. Corporate tax expenditures usually result in lower direct payments from businesses. Tax expenditures cover these and many more taxes. Whatever the expenditure may be and whatever the tax type involved, tax revenues are directly decreased because of these statutory exemptions.

The following list outlines each major tax type containing tax expenditures, with a brief description of the tax and an estimate of the amount of potential tax revenue not collected because of the tax expenditures related to that tax.

*Summary of Tax Expenditures for the Major Taxes*

- ❖ ***Alcoholic Beverage Taxes*** – Various taxes assessed on all types of alcoholic beverages. First assessed in 1936, rates vary significantly based on the type of beverage and the percent of alcohol the beverage contains. The tax is paid by the wholesaler or distributor of the product. For FY05, alcoholic beverage taxes generated \$81.8 million in Kentucky. Tax expenditures within these tax types are estimated at \$1.0 million for FY06.
  
- ❖ ***Cigarette Tax*** – A tax on each pack of cigarettes, it was first assessed in 1936. The rate of tax was three cents per pack. In June 2005, a surtax of 27 cents per pack is assessed, bringing the total tax to 30 cents per pack. The tax is paid by the wholesaler, who purchases stamps to affix to each pack of cigarettes. For FY05, the cigarette tax generated \$33.7 million in Kentucky. Tax expenditures within this tax type are estimated at \$24.5 million for FY06.
  
- ❖ ***Coal Severance and Processing Tax*** – Assessed against the severance (removal) and processing of coal, this tax was first utilized in 1972. The tax is assessed at the rate of 4.5 percent of the gross value of the coal, with a minimum of fifty cents per ton. The tax is assessed against the entity severing or processing the coal. For FY05, this tax generated \$184.4 million; tax expenditures for this tax type are estimated at \$18.1 million for FY06.
  
- ❖ ***Corporation Income and License Taxes*** – Income tax was first assessed in 1936, against the net income attributable to Kentucky. Current rates of tax range from 4 percent to 7 percent of net income for tax years ending prior to January 1, 2007. For tax years beginning on or after January 1, 2007, the rates range from 4 percent to 6 percent. License tax was first assessed in 1906, against capital employed (the combined value of owners' equity accounts and most borrowed monies). For tax years ending on or after December 31, 2005, the license tax is repealed. For FY05, corporation income and license taxes generated \$612.7 million. Tax expenditures for these taxes are estimated at \$416.5 million for FY06.

- ❖ ***Gasoline Tax*** – First levied in 1920, this tax is assessed on gallons of gasoline received in Kentucky. The floor of the gasoline rate is 16 cents per gallon; if the wholesale price rises above \$1.22, the tax rate may also rise. For FY05, this tax generated \$351.1 million; tax expenditures for this tax are estimated at \$10.1 million for FY06.
- ❖ ***Individual Income Tax*** – First imposed in 1936, this tax has been the most productive revenue source in Kentucky. Beginning in 2005, a restructuring of the graduated rates occurred to apply a rate of 5.8 percent to net income over \$8,000 but less than \$75,000 and the top 6 percent rate applies to net income over \$75,000. Additionally, pass-through entities will be taxed at the entity level, further reducing individual income tax receipts. For FY05, this tax generated \$3.0 billion; tax expenditures for this tax are estimated at \$2.9 billion for FY06.
- ❖ ***Inheritance and Estate Tax*** – First adopted in 1906, this tax is assessed against the value transferred from the estates of deceased Kentuckians. The tax rate and the amount subject to tax are based on the “class” of the beneficiary. For FY05, this tax generated \$63.2 million; tax expenditures for this tax are estimated at \$79.0 million for FY06.
- ❖ ***Liquefied Petroleum Gas Tax*** – Implemented in 1960 as a “companion” to the gasoline tax, this tax is assessed on gallons sold. The floor of the tax rate is 16 cents per gallon; if the wholesale price rises above \$1.22, the tax rate may also rise. For FY05, this tax generated \$0.2 million; tax expenditures for this tax are estimate at \$12,000 for FY06.
- ❖ ***Motor Vehicle Usage Tax*** – First assessed in 1936, the current tax rate is 6 percent of the retail price of motor vehicles. Many people think of this tax as a “sales” tax, but the tax is assessed for the privilege of using a motor vehicle upon the public highways of the Commonwealth. As such, the proceeds are deposited in the Road Fund. For FY05, this tax generated \$407.5 million; tax expenditures are estimated at \$90.4 million for FY06.
- ❖ ***Natural Resources Severance and Processing Tax*** – First assessed in 1980, taxes are levied against the gross value of all minerals severed or processed in Kentucky, excluding coal and oil. For FY05, these taxes generated \$43.5 million; tax expenditures are estimated at \$6.3 million for FY06.

- ❖ **Property Taxes** – Kentucky has levied a property tax since becoming a Commonwealth on June 1, 1792. Property is assessed at its fair market value; rates vary depending upon the type of property. For FY05, property taxes generated \$472.6 million; tax expenditures are estimated at \$1.0 billion for FY06.
  
- ❖ **Sales and Use Tax** – The sales and use tax was first levied in its current form in 1960. The tax is collected on retail sales within the state, at a rate of 6 percent of the sales price. For FY05, this tax generated \$2.6 billion; tax expenditures are estimated at \$5.3 billion for FY06.
  
- ❖ **Special Fuels Tax** – This tax includes fuels other than gasoline that are used in motor vehicles. The floor of the special fuels rate is 13 cents per gallon; if the wholesale price rises above \$1.22, the tax rate may also rise. For FY05, this tax generated \$118.3 million; tax expenditures for this tax are estimated at \$53.2 million for FY06.
  
- ❖ **Earmarked Funds** – These items are included for informational purposes only. They have a negative impact on the General Fund, but are technically not a tax expenditure since the tax is still collected from the taxpayer. Identified earmarked funds that are not deposited into the General Fund are estimated at \$34.9 million for FY06.

### *Summary of Tax Expenditures By Program*

New to the edition of the report is a view of tax expenditures by program. Many of the expenditures could be placed in multiple categories. This depiction considers the primary purpose or use of the expenditure and accordingly places the expenditure within that category. The following list outlines the major program categories, subcategories and an estimate of the amount of potential tax revenue not collected because of the tax expenditures related to the purpose.

#### **Summary of Expenditures by Program (\$ millions)**

	FY 06	FY 07	FY 08	Total
<b>Agriculture</b>	<b>189.379</b>	<b>187.093</b>	<b>190.598</b>	<b>567.070</b>
Agricultural Development	158.423	155.836	159.039	473.298
Equine Industry Support	30.956	31.257	31.559	93.772
<b>Business</b>	<b>6,252.886</b>	<b>6,475.447</b>	<b>6,756.943</b>	<b>19,485.276</b>
Banking Support	150.500	151.800	154.200	456.500
Economic Development	98.950	95.150	93.750	287.850
Excluded Services	1,437.700	1,551.400	1,673.100	4,662.200
Existing Business Support	4,203.895	4,288.725	4,427.535	12,920.155
Job Development	118.605	126.705	134.905	380.215
Manufacturing Support	129.800	133.700	137.900	401.400
Motion Picture Industry Development	1.800	1.900	1.900	5.600
Reduced Compliance Burden	28.031	36.201	37.281	101.513
Transportation Industry Support	83.605	89.866	96.372	269.843
<b>Natural Resources</b>	<b>348.773</b>	<b>362.424</b>	<b>360.884</b>	<b>1,072.081</b>
Energy Development and Coal Industry Support	306.600	305.600	299.400	911.600
Environmental Support and Historical Preservation	32.313	47.114	51.814	131.241
Natural Resource	9.860	9.710	9.670	29.240
<b>Individual</b>	<b>3,605.308</b>	<b>3,748.995</b>	<b>3,947.042</b>	<b>11,301.346</b>
Education Support	33.000	34.200	35.600	102.800
Family Support	342.176	362.948	386.517	1,091.641
Health Care Support	916.100	977.300	1,051.400	2,944.800
Housing Development	694.412	738.047	782.315	2,214.775
Income Maintenance	587.890	602.070	623.800	1,813.760
Retirement Support	1,031.730	1,034.430	1,067.410	3,133.570
<b>Government</b>	<b>227.399</b>	<b>231.239</b>	<b>238.205</b>	<b>696.843</b>
Federal Government Support	40.000	40.410	40.930	121.340
Intergovernmental Transfers	9.200	9.700	10.200	29.100
Local Government Support	159.699	161.129	165.875	486.703
Military Support	18.500	20.000	21.200	59.700
<b>Other</b>	<b>711.080</b>	<b>457.800</b>	<b>460.370</b>	<b>1,629.250</b>
Charitable Organization Support	376.700	384.250	398.150	1,159.100
Community Development	14.900	38.400	26.640	79.940
Earmarked Funds	34.880	35.150	35.580	105.610
Investment Development	284.600	-	-	284.600

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# INTRODUCTION

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**What are tax expenditures?**

Tax expenditures are provisions such as special exemptions, exclusions, deductions, credits, deferrals, and preferential rates in tax law that result in a loss of tax revenue. House Bill 267 enacted by the 2005 General Assembly defines the term “tax expenditure” to mean an exemption, exclusion or deduction from the base of a tax, a credit against the tax, a deferral of a tax, or a preferential tax rate.

Tax expenditures differ from normal budget expenditures in that normal budget expenditures are explicitly appropriated on an annual or biennial basis as part of the budgetary process. Tax expenditures are approved by the legislature and then become a permanent part of a state’s tax laws, often without being routinely reviewed to determine fiscal impacts. As a result, tax expenditures have a tendency to become an increasingly larger part of state government expenditures without explicit approval by succeeding legislatures.

Not all deductions and exemptions allowed under the laws are classified as tax expenditures. Tax expenditures are best described as deviations from the “normal” or “appropriate” tax structure. For example, income tax is normally levied on income, after reducing the expenses incurred to produce that income. Consequently, most business expenses are not tax expenditures. However, income that is exempted because of special circumstances, such as retirement income, is considered a tax expenditure. Similarly, sales tax is usually levied on retail sales of tangible property. Therefore, the failure to tax sales for resale, wholesale sales, or sales of certain services does not create a tax expenditure.

**Why publish a tax expenditure report?**

Tax expenditures are increasingly used to encourage certain kinds of behavior or to provide financial aid to taxpayers in certain circumstances. Major objectives include economic development, equity, fiscal responsibility, and tax reform. The unintended result is an increase in the complexity of the tax laws. Individual taxpayers as well as tax experts have found it difficult to keep informed of these many changes. In many

cases, these decisions lead to less similarity between state and federal laws and ultimately to even more complexity. When such provisions are enacted, the resulting tax loss reduces the revenue available to fund other programs, unless tax rates are raised or new taxes are enacted to compensate for the loss.

Unlike direct appropriations, which must be continuously reviewed and approved by the General Assembly to remain in effect, tax expenditures are usually not included in this review process. As a result, programs funded through tax expenditures receive priority funding over all other programs. In all probability, many “tax expenditure” programs would not receive the same priority if they had to compete with “direct funding” programs.

A tax expenditure analysis can be used to evaluate the cost to state government of the many programs funded through tax expenditures. This analysis identifies, quantifies, and explains many of the Kentucky tax expenditures. When possible, estimates of the costs of the tax expenditures were developed from information contained on taxpayers’ Kentucky tax returns, the most reliable source for data. In many cases, however, necessary information is not reflected on tax returns or the data is not captured. For these tax expenditures, alternative sources were used, including U.S. Census Bureau statistics, federal tax expenditure estimates, Bureau of Labor Statistics data, information from federal tax returns, and other studies.

Whenever possible, an estimate of the expected value or cost of the tax expenditure is included in this report. However, there are some tax expenditures that cannot be reliably quantified, whether from conflicting data or lack of data. When this situation occurs, the value of the expenditure is reported as:

- ◆ “Minimal” if its value is expected to be below \$1 million; or
- ◆ “Substantial” if its value is expected to be above \$1 million.

The value of this analysis is not so much for potential revenue estimating purposes, but to give a description of Kentucky's tax expenditures and their estimated impact in terms of lost General Fund and Road Fund revenue for a specific time period. The estimates for each tax expenditure contained in this analysis were made independently, with the assumption that all other provisions of the tax laws remained unchanged and that taxpayer behavior remained constant. This was done because the analysis attempts to measure the costs of the expenditures as they exist and not what would happen if one or more were repealed. This analysis should not be viewed as an estimate of the impact of repealing one or more tax expenditures since the estimated cost of the expenditure(s) may not necessarily equal the increased revenue resulting from repeal. Similarly, the costs of two or more expenditures cannot be added together to produce the impact of simultaneous repeal, because each was computed without regard to the others. Due to graduated rates or other factors, the combined impact may be more or less than the sum of the individual tax expenditure amounts.

A number of states regularly compile tax expenditure reports and many have just started issuing the report in recent years. The information provided by such studies assists policymakers in devising a fairer tax structure.

### **How to Read This Report**

This report contains the traditional method of identifying each expenditure by statutes, with an estimate of the impact of that particular item, whether deduction, credit, exemption, rate reduction or other means utilized to alter or reduce a taxpayer's liability. Each identified tax type includes the following sections:

- ◆ *Background* – a brief history of the tax;
- ◆ *Current rate structure* – how the tax is assessed and in what amount;
- ◆ *Tax base* – who owes the tax, who is assessed, or who collects the tax; and
- ◆ *Tax due* – how, when, and where the tax is paid.

New to this report is an expanded summary table format. In addition to reflecting tax expenditures by tax type, the report also depicts the expenditures by purpose or use of the tax expenditures. Additionally, “*What’s New in 2005?*” recaps the major legislative actions related to *JOBS for Kentucky* proposed by Governor Fletcher and enacted by the 2005 General Assembly.

This report continues to quantify the exemption of certain services from sales tax even though these exemptions are not considered a tax expenditure. A list of specific services and the estimated costs can be found on pages 154-156 of this report.

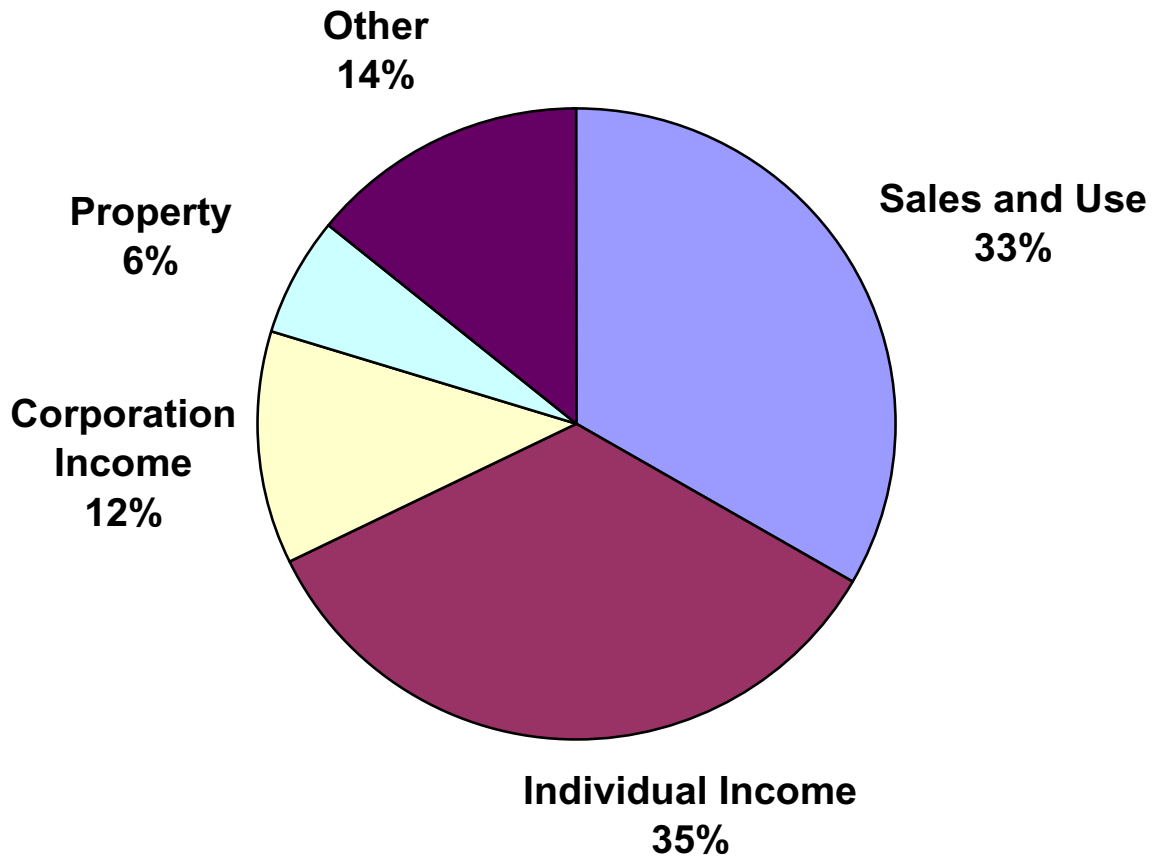
Some taxes are allocated to a particular fund or purpose. These items are not listed as expenditures. Rather, these allocations are listed under the heading “Earmarked Funds” and can be found on pages 162-166.

The Governor’s Office for Economic Analysis welcomes your comments and any questions you may have about this report. We wish to extend our appreciation to Mark Treesh, Commissioner of the Department of Revenue and the many members from his staff who participated in the data collection process of this project. Without their assistance, this publication would not have been possible.

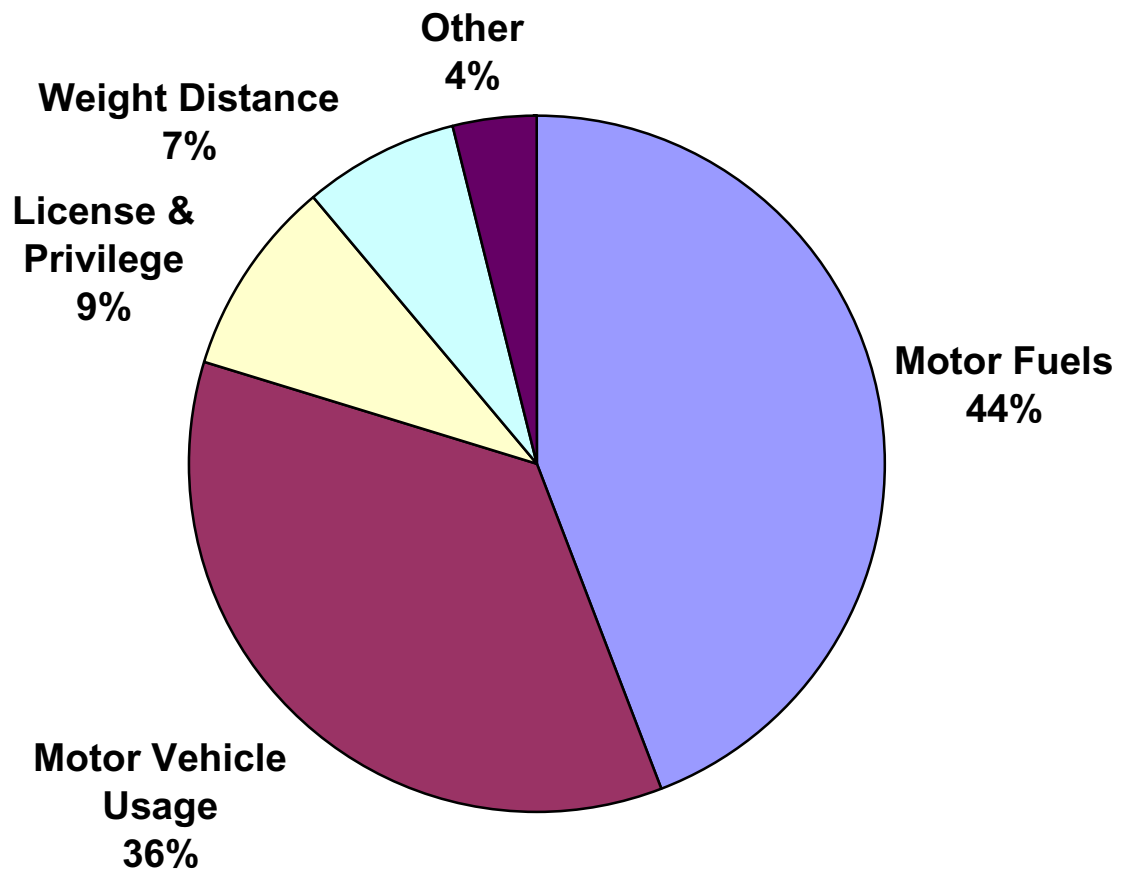
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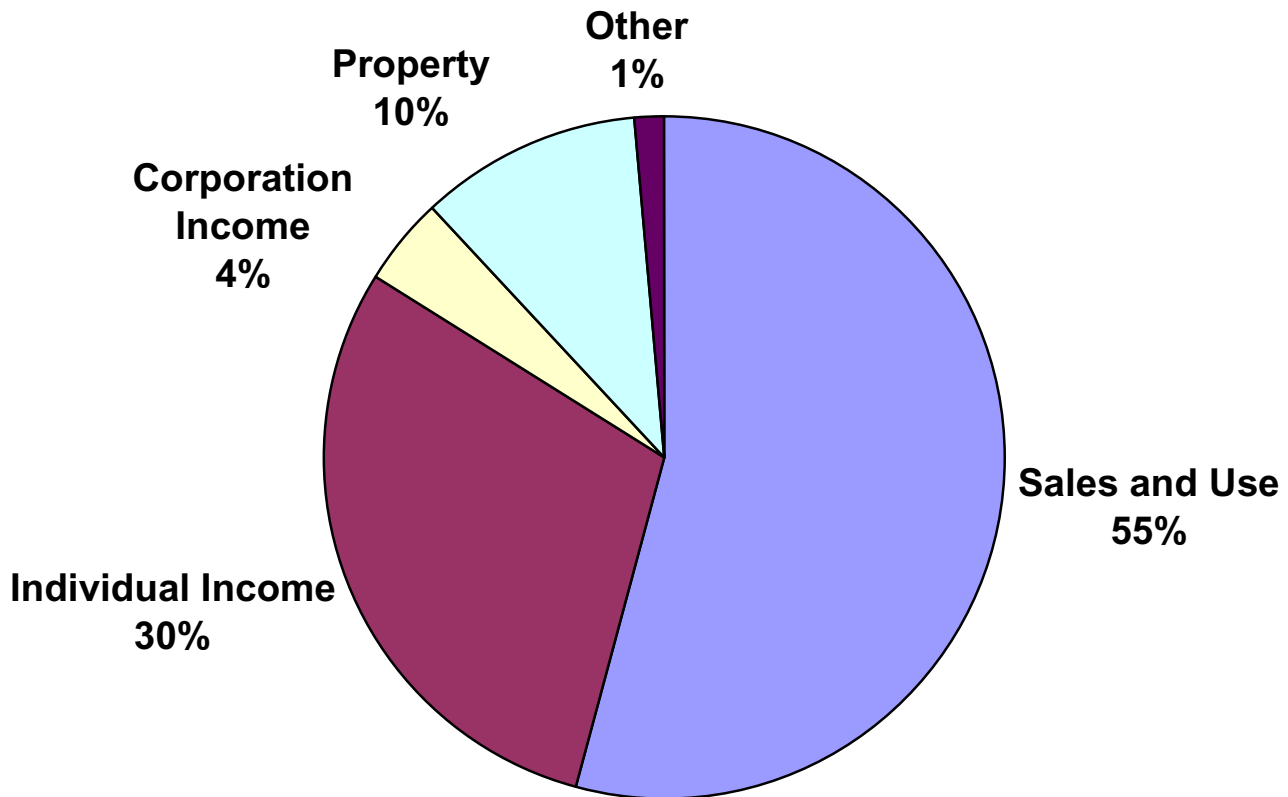
## General Fund Receipts - FY 2005



## Road Fund Receipts - FY 2005

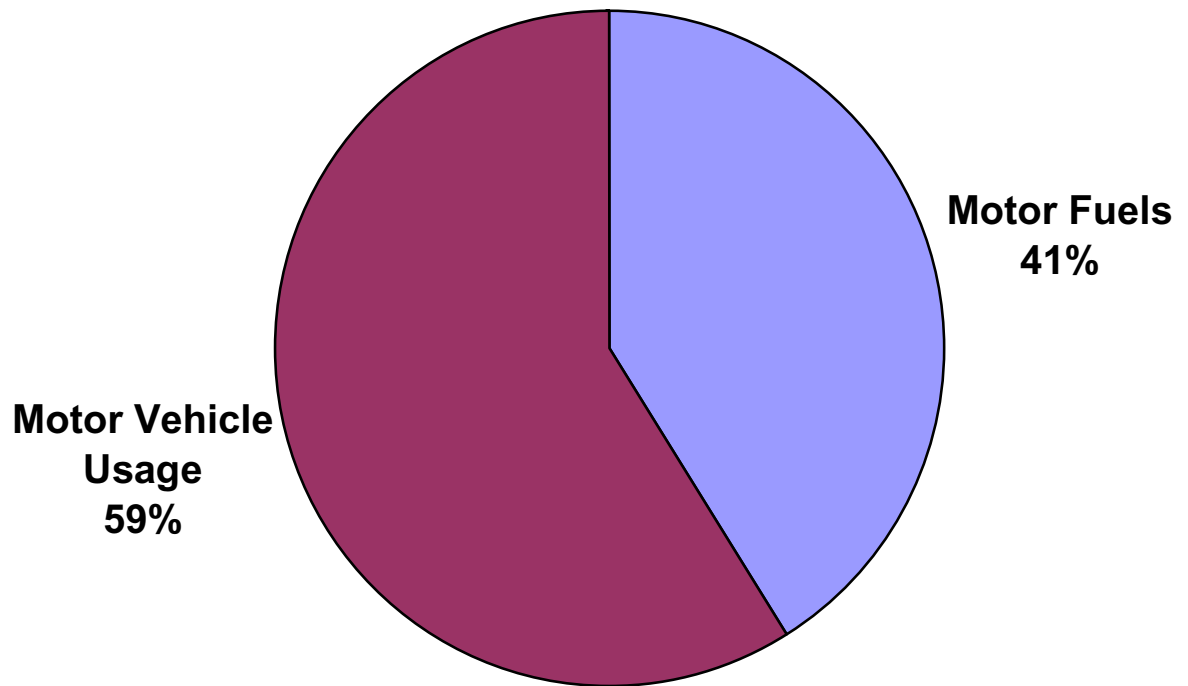


## General Fund Tax Expenditures - FY 2006





## Road Fund Tax Expenditures - FY 2006



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# *What's New*

## *For The General Fund In 2005?*

### *Alcoholic Beverages Tax*

The rates for the alcoholic beverages wholesale tax related to Distilled Spirits, Beer, and Wine were increased effective June 1, 2005. The new tax rates are 11 percent, increased from the old rate of 9 percent.

### *Corporation Income Tax*

Many changes were enacted impacting the corporation income tax. These changes are effective for tax periods beginning on or after January 1, 2005, unless otherwise noted. The major corporation income tax changes are:

**Alternative Minimum Calculation:** Corporations must pay the greater of the income tax, an alternative minimum calculation, or \$175. Taxpayers may choose between two methods to calculate the alternative minimum: 9.5 cents per \$100 of the corporation's gross receipts or 75 cents per \$100 of the corporation's Kentucky gross profits. Kentucky gross receipts equal the numerator of the sales factor for apportionment purposes. The term "Kentucky gross profits" equals Kentucky gross receipts reduced by Kentucky returns and allowances and Kentucky cost of goods sold. Cost of goods sold includes direct labor and the cost of specialized transportation for gasoline and special fuels.

**Apportionment of Income Subject to Multiple Taxing Jurisdictions:** All business entities subject to tax in Kentucky and at least one other state are required to utilize a three-factor apportionment formula to apportion income to Kentucky. This includes corporations, limited liability entities, and general partnerships.

**Doing Business Nexus Standard:** The nexus standard in Kentucky has changed to an economic nexus standard from a physical presence standard. If the corporation is doing business in Kentucky, deriving income from or attributable to sources within this state, or directing activities at Kentucky customers for the purpose of selling them goods or services, then a jurisdictional link has been established and tax is due.

**Economic Development Incentives and Credits:** The primary purpose of any credit or incentive is to create economic growth in a specific industry or to provide stimulus for investment. The newly enacted corporation income tax incentives focus primarily on environmental protection and energy initiatives through a combination of several programs.

- ❖ **Biodiesel Credit** – Taxpayers producing or blending biodiesel fuels may be eligible for a credit of up to \$1 per gallon produced or blended, limited to a maximum statewide credit of \$1.5 million. The credit may not be carried forward.
- ❖ **Clean Coal Incentive Credit** – Effective for tax periods ending on or after December 31, 2006, a credit is available to an electricity generation facility certified as using clean coal equipment and technology and burning coal subject to Kentucky's severance tax. The credit applies to electricity generation facilities with an investment of more than \$150 million that meet Environmental and Public Protection Cabinet standards. The credit is \$2 per ton of qualifying coal burned.
- ❖ **Environmental Remediation (Brownfield) Credit** – Taxpayers who agree to clean up or develop an existing abandoned brownfield area may qualify for a credit up to a maximum amount of \$150,000 of expenditures to characterize and remediate the contamination.
- ❖ **Environmental Stewardship Credit** – Effective for tax years ending on or after January 31, 2007, a credit is available for a corporation that undertakes an environmental stewardship project with a minimum investment of at least \$5 million. The taxpayer must meet certain wage requirements in order to qualify. The credit covers 100 percent of eligible skills upgrade training costs and 25 percent of eligible equipment costs. The project must produce new manufactured products or improved existing manufactured products that have a reduced adverse effect on human health and the environment.
- ❖ **Historic Preservation Credit** – Effective for taxable period ending on or after December 31, 2005, taxpayers may receive a credit for a portion of the cost of restoring a qualified residential or commercial structure listed on the National Registry of Historic Places. The credit for corporations is equal to 20 percent of the rehabilitation expenses. The total credit available is capped at \$3 million annually.

- ❖ **New limits on Kentucky Investment Fund Act (KIFA) credits** – Effective July 1, 2005, KIFA tax credits available to any single investment fund are limited to \$1.3 million for all investors and all taxable years. Total KIFA tax credits available for all investors in all investment funds shall not exceed \$5 million per fiscal year.
- ❖ **Recycling Tax Credits** – Recycling credits are expanded for major recyclers who make a \$10 million investment in recycling equipment and who meet certain employment standards. Credits are allowed for up to 50 percent of the cost of new recycling equipment, limited each taxable year to 50 percent of the excess of the year's total tax liability over the tax liability for the most recent taxable year ending prior to January 1, 2005, or \$2.5 million, whichever is less. The legislation also provided for the recapture of the credit if the equipment is no longer used in a qualifying manner or is sold or disposed of prior to the end of the useful life of the equipment.

**Intangible Property, Management Fees and Other Related Party Expenses:**

Certain deductions created by transactions with one or more related members of an affiliated group may be disallowed unless:

- ❖ The corporation and the related member are included in the same consolidated Kentucky corporation income tax return for the relevant taxable year;
- ❖ A disclosure is made and evidence is provided to establish
  - ◆ that the transaction was at arm's length,
  - ◆ that the payment made to the related member was subject to income tax in another jurisdiction, and
  - ◆ that the related member has substantial business activities other than the management or ownership of intangible property;
- ❖ The corporation establishes that the recipient regularly engages in transactions with one or more unrelated parties on terms identical to that of the subject transaction; or
- ❖ The corporation and the Department of Revenue agree in writing to an alternative method of apportionment.

**Mandatory Nexus Consolidated Returns:** All corporations doing business in Kentucky that are connected through an ownership interest of 80 percent or more must file a consolidated Kentucky return.

**Net Operating Loss (NOL):** Corporations may no longer carry NOLs back to previous years. Only NOL carry forwards are allowed.

**Phase II Tobacco Payments:** State funds that may be paid out as an addition to or a replacement of Phase II tobacco payments are exempt from corporation income tax.

**Rate Reduction:** The top corporate rate was reduced and the lower brackets are expanded. The 4 percent bracket applies to taxable net income up to \$50,000, and the 5 percent bracket applies to taxable net income between \$50,000 and \$100,000. For taxable years beginning on or after January 1, 2005 and prior to January 1, 2007, the top corporate rate is 7 percent on all taxable net income over \$100,000. For taxable years beginning on or after January 1, 2007, the top rate is 6 percent.

**Reference to the Internal Revenue Code:** The Internal Revenue Code reference date is updated to December 31, 2004, except that depreciation and Section 179 expenses are calculated based on the Code in effect on December 31, 2001.

**Tax Base Expansion:** The corporation income tax base was expanded to include all limited liability entities. In addition to applying the corporation income tax to formally incorporated entities, the tax also applies to limited liability companies, limited liability partnerships, limited partnerships, and S corporations. General partnerships and sole proprietorships are not subject to the expanded corporation income tax. With the expansion, there is no pass-through of income, loss, or credit to non-individual owners of pass-through entities subject to corporation income tax. Individual owners will receive pass-through income, loss, and credit for the tax paid at the entity level.

### **Corporation License Tax**

The anticipated increases resulting from the *Illinois Tool Works (ITW)* decision will not apply for any year. Legislation retroactively addresses the questions raised by this and other litigation related to the corporation license tax. Additionally, the corporation license tax is repealed effective for tax periods ending on or after December 31, 2005.

**Individual Income Tax**

A primary goal of the Fletcher *JOBS for Kentucky* plan was to strengthen Kentucky's families by decreasing the individual income tax burden on working Kentuckians. The changes made to the Individual Income Tax are effective for tax period beginning on or after January 1, 2005, unless otherwise noted.

**Education Tuition Tax Credit:** A credit equal to 25 percent of the amount of the federal Hope Scholarship and the Lifetime Learning Credit is available for Kentucky income tax purposes. The credit applies only to undergraduate studies, phases out for higher incomes and applies to most higher education opportunities within Kentucky.

**Expanded Low Income Tax Credit:** The low income tax credit is expanded to provide a 100 percent credit for family sizes up to four members with incomes at or below federal poverty levels. The Expanded Low Income Tax Credit is based on modified gross income (MGI) which includes income from pensions, IRAs and other retirement sources. Single and married taxpayers whose MGI is at or below federal poverty level for the family size will receive 100 percent tax credit. For 2005, MGI levels that qualify for the 100 percent tax credit are as follows:

<u>Size of Family</u>	<u>Unit Amount</u>
1	\$ 9,570
2	\$ 12,830
3	\$ 16,090
4	\$ 19,350

The Expanded Low Income Tax Credit provides benefit to individuals and families at incomes up to 133 percent of the federal poverty level, through a phase out of the credit.

**Health Savings Accounts:** As a part of the IRC update, Kentucky allows the same tax advantages currently available at the federal level for health savings accounts. Benefits include permitting pretax treatment of contributions to health savings accounts and more potential uses of funds than are allowed with flexible spending accounts.

**Net Operating Losses (NOL):** Individuals may no longer carry NOLs back to previous years. Only NOL carry forwards are allowed.

**Pensions:** The pension exclusion is capped at the 2005 amount of \$41,110, and KRS 141.105, which provided for the cost of living adjustment, is repealed.

**Phase II Tobacco Payments:** State funds that may be paid out as an addition to or a replacement of Phase II tobacco payments are exempt from individual income tax.

**Rate Reduction:** The tax rate for taxable income between \$8,000 and \$75,000 drops to 5.8 percent with taxable income over \$75,000 continuing to be taxed at 6 percent.

**Reference to the Internal Revenue Code (IRC):** The IRC reference date is updated to reflect conformity with the IRC in effect on December 31, 2004 as the basis for Kentucky income taxes, with three exceptions. The exceptions are:

- ❖ **Depreciation** – For property placed in service after September 10, 2001, only the depreciation and expense deductions allowed under Sections 168 and 179 of the IRC in effect on December 31, 2001, exclusive of any amendments made subsequent to that date, shall be allowed;
- ❖ **Military Family Tax Relief** – The provisions of the Military Family Tax Relief Act of 2003, Pub. L. No. 108-121, are effective on the dates specified in that act; and
- ❖ **Deduction for Sales and Use Taxes** – Kentucky will not allow the deduction for sales and use taxes in lieu of state income taxes.

By updating the reference date, Kentucky's tax laws conform more closely with federal laws, providing ease of filing for taxpayers.

### **Pari-Mutuel Tax**

**International Horse Racing Events** — (Effective January 1, 2006.) An excise tax will not be imposed on pari-mutuel wagering on live racing occurring on any one day that a Kentucky track hosts an international horse racing event that distributes in excess of \$10 million in purses. This tax exemption remains in effect for any such succeeding event if the event returns within three years of the previously held event.



**Property Tax**

**Airport Authorities** — KRS 382.135 now exempts deeds conveying real property to airport authorities from certain filing requirements.

**Barge Lines** — (Effective January 1, 2006.) The ad valorem reporting and payment requirements of affected commercial watercraft companies are simplified. The Department of Revenue will begin to bill, collect and distribute all state and local property taxes for common carrier water transportation companies.

**Biotechnology Products** — (Effective January 1, 2002.) Biotechnology products are defined and exempted from assessments for local property taxes.

**Environmental Remediation (Brownfield) Incentive** — (Effective January 1, 2005.) This bill reduces the real property tax rate to .015 cents per \$100 of value for approved properties for three years.

**Intangible Property Tax Repealed** — (Effective January 1, 2006.) Most intangible property taxes are repealed, other than some of the intangible taxes paid by financial institutions and other businesses.

**Local School Districts** — (Effective July 1, 2005.) Local school districts that are deemed *hold harmless* pursuant to Fiscal Year 2005-2006 Support Education Excellence in Kentucky (SEEK) tentative calculation shall not be required to levy a property tax rate lower in Fiscal Year 2005-2006 than the previous year's rate.

**Property Owned by Another State** — (Effective July 1, 2005.) All real and personal property owned by another state and used exclusively for public purposes is exempt from taxation if that state comparably exempts the Commonwealth's property.

**School Funding** — (Effective for assessments on or after January 1, 2006.) A district board of education may levy a general tax rate that produces revenue from real property, exclusive of revenue from new property, which is 4 percent over the amount of revenue produced by the compensating rate as defined in KRS 132.010.

**School Tax Recall** — (Applies to orders, ordinances, resolutions or motions passed after July 15, 2005.) A school tax recall petition in a district in a consolidated local government must include 5 percent of registered and qualified voters voting in the last presidential election. Each sheet must include names of voters from one precinct and an invalid signature shall not disqualify the entire page but result in striking the invalid signature only.

**State Real Property Tax Rate** — (Effective January 1, 2005.) Revenue and assessment growth resulting from new property is excluded from the 4 percent growth limit established by HB 44.

**Sales and Use Tax**

**Breeder Incentives** — (Effective June 1, 2005.) Sales tax receipts from stud fees for breeding of horses in this state are earmarked for use in creating breeder incentives. The sales tax will be deposited into special funds for future disbursement by the Kentucky Horse Racing Authority.

**Commercial Printers or Mailers** — (Effective July 1, 2005.) Commercial printers or mailers engaged in business in this state are not required to collect use tax on sales of printing or direct mail advertising materials that are both printed out of state and delivered out of state to the postal service for mass mailing to third-party Kentucky residents who do not purchase the advertising materials.

**County Fair Admissions** — The first \$50,000 in county fair admissions are exempt from sales and use tax.

**Donated Goods** — (Effective August 1, 2005.) A sales tax refund equal to 25 percent (up to \$1 million) of the tax collected on sales of donated goods by resident nonprofit educational, charitable or religious institutions is available, if the entity uses the refund exclusively as reimbursement for capital construction costs of additional retail locations in this state.

**Natural Gas** — (Effective June 1, 2005.) The sales and use tax is levied upon distributing, transmitting or transporting natural gas for storage, use or other consumption in this state, excluding natural gas classified for residential use or to a seller or reseller of natural gas. Charges for related distribution, transmission

and transportation for energy that is billed to the user will be included in the cost of production when calculating the 3 percent cost of production for energy direct pay.

**Nexus** — (Effective August 1, 2005.) The sales tax nexus standard is broadened to include remote sellers that use in-state affiliates to facilitate remote sales.

**Repair and Replacement Parts for Charter Buses** — (Effective August 1, 2005.) Repair and replacement parts for operating and maintaining a charter bus certified by the Transportation Cabinet are exempt.

**Streamlined Sales Tax Agreement** — (Effective July 1, 2005.) Various sections of KRS Chapter 139 are amended to conform to the Streamlined Sales and Use Tax Agreement. The bill also amends KRS 139.472 to exempt mobility enhancing equipment from sales and use tax.

**Study** — (Findings to be reported December 1, 2006.) Legislative Research Commission will study the effectiveness of sales tax exemptions.

**Telephones/Pay Phones** (See Telecommunications Services) — (Effective January 1, 2006.) Switch access and pay phone receipts are no longer subject to sales tax.

**Vendor Compensation** — (For tax periods after June 30, 2005.) The compensation a taxpayer may receive for collecting and remitting sales and use tax is limited to \$1,500 per month.

**Water Withdrawal Fees** — (Effective July 1, 2005.) Water withdrawal fees imposed by the Kentucky River Authority are no longer subjected to state and local taxes.

**Telecommunications Services**

**Excise Tax** — (Effective January 1, 2006.) An excise tax of 3 percent is imposed on multichannel video and audio programming services. Telephone services remain subject to the sales and use tax at a rate of 6 percent. Local governments will receive a guaranteed, fixed amount to replace the franchise fees and unit valuation property taxes that they will no longer receive.

**Gross Revenues Tax** — (Effective January 1, 2006.) An internal gross revenues tax is levied against telephone providers at a rate of 1.3 percent of gross revenues and against multichannel video and audio programming providers at a rate of 2.4 percent of gross revenues.

**Tobacco Taxes**

**Cigarettes** — (Effective June 1, 2005.) A 26-cent-per-pack surtax is added to the existing excise tax of 3 cents per pack. Vendor compensation remains based on the previous, rather than the increased amount of the surtax. An additional one cent cigarette tax levy is deposited in a special fund to be matched by the University of Kentucky and the University of Louisville for cancer research.

**Cigarette Compensation** — (Effective June 1, 2005 to Nov. 30, 2005.) For a limited time of six months, additional compensation is allowed; equal to 12 cents face value for each \$3 of tax evidence purchased at face value on or after June 1, 2005 and before Dec. 1, 2005. The additional compensation sunsets at 12 midnight on November 30, 2005. The qualifying compensation is limited to 150 percent of the amount of stamps purchased for the period of Dec. 1, 2004 and ending before May 31, 2005.

**Inventory Floor Stock Tax** — (Encompasses products and stamps on the shelf and in facilities on May 31, 2005.) An inventory floor tax is imposed on cigarettes and allows for payment of the tax in three equal monthly installments.

**Other Tobacco Products** — (Effective Aug. 1, 2005.) A 7.5 percent gross receipts tax is imposed on other tobacco products of any wholesaler derived from wholesale sales of other tobacco products, except snuff, made within the Commonwealth and 0.095 cents per unit of snuff.

**Tobacco Research Trust Fund** — The tobacco research trust fund will receive at least \$3.14 million regardless of whether the half-cent cigarette tax levy produces that amount.

**Tourism**

**State or National Parks** — Enhanced tourism development credits are available for facilities in state or national parks.

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# *What's New*

## *For The Road Fund In 2005?*

### *Motor Fuels Tax*

**Average Wholesale Price of Gas** — For purposes of the motor fuels tax calculation, the “average wholesale price” is deemed to be not less than one dollar and twenty-two cents (\$1.22) per gallon; amended from one dollar and eleven cents (\$1.11) per gallon.

**Bulk Sales** — The motor fuels exemption for sales to the federal government is clarified as applying only to bulk sales and not retail sales.

**Financial Instruments** — The statute was amended to substitute the words “*bond(s)*” for “*financial instrument(s)*” in certain circumstances.

**Payments** — Motor fuels dealers in good financial standing may pay either by a dealer’s check or electronic fund transfer payments.

**Refunds** — A motor fuels refund may only be requested on fuel purchased after the effective date of the refund permit.

**Underground Storage Tank Fees** — The underground storage tank fee exclusion extends to include all the special fuels for which a credit is provided by KRS 138.358.

### *Motor Vehicle Usage Tax*

**Charter Buses** — (Effective August 1, 2005.) Charter buses are exempt from the motor vehicle usage tax.

**Collection of Motor Vehicle Usage Tax at Titling** — (Effective July 1, 2005.) Collection of motor vehicle usage tax is required when an owner titles, rather than registers, a vehicle. This provision allows an owner to submit an affidavit of nonhighway use to prevent payment of motor vehicle usage tax on vehicles that will not be operated on Kentucky highways but requires collection of sales and use tax on vehicles not used on the highway.

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## SUMMARY TABLES OF TAX EXPENDITURES

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This chapter of the Tax Expenditure Analysis contains a condensed presentation of the Tax Expenditure items in table format. The first table is a recap of the tax expenditures listing each statutory exemption, deduction, credit rate adjustment, or other tax reduction by major tax type.

The second table is a recap of the expenditures categorized by the primary purpose or use of the expenditure even though many of the expenditures could be placed in multiple categories.

It is important to once again point out that each tax expenditure stands on its own, and that receipts from multiple expenditures repealed at the same time would not necessarily equal the sum of the amounts listed in this report. Many of the expenditures overlap and accordingly the totals listed under each category of tax type or program/recipient benefited are not reflective of the total tax benefit afforded that tax type or group. For example, the exclusion of 'life insurance proceeds' from the inheritance tax is estimated to remove \$25 million annually from inheritance tax receipts. However, the large majority of those proceeds would be received by Class A beneficiaries, where the funds received would be exempted from tax anyway (the Class A exemption is valued at \$68.2 million in FY04). To add the estimated amounts of those two categories together would overstate the expected value if the exemptions were repealed at the same time. The table makes no attempt to correct for this.

Because of the interaction of expenditures, it is difficult to project future values for many expenditures. Accordingly, these estimates may be an inadequate basis for future projections.

**Summary Tables**

<b>Tax Expenditures by Tax Type (\$ millions)</b>				
	FY 06	FY 07	FY 08	Total
<b>Total Alcoholic Beverage Taxes Expenditures</b>	<b>1.020</b>	<b>1.050</b>	<b>1.100</b>	<b>3.170</b>
U.S. Government Exemption	0.250	0.260	0.270	0.780
Reduced Rate for "Low Volume" Spirits	0.040	0.040	0.050	0.130
Wholesaler Compensation for Collection of Tax	0.730	0.750	0.780	2.260
<b>Total Cigarette Tax Expenditures</b>	<b>24.500</b>	<b>24.200</b>	<b>24.200</b>	<b>72.900</b>
Compensation Allowed Wholesaler	2.000	2.000	2.000	6.000
U.S. Government Purchases	22.200	22.200	22.200	66.600
Compensation Allowed Wholesaler - Cigarette Surtax	0.300	0.000	0.000	0.300
<b>Total Coal Severance and Processing Tax Expenditures</b>	<b>18.100</b>	<b>18.400</b>	<b>17.300</b>	<b>53.800</b>
Transportation Expense	17.700	18.000	16.900	52.600
Coal Used to Burn Solid Waste	0.000	0.000	0.000	0.000
Thin Seam Credit	0.400	0.400	0.400	1.200
<b>Total Corporation Income and License Taxes Expenditures</b>	<b>416.455</b>	<b>414.005</b>	<b>402.935</b>	<b>1,233.395</b>
Net Operating Loss Deduction	172.300	171.600	166.500	510.400
Exemption of Dividend Income	67.700	58.000	49.000	174.700
Exclusion of 50% of Coal Royalties	minimal	minimal	minimal	
Deductibility of the Excess of Percentage over Cost Depletion	0.900	0.950	0.980	2.830
Charitable Contribution Deduction	29.500	29.000	28.500	87.000
Patronage Dividend Deduction	15.400	14.500	14.200	44.100
Unemployment Tax Credit	0.005	0.005	0.005	0.015
Income Exemption for Credit Unions	17.500	16.400	16.100	50.000
Coal Conversion Credit	0.200	0.200	0.200	0.600
Double Weighted Sales Factor	69.700	65.500	64.200	199.400
Recycling Credit	1.400	9.100	9.300	19.800
Enterprise Zone Credit - Unemployed Hiring	0.050	0.050	0.050	0.150
KREDA Economic Development Credit	13.400	14.500	14.800	42.700
KIDA Economic Development Credit	12.600	13.000	13.500	39.100
KIRA Economic Development Credit	1.500	1.500	1.500	4.500
KJDA Economic Development Credit	8.900	9.500	9.800	28.200
Kentucky Investment Fund Credit	0.050	0.050	0.050	0.150
Skills Training Investment Credit	0.300	0.300	0.300	0.900
Real Estate Investment Trust	minimal	minimal	minimal	
KEOZ Economic Development Credit	0.050	0.050	0.050	0.150
Coal Incentive Tax Credit	0.100	0.100	0.100	0.300
Environmental Remediation Tax Credit	1.000	1.000	1.000	3.000
Biodiesel Credit	1.500	1.500	1.500	4.500
Environmental Stewardship Tax Credit	0.000	5.000	5.000	10.000
Clean Coal Incentive Credit	0.000	0.000	4.200	4.200
Exclusion of Publicly Traded Partnerships	2.400	2.200	2.100	6.700
<b>Total Gasoline Tax Expenditures</b>	<b>10.140</b>	<b>10.700</b>	<b>10.815</b>	<b>31.655</b>
Dealer's Monthly Reporting Allowance	8.700	9.200	9.300	27.200
U.S. Government Exemption	0.150	0.150	0.160	0.460
Agricultural Exemption	0.060	0.070	0.070	0.200
Aircraft Refund	0.230	0.240	0.240	0.710
Watercraft Refund	0.700	0.740	0.745	2.185
Bus, Taxicab, and Certain Senior Citizen's Program Refund	0.300	0.300	0.300	0.900
<b>Total Individual Income Tax Expenditures</b>	<b>2,890.797</b>	<b>3,055.214</b>	<b>3,209.537</b>	<b>9,155.548</b>
Net Exclusion of Pension Contributions and Earnings	325.800	342.800	340.500	1,009.100
Personal and Dependent Tax Credits	83.200	84.700	86.200	254.100
Standard Deduction	91.700	93.600	95.500	280.800
Deductibility of Home Mortgage Interest	182.200	193.800	203.900	811.359
Deductibility of State and Local Taxes Other Than Home Property Taxes	28.429	27.009	26.155	81.593
Exclusion of Employer Contributions for Medical Insurance Premiums and Care	412.900	456.800	501.100	1,370.800



<b>Tax Expenditures by Tax Type (\$ millions)</b>				
	FY 06	FY 07	FY 08	Total
Exclusion of Social Security Benefits: OASI for Retirees				
Disability Insurance Survivors' Benefits	308.200	325.000	339.000	972.200
Deductibility of Property Tax on Owner-Occupied Homes	48.712	46.347	44.015	139.075
Deductibility of Charitable Contributions	67.400	69.000	71.000	207.400
Exclusion of Interest on Life Insurance Savings	71.607	77.552	85.041	234.201
Exclusion of Capital Gains at Death	94.469	103.896	114.275	312.640
Deductibility of Individual Retirement Account Contributions	24.000	23.000	21.900	68.900
Deductibility of Keogh Plan Contributions	32.800	35.000	38.100	105.900
Exclusion of Federal and Military Retirement Income Received	68.700	71.300	75.900	215.900
Exclusion of Employee Benefits Premiums on Group Term Life Insurance, Accident and Disability Insurance				
Life Insurance	6.900	6.900	7.000	20.800
Accident & Disability Insurance	1.000	1.000	1.000	3.000
Exclusion of Worker's Compensation Benefits	18.000	20.000	20.700	58.700
Exclusion of Veteran's Disability Benefits	12.300	13.200	13.800	39.300
Credit for Child and Dependent Care Expenses	7.100	7.100	7.200	21.400
Health Savings Accounts	2.600	3.000	3.400	9.000
Exclusion of Income Earned Abroad by US Citizens	9.200	9.700	10.200	29.100
Deductibility of Excess of Percentage Over Cost Depletion	0.360	0.360	0.390	1.110
Deductibility of Medical Expenses	30.000	32.800	36.500	99.300
Deductibility of Net Operating Losses	substantial	substantial	substantial	
Exclusion of Employee Meals and Lodging on Employer Premises	2.900	3.000	3.200	9.100
Exclusion of Railroad and Supplemental Railroad Retirement System Benefits	11.300	12.000	12.600	35.900
Exclusion of State Employee Pension Benefits and Contributions	49.100	57.000	66.100	172.200
Exclusion of Private Pensions and Individual Retirement Accounts	158.900	167.200	172.400	498.500
Exclusion of Scholarship and Fellowship Income	4.800	5.000	5.300	15.100
Exclusion of Public Assistance Benefits	1.500	1.500	1.600	4.600
Credit for Hiring Unemployed	minimal	minimal	minimal	
Exclusion of Special Benefits for Disabled Coal Miners	1.130	1.130	0.910	3.170
Exclusion of GI Bill Benefits	0.500	0.600	0.600	1.700
Deductibility of Expenses of Certain Capital Outlays	3.600	3.600	3.600	10.800
Expanded Low Income Tax Credit	69.100	69.700	70.300	209.100
Exclusion of Miscellaneous Fringe Benefits	10.800	11.500	12.300	34.600
Deductibility of Casualty and Theft Losses	0.890	0.920	0.950	2.760
Credit for Recycling and/or Composting Equipment	1.200	1.200	1.200	3.600
Job Development Credit	49.800	54.000	59.000	162.800
Exclusion of Untaxed Medicare Benefits: Hospital Insurance & Supplementary Medical Insurance	180.200	187.000	199.000	566.200
Deductibility of Moving Expenses	10.500	11.500	12.500	34.500
Gain on the Sale of a Personal Residence	119.100	131.500	145.300	395.900
Health Insurance Premiums Paid by Self-Employed	14.200	15.800	17.300	47.300
Health Insurance Premiums	substantial	substantial	substantial	
Interest on Educational Loans	2.600	2.700	2.700	8.000
Precinct Workers	0.100	0.100	0.100	0.300
Tobacco Settlement	15.400	9.500	9.500	34.400
Capital Gains - Eminent Domain	minimal	minimal	minimal	
Long-Term Care Insurance	minimal	minimal	minimal	
Financial Institutions Structured as S Corporations	minimal	minimal	minimal	
Postsecondary Education Tuition Tax Credit	16.000	16.900	17.900	50.800
Historic Preservation Tax Credit	3.000	3.000	3.000	9.000
Member, Shareholder or Partner Credit	236.600	245.000	249.400	731.000

<b>Tax Expenditures by Tax Type (\$ millions)</b>				
	FY 06	FY 07	FY 08	Total
<b>Total Inheritance and Estate Tax Expenditures</b>	<b>79.000</b>	<b>82.500</b>	<b>86.100</b>	<b>247.600</b>
Class A Beneficiaries	64.100	66.900	69.900	200.900
Transfers to Educational, Religious, Charitable, or Certain Governmental Organizations	13.600	14.200	14.800	42.600
Discount for Early Payment of Tax	1.300	1.400	1.400	4.100
Class B Beneficiaries	minimal	minimal	minimal	
Class C Beneficiaries	minimal	minimal	minimal	
Life Insurance Proceeds	substantial	substantial	substantial	
Assessment of Land at its Agricultural or Horticultural Value	minimal	minimal	minimal	
Certificates of Deposit Exempt from the Contemplation of Death Rule	minimal	minimal	minimal	
Annuities Under Qualified Retirement Plans	minimal	minimal	minimal	
Individual Retirement Accounts	minimal	minimal	minimal	
Recurring Tax Credits	minimal	minimal	minimal	
Benefits Paid to a Beneficiary of Military Personnel Under Certain Retirement Plans	minimal	minimal	minimal	
Benefits Paid by the Federal Government Due to Service in Time of War	minimal	minimal	minimal	
<b>Total Liquefied Petroleum Gas Tax Expenditures</b>	<b>0.012</b>	<b>0.013</b>	<b>0.013</b>	<b>0.038</b>
Dealer's Monthly Reporting Allowance	0.001	0.001	0.001	0.003
Approved Carburetion Systems	0.011	0.012	0.012	0.035
<b>Total Motor Vehicle Usage Tax Expenditures</b>	<b>90.420</b>	<b>99.650</b>	<b>109.390</b>	<b>299.460</b>
Trade-in Allowance on Used Vehicles	31.800	33.600	35.600	101.000
Immediate Family Member	15.300	16.200	17.100	48.600
Governmental Exemption	10.200	10.600	11.000	31.800
Enterprise Zone Exemption	0.300	0.100	0.040	0.440
Military Exemption	5.700	6.200	6.800	18.700
Repossessed Exemption	0.700	0.900	1.100	2.700
Transfers by Will or Court Order	2.700	2.800	2.900	8.400
Educational & Charitable Organizations	1.000	1.200	1.400	3.600
Enterprise Zone Exemption - U Drive-It Tax	1.000	0.900	0.800	2.700
Commercial Motor Vehicle Exemption	minimal	minimal	minimal	
Change in Business Structure	0.200	0.200	0.200	0.600
Transfers Between a Limited Liability Company and its Members	0.400	0.600	1.000	2.000
Transfers Between a Subsidiary and a Parent Corporation	0.100	0.100	0.100	0.300
Partnership Interests	0.070	0.100	0.200	0.370
Insurance Company Transfers	0.100	0.100	0.100	0.300
Adapted Equipment for Physically Handicapped Persons	0.000	0.000	0.000	0.000
Large Truck Exclusion	20.800	26.000	31.000	77.800
Charter Bus Exemption	0.050	0.050	0.050	0.150
<b>Total Natural Resources Severance and Processing Tax Expenditures</b>	<b>6.300</b>	<b>6.300</b>	<b>6.300</b>	<b>18.900</b>
Transportation Expense	4.300	4.300	4.300	12.900
Limestone Sold in Interstate Commerce	1.000	1.000	1.000	3.000
Limestone Sold or Used for Agricultural Purposes	0.200	0.200	0.200	0.600
Ball Clay, Fluorspar, Lead, Zinc, Tar Sands, Barite, and Stone Used for Privately Maintained but Publicly Dedicated Roads	0.450	0.450	0.450	1.350
Limit on Tax from Clay	0.150	0.150	0.150	0.450
Clay Used in Landfill Construction	0.100	0.100	0.100	0.300
Inactive Crude Oil & Natural Gas Wells	0.100	0.100	0.100	0.300

<b>Tax Expenditures by Tax Type (\$ millions)</b>				
	FY 06	FY 07	FY 08	Total
<b>Total Property Tax Expenditures</b>	<b>1,014.892</b>	<b>709.392</b>	<b>741.792</b>	<b>2,466.076</b>
<b>Real Property</b>				
State Real Property Tax Yearly Revenue Ceiling	331.100	352.300	374.100	1,057.500
Alcohol Production Facilities	0.000	0.000	0.000	0.000
Leasehold Interest in Building Financed with Industrial Revenue Bonds	2.800	3.000	3.200	9.000
Homestead Exemption	13.300	14.100	15.000	42.400
Agricultural and Horticultural Land Assessment Protection	0.100	0.100	0.100	0.300
Intrastate Railroads and Railway Companies	0.030	0.030	0.030	0.090
Property of Local Governments in Neighboring States	0.020	0.020	0.020	0.060
Environmental Remediation Property	0.002	0.002	0.002	0.006
<b>Tangible Property</b>				
Business Inventories	60.000	62.900	66.100	189.000
Leasehold Interests	2.400	2.400	2.400	7.200
Manufacturing Machinery; Pollution Control Equipment; and Radio, Television & Telephonic Equipment	64.600	68.000	71.600	204.200
Machinery Used in Farming and Livestock & Domestic Fowl	22.500	22.500	22.500	67.500
Agricultural Products	0.360	0.360	0.360	1.080
Foreign Trade Zone	22.100	22.100	22.100	66.300
Historic Vehicles	0.100	0.100	0.100	0.300
Intrastate Railroads and Railway Companies	0.180	0.180	0.180	0.540
Interstate Trucks, Tractors, Semi-Trailers & Buses	3.300	3.500	3.700	10.500
Carlines	3.800	3.800	3.800	11.400
Aircraft	1.300	1.300	1.300	3.900
Federally Documented Vessels	minimal	minimal	minimal	
Floor Plan Machinery and Equipment	minimal	minimal	minimal	
In-Transit Goods	16.800	16.800	16.800	50.400
Motor Vehicles with a Salvage Title	minimal	minimal	minimal	
Property of Local Government in Neighboring States	2.700	2.700	2.700	8.100
<b>Intangible Property</b>				
Certain Classes of Intangible Properties at a 1.5 Cent Rate	31.600	0.000	0.000	31.600
Bank Deposits	117.200	119.800	122.400	359.400
Exemption of Stock from Intangible Tax	180.400	0.000	0.000	180.400
Retirement Plans	51.800	0.000	0.000	51.800
Banks for Cooperatives, Production Credit and Domestic Savings and Loans Associations	4.500	4.100	4.000	12.600
Certain Classes of Intangible Property at One-Tenth Cent Rates, Including Annuities and Rights to Receive Income	71.200	0.000	0.000	71.200
Credit Union Accounts and Shares	8.500	8.500	8.500	25.500
Broker's Account Receivable	0.500	0.000	0.000	0.500
Reserves and Capital of Domestic Life Insurance Companies	0.900	0.000	0.000	0.900
Agricultural Credit Associations	0.800	0.800	0.800	2.400
<b>Total Sales and Use Tax Expenditures</b>	<b>5,257.394</b>	<b>5,399.698</b>	<b>5,578.703</b>	<b>16,235.795</b>
Food Items	371.500	379.300	395.700	1,146.500
Non-profit Educational, Charitable and Religious Institutions	264.300	269.900	281.500	815.700
Labor or Services Used in Property Sold	212.900	217.300	226.700	656.900
Residential Utilities	187.100	183.700	182.900	553.700
Prescription Medicine, Prosthetic Devices and Physical Aids	274.500	280.200	292.300	847.000
Machinery for New and Expanded Industry and Certain Industrial Machinery	65.200	65.700	66.300	197.200
Coal Used in the Manufacture of Electricity	78.700	80.200	75.200	234.100
Energy and Energy Producing Fuels	20.800	21.400	22.100	64.300
Retailers' Compensation for Collecting and Remitting the Tax	12.000	19.800	20.700	52.500
Enterprise Zones	7.900	6.900	0.700	15.500
State, Cities, Counties and Special Districts	117.800	120.200	125.400	363.400
Textbooks	2.400	2.400	2.500	7.300

Summary Tables

<b>Tax Expenditures by Tax Type (\$ millions)</b>				
	FY 06	FY 07	FY 08	Total
Recycling Machinery and Equipment	4.600	6.400	6.400	17.400
Pollution Control Facilities	21.000	21.300	21.600	63.900
Tombstones and Other Grave Markers	3.700	3.800	3.900	11.400
Lodgings of Thirty Days or More	substantial	substantial	substantial	
Garage or Yard Sales	2.000	2.000	2.000	6.000
Semi-Trailers and Trailers	0.150	0.150	0.150	0.450
Vessels and Maritime Supplies	3.400	3.400	3.400	10.200
Sales by Elementary and Secondary Nonprofit, School-Sponsored Clubs and Organizations	5.900	5.900	5.900	17.700
Interstate Cargo and Passenger Aircraft, Parts and Supplies	9.600	9.600	9.600	28.800
Sales by Nonprofit Higher Educational School-Sponsored Clubs and Organizations	1.300	1.300	1.300	3.900
Sales to Motion Picture Companies	minimal	minimal	minimal	
Admissions to and Purchases by Historical Sites	substantial	substantial	substantial	
Credit Unions	1.300	1.300	1.300	3.900
Coin-Operating Bulk Vending Machines	0.085	0.085	0.085	0.255
Non-returnable and Returnable Containers	1.200	1.200	1.200	3.600
Occasional Sales	substantial	substantial	substantial	
Locomotives and Rolling Stock	substantial	substantial	substantial	
Procurement, Processing or Distribution of Blood or Human Tissue	1.700	1.700	1.800	5.200
Rate Increase for School Taxes added to Residential Telephone Bills	5.200	5.400	5.600	16.200
Raw Materials and Industrial Supplies	3,378.000	3,450.000	3,584.000	10,412.000
Federal Taxes Imposed on Sales of Tangible Personal Property	6.600	6.600	6.700	19.900
Sales to Common Carriers Under a Bill of Lading	0.000	0.000	0.000	0.000
Lease or Rental of Films by Commercial Theaters	1.800	1.900	1.900	5.600
Tourism Attraction Project Credit/Refund	7.100	7.500	7.400	22.000
Alcohol Production Facilities	0.000	0.000	0.000	0.000
Property Certified as a Fluidized Bed Energy Production Facility	0.000	0.000	0.000	0.000
Catalogs and Newspaper Inserts Shipped Outside Kentucky	substantial	substantial	substantial	
4-H Sales	0.100	0.100	0.100	0.300
Jet Fuel	23.000	23.500	24.500	71.000
Repair Parts for Large Trucks	1.600	1.600	1.700	4.900
Donated Goods	0.500	0.500	0.500	1.500
Kentucky Enterprise Initiative	5.600	30.400	25.000	61.000
Internet Tax Nondiscrimination Act	9.400	16.100	16.300	41.800
Charter Bus Repair & Replacement Parts	0.100	0.100	0.100	0.300
County Fair Admissions	0.100	0.100	0.100	0.300
<b>Subtotal for Farming Tax Expenditures</b>	<b>147.259</b>	<b>150.763</b>	<b>154.168</b>	<b>452.190</b>
Livestock, Poultry, Ratite Birds, Embryos and Semen, Alpacas, Llamas, Buffalo, Farm Work Stock and Feed, Seeds and Fertilizers	67.900	69.800	71.600	209.300
Horses Purchased for Breeding	12.300	12.400	12.500	37.200
Farm Machinery, Attachments, and Replacements, On-Farm Grain Storage Facilities, and On-Farm Facilities for Raising Chickens, Livestock, Ratite Birds, Llamas and Alpacas, and Buffalo	35.600	36.500	37.500	109.600
Fuel Used for Farm Purposes	7.500	7.700	7.900	23.100
Water Used for Farm Purposes	0.056	0.057	0.059	0.172
Equine Water	0.056	0.057	0.059	0.172
Aquaculture	0.014	0.015	0.015	0.044
Twine and Wire	0.033	0.034	0.035	0.102
Horses Less Than Two Years of Age	18.600	18.800	19.000	56.400
Farm Chemicals	5.200	5.400	5.500	16.100

<b>Tax Expenditures by Tax Type (\$ millions)</b>				
	FY 06	FY 07	FY 08	Total
<b>Total for Excluded Services</b>	<b>1,437.700</b>	<b>1,551.400</b>	<b>1,673.100</b>	<b>4,662.200</b>
Personal services	55.200	59.100	63.400	177.700
Business services	219.400	238.100	259.700	717.200
Specialized Design Services	5.300	5.800	6.300	17.400
Computer System Designs	55.300	60.000	65.400	180.700
Scientific R&D	6.300	6.800	7.400	20.500
Advertising	27.100	29.400	32.100	88.600
Other Professional Services	28.100	30.500	33.300	91.900
Health services	654.600	704.500	754.000	2,113.100
Legal services	80.600	87.500	95.400	263.500
Education services	16.500	17.700	19.000	53.200
Social services	7.600	8.200	8.800	24.600
Engineering, accounting, research, management	135.800	147.400	160.800	444.000
Automotive and miscellaneous repair services	112.000	120.000	128.700	360.700
Amusement and recreational services	28.500	30.600	32.600	91.700
Other services	5.400	5.800	6.200	17.400
<b>Total Special Fuels Tax Expenditures</b>	<b>53.215</b>	<b>55.326</b>	<b>57.177</b>	<b>165.718</b>
Non-Highway Use	29.000	30.500	32.000	91.500
Railroad Companies	14.700	15.000	15.200	44.900
Agricultural Use	3.700	3.800	3.900	11.400
Dealer's Monthly Reporting Allowance	3.000	3.050	3.100	9.150
Residential Heating	1.400	1.450	1.450	4.300
Bus, Taxicab and Certain Senior Citizen's Programs Refunds	0.320	0.330	0.330	0.980
State and Local Government Use	0.250	0.300	0.300	0.850
Religious, Charitable or Educational Use	0.200	0.250	0.250	0.700
Watercraft	0.045	0.046	0.047	0.138
U. S. Government Exemption	0.600	0.600	0.600	1.800
<b>Total Earmarked Funds</b>	<b>34.880</b>	<b>35.150</b>	<b>35.580</b>	<b>105.610</b>
Thoroughbred Development Fund-Pari-mutuel Tax	7.300	7.300	7.300	21.900
Equine Industry Program Trust Fund – Pari-mutuel Tax	0.470	0.470	0.470	1.410
Higher Education Equine Trust Fund – Pari-mutuel Tax	0.470	0.470	0.470	1.410
Standardbred Development Fund – Pari-mutuel Tax	0.100	0.100	0.100	0.300
Tobacco Enforcement Program – Cigarette Tax	0.350	0.350	0.350	1.050
Kentucky Transportation Center – Motor Fuels Tax	0.190	0.190	0.190	0.570
Tobacco Research Trust Fund – Cigarette Tax	3.500	3.500	3.500	10.500
Agricultural Diversification & Development Fund – Cigarette Tax	0.000	0.000	0.000	0.000
Equine Drug Research – Pari-mutuel Tax	0.400	0.400	0.400	1.200
Aviation Economic Development Fund – Sales Tax	5.100	4.500	4.600	14.200
Tax Increment Financing – Various	2.000	2.000	2.000	6.000
Kentucky Thoroughbred Breeders Incentive Fund	12.000	12.480	13.000	37.480
Kentucky Standardbred Breeders Incentive Fund	1.950	2.300	2.100	6.350
Kentucky Horse Breeders Incentive Fund	1.050	1.090	1.100	3.240

Summary Tables

Tax Expenditures by Program (\$ millions)					
Tax Type		FY 06	FY 07	FY 08	Total
<b>Agricultural Development</b>		<b>158.423</b>	<b>155.836</b>	<b>159.039</b>	<b>473.298</b>
Gasoline Tax	Agricultural Exemption	0.060	0.070	0.070	0.200
Individual Income	Tobacco Settlement	15.400	9.500	9.500	34.400
Inheritance Tax	Assessment of Land at its Agricultural or Horticultural Value	minimal	minimal	minimal	
Real Property	Agricultural and Horticultural Land Assessment Protection	0.100	0.100	0.100	0.300
Tangible Property	Machinery Used in Farming and Livestock & Domestic Fowl	22.500	22.500	22.500	67.500
Tangible Property	Agricultural Products	0.360	0.360	0.360	1.080
Sales Tax	Livestock, Poultry, Ratite Birds, Embryos and Semen, Alpacas, Llamas, Buffalo, Farm Work Stock and Feed, Seeds and Fertilizers	67.900	69.800	71.600	209.300
Sales Tax	Farm Machinery, Attachments, and Replacements, On-Farm Grain Storage Facilities, and On-Farm Facilities for Raising Chickens, Livestock, Ratite Birds, Llamas and Alpacas, and Buffalo	35.600	36.500	37.500	109.600
Sales Tax	Fuel Used for Farm Purposes	7.500	7.700	7.900	23.100
Sales Tax	Water Used for Farm Purposes	0.056	0.057	0.059	0.172
Sales Tax	Aquaculture	0.014	0.015	0.015	0.044
Sales Tax	Twine and Wire	0.033	0.034	0.035	0.102
Sales Tax	Farm Chemicals	5.200	5.400	5.500	16.100
Special Fuels	Agricultural Use	3.700	3.800	3.900	11.400
<b>Banking Support</b>		<b>150.500</b>	<b>151.800</b>	<b>154.200</b>	<b>456.500</b>
Corporation Income	Income Exemption for Credit Unions	17.500	16.400	16.100	50.000
Corporation Income	Real Estate Investment Trust	minimal	minimal	minimal	
Individual Income	Financial Institutions Structured as S Corporations	minimal	minimal	minimal	
Motor Vehicle	Repossessed Exemption	0.700	0.900	1.100	2.700
Intangible Property	Bank Deposits	117.200	119.800	122.400	359.400
Intangible Property	Banks for Cooperatives, Production Credit and Domestic Savings and Loans Associations	4.500	4.100	4.000	12.600
Intangible Property	Credit Union Accounts and Shares	8.500	8.500	8.500	25.500
Intangible Property	Agricultural Credit Associations	0.800	0.800	0.800	2.400
Sales Tax	Credit Unions	1.300	1.300	1.300	3.900
<b>Charitable Organization Support</b>		<b>376.700</b>	<b>384.250</b>	<b>398.150</b>	<b>1,159.100</b>
Corporation Income	Charitable Contribution Deduction	29.500	29.000	28.500	87.000
Individual Income	Deductibility of Charitable Contributions	67.400	69.000	71.000	207.400
Inheritance Tax	Transfers to Educational, Religious, Charitable, or Certain Governmental Organizations	13.600	14.200	14.800	42.600
Inheritance Tax	Class C Beneficiaries	minimal	minimal	minimal	
Motor Vehicle	Educational & Charitable Organizations	1.000	1.200	1.400	3.600
Sales Tax	Non-profit Educational, Charitable and Religious Institutions	264.300	269.900	281.500	815.700
Sales Tax	4-H Sales	0.100	0.100	0.100	0.300
Sales Tax	Donated Goods	0.500	0.500	0.500	1.500
Sales Tax	County Fair Admissions	0.100	0.100	0.100	0.300
Special Fuels	Religious, Charitable or Educational Use	0.200	0.250	0.250	0.700
<b>Community Development</b>		<b>14.900</b>	<b>38.400</b>	<b>26.640</b>	<b>79.940</b>
Corporation Income	Enterprise Zone Credit - Unemployed Hiring	0.050	0.050	0.050	0.150
Corporation Income	KEOZ Economic Development Credit	0.050	0.050	0.050	0.150
Motor Vehicle	Enterprise Zone Exemption	0.300	0.100	0.040	0.440
Motor Vehicle	Enterprise Zone Exemption - U Drive-It Tax	1.000	0.900	0.800	2.700
Sales Tax	Enterprise Zones	7.900	6.900	0.700	15.500
Sales Tax	Kentucky Enterprise Initiative	5.600	30.400	25.000	61.000
<b>Earmarked Funds</b>		<b>34.880</b>	<b>35.150</b>	<b>35.580</b>	<b>105.610</b>
Earmarked Funds	Thoroughbred Development Fund-Pari-mutuel Tax	7.300	7.300	7.300	21.900
Earmarked Funds	Equine Industry Program Trust Fund - Pari-mutuel Tax	0.470	0.470	0.470	1.410
Earmarked Funds	Higher Education Equine Trust Fund - Pari-mutuel Tax	0.470	0.470	0.470	1.410
Earmarked Funds	Standardbred Development Fund - Pari-mutuel Tax	0.100	0.100	0.100	0.300
Earmarked Funds	Tobacco Enforcement Program - Cigarette Tax	0.350	0.350	0.350	1.050
Earmarked Funds	Kentucky Transportation Center - Motor Fuels Tax	0.190	0.190	0.190	0.570
Earmarked Funds	Tobacco Research Trust Fund - Cigarette Tax	3.500	3.500	3.500	10.500
Earmarked Funds	Agricultural Diversification & Development Fund - Cigarette Tax	-	-	-	-
Earmarked Funds	Equine Drug Research - Pari-mutuel Tax	0.400	0.400	0.400	1.200
Earmarked Funds	Aviation Economic Development Fund - Sales Tax	5.100	4.500	4.600	14.200
Earmarked Funds	Tax Increment Financing - Various	2.000	2.000	2.000	6.000
Earmarked Funds	Kentucky Thoroughbred Breeders Incentive Fund	12.000	12.480	13.000	37.480
Earmarked Funds	Kentucky Standardbred Breeders Incentive Fund	1.950	2.300	2.100	6.350
Earmarked Funds	Kentucky Horse Breeders Incentive Fund	1.050	1.090	1.100	3.240

<b>Tax Expenditures by Program (\$ millions)</b>					
<b>Tax Type</b>		<b>FY 06</b>	<b>FY 07</b>	<b>FY 08</b>	<b>Total</b>
<b>Economic Development</b>		<b>98.950</b>	<b>95.150</b>	<b>93.750</b>	<b>287.850</b>
Corporation Income	Double Weighted Sales Factor	69.700	65.500	64.200	199.400
Corporation Income	Kentucky Investment Fund Credit	0.050	0.050	0.050	0.150
Tangible Property	Foreign Trade Zone	22.100	22.100	22.100	66.300
Sales Tax	Tourism Attraction Project Credit/Refund	7.100	7.500	7.400	22.000
<b>Education Support</b>		<b>33.000</b>	<b>34.200</b>	<b>35.600</b>	<b>102.800</b>
Individual Income	Exclusion of Scholarship and Fellowship Income	4.800	5.000	5.300	15.100
Individual Income	Interest on Educational Loans	2.600	2.700	2.700	8.000
Individual Income	Postsecondary Education Tuition Tax Credit	16.000	16.900	17.900	50.800
Sales Tax	Sales by Nonprofit Higher Educational School-Sponsored Clubs and Organizations	1.300	1.300	1.300	3.900
Sales Tax	Textbooks	2.400	2.400	2.500	7.300
Sales Tax	Sales by Elementary and Secondary Nonprofit, School-Sponsored Clubs and Organizations	5.900	5.900	5.900	17.700
<b>Energy Development and Coal Industry Support</b>		<b>306.600</b>	<b>305.600</b>	<b>299.400</b>	<b>911.600</b>
Corporation Income	Biodiesel Credit	1.500	1.500	1.500	4.500
Natural Resources	Inactive Crude Oil & Natural Gas Wells	0.100	0.100	0.100	0.300
Real Property Tax	Alcohol Production Facilities	-	-	-	-
Sales Tax	Energy and Energy Producing Fuels	20.800	21.400	22.100	64.300
Sales Tax	Alcohol Production Facilities	-	-	-	-
Sales Tax	Property Certified as a Fluidized Bed Energy Production Facility	-	-	-	-
Sales Tax	Residential Utilities	187.100	183.700	182.900	553.700
Coal Severance	Transportation Expense	17.700	18.000	16.900	52.600
Coal Severance	Coal Used to Burn Solid Waste	-	-	-	-
Coal Severance	Thin Seam Credit	0.400	0.400	0.400	1.200
Corporation Income	Exclusion of 50% of Coal Royalties	minimal	minimal	minimal	
Corporation Income	Coal Conversion Credit	0.200	0.200	0.200	0.600
Corporation Income	Coal Incentive Tax Credit	0.100	0.100	0.100	0.300
Sales Tax	Coal Used in the Manufacture of Electricity	78.700	80.200	75.200	234.100
<b>Motion Picture Industry Development</b>		<b>1.800</b>	<b>1.900</b>	<b>1.900</b>	<b>5.600</b>
Sales Tax	Sales to Motion Picture Companies	minimal	minimal	minimal	
Sales Tax	Lease or Rental of Films by Commercial Theaters	1.800	1.900	1.900	5.600
<b>Environmental Support and Historical Preservation</b>		<b>32.313</b>	<b>47.114</b>	<b>51.814</b>	<b>131.241</b>
Corporation Income	Recycling Credit	1.400	9.100	9.300	19.800
Corporation Income	Environmental Remediation Tax Credit	1.000	1.000	1.000	3.000
Corporation Income	Environmental Stewardship Tax Credit	-	5.000	5.000	10.000
Corporation Income	Clean Coal Incentive Credit	-	-	4.200	4.200
Individual Income	Credit for Recycling and/or Composting Equipment	1.200	1.200	1.200	3.600
Liquefied Petroleum	Approved Carburetion Systems	0.011	0.012	0.012	0.035
Real Property Tax	Environmental Remediation Property	0.002	0.002	0.002	0.006
Sales Tax	Recycling Machinery and Equipment	4.600	6.400	6.400	17.400
Sales Tax	Pollution Control Facilities	21.000	21.300	21.600	63.900
Sales Tax	Admissions to and Purchases by Historical Sites	substantial	substantial	substantial	
Individual Income	Historic Preservation Tax Credit	3.000	3.000	3.000	9.000
Tangible Property	Historic Vehicles	0.100	0.100	0.100	0.300
<b>Equine Industry Support</b>		<b>30.956</b>	<b>31.257</b>	<b>31.559</b>	<b>93.772</b>
Sales Tax	Horses Purchased for Breeding	12.300	12.400	12.500	37.200
Sales Tax	Equine Water	0.056	0.057	0.059	0.172
Sales Tax	Horses Less Than Two Years of Age	18.600	18.800	19.000	56.400
<b>Excluded Services</b>		<b>1,437.700</b>	<b>1,551.400</b>	<b>1,673.100</b>	<b>4,662.200</b>
Sales Tax	Personal services	55.200	59.100	63.400	177.700
Sales Tax	Business services	219.400	238.100	259.700	717.200
Sales Tax	Health services	654.600	704.500	754.000	2,113.100
Sales Tax	Legal services	80.600	87.500	95.400	263.500
Sales Tax	Education services	16.500	17.700	19.000	53.200
Sales Tax	Social services	7.600	8.200	8.800	24.600
Sales Tax	Engineering, accounting, research, management	135.800	147.400	160.800	444.000
Sales Tax	Automotive and miscellaneous repair services	112.000	120.000	128.700	360.700
Sales Tax	Amusement and recreational services	28.500	30.600	32.600	91.700
Sales Tax	Other services	5.400	5.800	6.200	17.400
Sales Tax	Specialized Design Services	5.300	5.800	6.300	17.400
Sales Tax	Computer System Designs	55.300	60.000	65.400	180.700
Sales Tax	Scientific R&D	6.300	6.800	7.400	20.500
Sales Tax	Advertising	27.100	29.400	32.100	88.600
Sales Tax	Other Professional Services	28.100	30.500	33.300	91.900

Summary Tables

<b>Tax Expenditures by Program (\$ millions)</b>					
Tax Type		FY 06	FY 07	FY 08	Total
<b>Existing Business Support</b>		<b>4,203.895</b>	<b>4,288.725</b>	<b>4,427.535</b>	<b>12,920.155</b>
Alcoholic Beverage	Reduced Rate for "Low Volume" Spirits	0.040	0.040	0.050	0.130
Corporation Income	Net Operating Loss Deduction	172.300	171.600	166.500	510.400
Corporation Income	Exemption of Dividend Income	67.700	58.000	49.000	174.700
Corporation Income	Patronage Dividend Deduction	15.400	14.500	14.200	44.100
Individual Income	Deductibility of Net Operating Losses	substantial	substantial	substantial	
Individual Income	Deductibility of Expenses of Certain Capital Outlays	3.600	3.600	3.600	10.800
Individual Income	Member, Shareholder or Partner Credit	236.600	245.000	249.400	731.000
Motor Vehicle	Change in Business Structure	0.200	0.200	0.200	0.600
Motor Vehicle	Transfers Between a Limited Liability Company and its Members	0.400	0.600	1.000	2.000
Motor Vehicle	Transfers Between a Subsidiary and a Parent Corporation	0.100	0.100	0.100	0.300
Motor Vehicle	Partnership Interests	0.070	0.100	0.200	0.370
Motor Vehicle	Insurance Company Transfers	0.100	0.100	0.100	0.300
Tangible Property	Business Inventories	60.000	62.900	66.100	189.000
Tangible Property	In-Transit Goods	16.800	16.800	16.800	50.400
Tangible Property	Motor Vehicles with a Salvage Title	minimal	minimal	minimal	
Tangible Property	Floor Plan Machinery and Equipment	minimal	minimal	minimal	
Sales Tax	Labor or Services Used in Property Sold	212.900	217.300	226.700	656.900
Sales Tax	Coin-Operating Bulk Vending Machines	0.085	0.085	0.085	0.255
Sales Tax	Non-returnable and Returnable Containers	1.200	1.200	1.200	3.600
Sales Tax	Occasional Sales	substantial	substantial	substantial	
Sales Tax	Raw Materials and Industrial Supplies	3,378.000	3,450.000	3,584.000	10,412.000
Sales Tax	Catalogs and Newspaper Inserts Shipped Outside Kentucky	substantial	substantial	substantial	
Sales Tax	Internet Tax Nondiscrimination Act	9.400	16.100	16.300	41.800
Special Fuels	Non-Highway Use	29.000	30.500	32.000	91.500
<b>Family Support</b>		<b>342.176</b>	<b>362.948</b>	<b>386.517</b>	<b>1,091.641</b>
Individual Income	Personal and Dependent Tax Credits	83.200	84.700	86.200	254.100
Individual Income	Exclusion of Interest on Life Insurance Savings	71.607	77.552	85.041	234.201
Individual Income	Exclusion of Capital Gains at Death	94.469	103.896	114.275	312.640
Individual Income	Credit for Child and Dependent Care Expenses	7.100	7.100	7.200	21.400
Inheritance Tax	Class A Beneficiaries	64.100	66.900	69.900	200.900
Inheritance Tax	Class B Beneficiaries	minimal	minimal	minimal	
Inheritance Tax	Life Insurance Proceeds	substantial	substantial	substantial	
Inheritance Tax	Certificates of Deposit from the Contemplation of Death Rule	minimal	minimal	minimal	
Inheritance Tax	Recurring Tax Credits	minimal	minimal	minimal	
Motor Vehicle	Immediate Family Member	15.300	16.200	17.100	48.600
Motor Vehicle	Transfers by Will or Court Order	2.700	2.800	2.900	8.400
Sales Tax	Tombstones and Other Grave Markers	3.700	3.800	3.900	11.400
<b>Federal Government Support</b>		<b>40.000</b>	<b>40.410</b>	<b>40.930</b>	<b>121.340</b>
Alcoholic Beverage	U.S. Government Exemption	0.250	0.260	0.270	0.780
Cigarette Tax	U.S. Government Purchases	22.200	22.200	22.200	66.600
Gasoline Tax	U.S. Government Exemption	0.150	0.150	0.160	0.460
Motor Vehicle	Governmental Exemption	10.200	10.600	11.000	31.800
Sales Tax	Federal Taxes Imposed on Sales of Tangible Personal Property	6.600	6.600	6.700	19.900
Special Fuels	U. S. Government Exemption	0.600	0.600	0.600	1.800
<b>Health Care Support</b>		<b>916.100</b>	<b>977.300</b>	<b>1,051.400</b>	<b>2,944.800</b>
Motor Vehicle	Adapted Equipment for Physically Handicapped Persons	-	-	-	-
Sales Tax	Prescription Medicine, Prosthetic Devices and Physical Aids	274.500	280.200	292.300	847.000
Sales Tax	Procurement, Processing or Distribution of Blood or Human Tissue	1.700	1.700	1.800	5.200
Individual Income	Exclusion of Employer Contributions for Medical Insurance Premiums and Care	412.900	456.800	501.100	1,370.800
Individual Income	Health Savings Accounts	2.600	3.000	3.400	9.000
Individual Income	Deductibility of Medical Expenses	30.000	32.800	36.500	99.300
Individual Income	Exclusion of Untaxed Medicare Benefits: Hospital Insurance & Supplementary Medical Insurance	180.200	187.000	199.000	566.200
Individual Income	Health Insurance Premiums Paid by Self-Employed	14.200	15.800	17.300	47.300
Individual Income	Health Insurance Premiums	substantial	substantial	substantial	
Individual Income	Long-Term Care Insurance	minimal	minimal	minimal	
<b>Housing Development</b>		<b>694.412</b>	<b>738.047</b>	<b>782.315</b>	<b>2,214.775</b>
Individual Income	Deductibility of Home Mortgage Interest	182.200	193.800	203.900	811.359
Individual Income	Deductibility of Property Tax on Owner-Occupied Homes	48.712	46.347	44.015	139.075
Individual Income	Gain on the Sale of a Personal Residence	119.100	131.500	145.300	395.900
Real Property Tax	State Real Property Tax Yearly Revenue Ceiling	331.100	352.300	374.100	1,057.500
Real Property Tax	Homestead Exemption	13.300	14.100	15.000	42.400
Sales Tax	Lodgings of Thirty Days or More	substantial	substantial	substantial	



<b>Tax Expenditures by Program (\$ millions)</b>					
<b>Tax Type</b>		<b>FY 06</b>	<b>FY 07</b>	<b>FY 08</b>	<b>Total</b>
<b>Income Maintenance</b>		<b>587.890</b>	<b>602.070</b>	<b>623.800</b>	<b>1,813.760</b>
Individual Income	Standard Deduction	91.700	93.600	95.500	280.800
Individual Income	Exclusion of Worker's Compensation Benefits	18.000	20.000	20.700	58.700
Individual Income	Exclusion of Public Assistance Benefits	1.500	1.500	1.600	4.600
Individual Income	Expanded Low Income Tax Credit	69.100	69.700	70.300	209.100
Individual Income	Deductibility of Casualty and Theft Losses	0.890	0.920	0.950	2.760
Motor Vehicle	Trade-in Allowance on Used Vehicles	31.800	33.600	35.600	101.000
Sales Tax	Food Items	371.500	379.300	395.700	1,146.500
Sales Tax	Garage or Yard Sales	2.000	2.000	2.000	6.000
Special Fuels	Residential Heating	1.400	1.450	1.450	4.300
<b>Intergovernmental Transfers</b>		<b>9.200</b>	<b>9.700</b>	<b>10.200</b>	<b>29.100</b>
Individual Income	Exclusion of Income Earned Abroad by US Citizens	9.200	9.700	10.200	29.100
<b>Investment Development</b>		<b>284.600</b>	<b>-</b>	<b>-</b>	<b>284.600</b>
Intangible Property	Reserves and Capital of Domestic Life Insurance Companies	0.900	-	-	0.900
Intangible Property	Certain Classes of Intangible Properties at a 1.5 Cent Rate	31.600	-	-	31.600
Intangible Property	Exemption of Stock from Intangible Tax	180.400	-	-	180.400
Intangible Property	Certain Classes of Intangible Property at One-Tenth Cent Rates, Including Annuities and Rights to Receive Income	71.200	-	-	71.200
Intangible Property	Broker's Account Receivable	0.500	-	-	0.500
<b>Job Development</b>		<b>118.605</b>	<b>126.705</b>	<b>134.905</b>	<b>380.215</b>
Corporation Income	Unemployment Tax Credit	0.005	0.005	0.005	0.015
Corporation Income	KREDA Economic Development Credit	13.400	14.500	14.800	42.700
Corporation Income	KIDA Economic Development Credit	12.600	13.000	13.500	39.100
Corporation Income	KIRA Economic Development Credit	1.500	1.500	1.500	4.500
Corporation Income	KJDA Economic Development Credit	8.900	9.500	9.800	28.200
Corporation Income	Skills Training Investment Credit	0.300	0.300	0.300	0.900
Individual Income	Exclusion of Employee Benefits Premiums on Group Term Life Insurance, Accident and Disability Insurance				
Individual Income	Life Insurance	6.900	6.900	7.000	20.800
Individual Income	Accident & Disability Insurance	1.000	1.000	1.000	3.000
Individual Income	Exclusion of Employee Meals and Lodging on Employer Premises	2.900	3.000	3.200	9.100
Individual Income	Credit for Hiring Unemployed	minimal	minimal	minimal	
Individual Income	Exclusion of Miscellaneous Fringe Benefits	10.800	11.500	12.300	34.600
Individual Income	Job Development Credit	49.800	54.000	59.000	162.800
Individual Income	Deductibility of Moving Expenses	10.500	11.500	12.500	34.500
<b>Local Government Support</b>		<b>159.699</b>	<b>161.129</b>	<b>165.875</b>	<b>486.703</b>
Individual Income	Deductibility of State and Local Taxes Other Than Home Property Taxes	28.429	27.009	26.155	81.593
Individual Income	Precinct Workers	0.100	0.100	0.100	0.300
Individual Income	Capital Gains - Eminent Domain	minimal	minimal	minimal	
Real Property Tax	Leasehold Interest in Building Financed with Industrial Revenue Bonds	2.800	3.000	3.200	9.000
Real Property Tax	Property of Local Governments in Neighboring States	0.020	0.020	0.020	0.060
Tangible Property	Leasehold Interests	2.400	2.400	2.400	7.200
Tangible Property	Property of Local Government in Neighboring States	2.700	2.700	2.700	8.100
Sales Tax	State, Cities, Counties and Special Districts	117.800	120.200	125.400	363.400
Sales Tax	Rate Increase for School Taxes added to Residential Telephone Bills	5.200	5.400	5.600	16.200
Special Fuels	State and Local Government Use	0.250	0.300	0.300	0.850
<b>Manufacturing Support</b>		<b>129.800</b>	<b>133.700</b>	<b>137.900</b>	<b>401.400</b>
Sales Tax	Machinery for New & Expanded Industry & Certain Industrial Machinery	65.200	65.700	66.300	197.200
Tangible Property	Manufacturing Machinery; Pollution Control Equipment; and Radio, Television & Telephonic Equipment	64.600	68.000	71.600	204.200
<b>Military Support</b>		<b>18.500</b>	<b>20.000</b>	<b>21.200</b>	<b>59.700</b>
Individual Income	Exclusion of GI Bill Benefits	0.500	0.600	0.600	1.700
Individual Income	Exclusion of Veteran's Disability Benefits	12.300	13.200	13.800	39.300
Inheritance Tax	Benefits Paid to a Beneficiary of Military Personnel Under Certain Retirement Plans	minimal	minimal	minimal	
Inheritance Tax	Benefits Paid by the Federal Government Due to Service in Time of War	minimal	minimal	minimal	
Motor Vehicle	Military Exemption	5.700	6.200	6.800	18.700

Summary Tables

Tax Expenditures by Program (\$ millions)					
Tax Type		FY 06	FY 07	FY 08	Total
<b>Natural Resource</b>		<b>9.860</b>	<b>9.710</b>	<b>9.670</b>	<b>29.240</b>
Individual Income	Deductibility of Excess of Percentage Over Cost Depletion	0.360	0.360	0.390	1.110
Natural Resources	Transportation Expense	4.300	4.300	4.300	12.900
Natural Resources	Limestone Sold in Interstate Commerce	1.000	1.000	1.000	3.000
Natural Resources	Limestone Sold or Used for Agricultural Purposes	0.200	0.200	0.200	0.600
Natural Resources	Ball Clay, Fluorspar, Lead, Zinc, Tar Sands, Barite, and Stone Used for Privately Maintained but Publicly Dedicated Roads	0.450	0.450	0.450	1.350
Natural Resources	Limit on Tax from Clay	0.150	0.150	0.150	0.450
Corporation Income	Deductibility of the Excess of Percentage over Cost Depletion	0.900	0.950	0.980	2.830
Corporation Income	Exclusion of Publicly Traded Partnerships	2.400	2.200	2.100	6.700
Natural Resources	Clay Used in Landfill Construction	0.100	0.100	0.100	0.300
<b>Reduced Compliance Burden</b>		<b>28.031</b>	<b>36.201</b>	<b>37.281</b>	<b>101.513</b>
Alcoholic Beverage	Wholesaler Compensation for Collection of Tax	0.730	0.750	0.780	2.260
Cigarette Tax	Compensation Allowed Wholesaler	2.000	2.000	2.000	6.000
Cigarette Tax	Compensation Allowed Wholesaler - Cigarette Surtax	0.300	-	-	0.300
Gasoline Tax	Dealer's Monthly Reporting Allowance	8.700	9.200	9.300	27.200
Inheritance Tax	Discount for Early Payment of Tax	1.300	1.400	1.400	4.100
Liquefied Petroleum	Dealer's Monthly Reporting Allowance	0.001	0.001	0.001	0.003
Sales Tax	Retailers' Compensation for Collecting and Remitting the Tax	12.000	19.800	20.700	52.500
Special Fuels	Dealer's Monthly Reporting Allowance	3.000	3.050	3.100	9.150
<b>Retirement Support</b>		<b>1,031.730</b>	<b>1,034.430</b>	<b>1,067.410</b>	<b>3,133.570</b>
Individual Income	Net Exclusion of Pension Contributions and Earnings	325.800	342.800	340.500	1,009.100
Individual Income	Exclusion of Social Security Benefits: OASI for Retirees				
Individual Income	Disability Insurance Survivors' Benefits	308.200	325.000	339.000	972.200
Individual Income	Deductibility of Individual Retirement Account Contributions	24.000	23.000	21.900	68.900
Individual Income	Deductibility of Keogh Plan Contributions	32.800	35.000	38.100	105.900
Individual Income	Exclusion of Federal and Military Retirement Income Received	68.700	71.300	75.900	215.900
Individual Income	Exclusion of Railroad and Supplemental Railroad Retirement System Benefits	11.300	12.000	12.600	35.900
Individual Income	Exclusion of State Employee Pension Benefits and Contributions	49.100	57.000	66.100	172.200
Individual Income	Exclusion of Private Pensions and Individual Retirement Accounts	158.900	167.200	172.400	498.500
Individual Income	Exclusion of Special Benefits for Disabled Coal Miners	1.130	1.130	0.910	3.170
Inheritance Tax	Annuities Under Qualified Retirement Plans	minimal	minimal	minimal	
Inheritance Tax	Individual Retirement Accounts	minimal	minimal	minimal	
Intangible Property	Retirement Plans	51.800	-	-	51.800
<b>Transportation Industry Support</b>		<b>83.605</b>	<b>89.866</b>	<b>96.372</b>	<b>269.843</b>
Gasoline Tax	Aircraft Refund	0.230	0.240	0.240	0.710
Gasoline Tax	Watercraft Refund	0.700	0.740	0.745	2.185
Gasoline Tax	Bus, Taxicab, and Certain Senior Citizen's Program Refund	0.300	0.300	0.300	0.900
Motor Vehicle	Commercial Motor Vehicle Exemption	minimal	minimal	minimal	
Motor Vehicle	Large Truck Exclusion	20.800	26.000	31.000	77.800
Motor Vehicle	Charter Bus Exemption	0.050	0.050	0.050	0.150
Real Property Tax	Intrastate Railroads and Railway Companies	0.030	0.030	0.030	0.090
Tangible Property	Intrastate Railroads and Railway Companies	0.180	0.180	0.180	0.540
Tangible Property	Interstate Trucks, Tractors, Semi-Trailers & Buses	3.300	3.500	3.700	10.500
Tangible Property	Carlines	3.800	3.800	3.800	11.400
Tangible Property	Aircraft	1.300	1.300	1.300	3.900
Tangible Property	Federally Documented Vessels	minimal	minimal	minimal	
Sales Tax	Sales to Common Carriers Under a Bill of Lading	-	-	-	-
Sales Tax	Semi-Trailers and Trailers	0.150	0.150	0.150	0.450
Sales Tax	Vessels and Maritime Supplies	3.400	3.400	3.400	10.200
Sales Tax	Interstate Cargo and Passenger Aircraft, Parts and Supplies	9.600	9.600	9.600	28.800
Sales Tax	Locomotives and Rolling Stock	substantial	substantial	substantial	
Sales Tax	Jet Fuel	23.000	23.500	24.500	71.000
Sales Tax	Repair Parts for Large Trucks	1.600	1.600	1.700	4.900
Sales Tax	Charter Bus Repair & Replacement Parts	0.100	0.100	0.100	0.300
Special Fuels	Railroad Companies	14.700	15.000	15.200	44.900
Special Fuels	Bus, Taxicab and Certain Senior Citizen's Programs Refunds	0.320	0.330	0.330	0.980
Special Fuels	Watercraft	0.045	0.046	0.047	0.138

# ALCOHOLIC BEVERAGE TAXES

## Background

Alcoholic beverage excise taxes on distilled spirits, beer, and wine became effective in 1936 at the following rates: distilled spirits - \$1.04 a gallon; beer - \$1.50 a barrel and wine - \$0.25 a gallon.

In 1940, the excise tax rate for distilled spirits was raised to \$1.20 and in 1948, it was raised to \$1.28. In 1970, the rate was raised to \$1.92 a gallon where it remains today. In 1986, the tax rate was lowered to \$0.25 per gallon on distilled spirits placed in containers for sale at retail, where the distilled spirits represent 6 percent or less of the total volume of contents of such containers.

In 1954, the rate on wine excise was raised to \$0.50 a gallon and the rate on beer excise was increased to \$2.50 a barrel (\$0.083/gallon). Effective August 1, 1992, the liability for the excise tax on beer was shifted from the brewer to the distributor or retailer.

In 1982, a consumption tax was imposed at the rate of 9 percent of the gross receipts derived from “sales at wholesale” or “wholesale sales of distilled spirits, wine, and beer”. The 2005 General Assembly raised the consumption tax to 11 percent effective June 1, 2005.

Although insignificant from a revenue standpoint, each wholesaler pays a 5-cents-per-case tax on each case of distilled spirits sold within the state.

Total alcoholic beverage taxes were \$81.8 million in FY05, which represents 1.07 percent of the total General Fund revenue.

## Current Rate Structure

### Current Rate Structure

Distilled Spirits Excise .....	\$1.92 a gallon
Beer Excise Tax .....	\$2.50 a barrel
Wine Excise Tax .....	\$0.50 a gallon
Wholesale Sales Tax .....	11% of gross receipts
Distilled Spirits Case Sales Tax .....	\$0.05 per case

**Tax Base** The consumption tax is a gallonage tax and becomes the liability of the distilled spirits and wine wholesaler when these beverages are sold to retailers or consumers within the state. The gallonage tax on beer is paid by the distributor selling in this state. The wholesale sales tax is based on gross receipts derived at the wholesale level. When reporting and paying the sales tax, the wholesaler, distributor, or anyone required to pay the tax is allowed to deduct one percent of the tax due as compensation. The wholesaler of distilled spirits in Kentucky pays the case sales tax.

**Tax Due** The consumption tax, the wholesale sales tax, and the case sales tax must be remitted to the Department of Revenue on or before the twentieth day of the month following the month in which the transactions occurred.

**Exemptions:**

- Wine manufactured, sold, given away or distributed and used solely for sacramental purposes.
- Distilled spirits and wine purchased by holders of special licenses provided for in KRS 243.320 and 243.330 and used as non-beverage alcohol, e.g. medicinal alcohol, antiseptic alcohol, flavoring extracts, syrups, etc.
- Holders of railroad or commercial airline system licenses exempted from excise tax.
- Sales to federal agencies and instrumentalities.
- Sales for shipment outside Kentucky for sales through retail outlets and consumption outside Kentucky

**Table 1. Total Tax Expenditures for Alcoholic Beverage Taxes**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.02 million	\$1.05 million	\$1.10 million

## Tax Expenditures

### 1. U.S. Government Exemption

*Regulation 103 KAR 40:035, effective 1982*

Alcoholic beverages sold to agencies and instrumentalities of the federal government, including the military, are not subject to alcoholic beverage taxes.

FY 2006	FY 2007	FY 2008
\$250,000	\$260,000	\$270,000

### 2. Low Volume Distilled Spirits Taxed at Reduced Rate

*Kentucky Revised Statute 243.720, effective 1986*

Distilled spirits in containers where the distilled spirits represent 6 percent or less of the total volume of the contents of such containers are taxed at the reduced rate of 25 cents per gallon.

FY 2006	FY 2007	FY 2008
\$40,000	\$40,000	\$50,000

### 3. Allowance for Collecting and Reporting

*Kentucky Revised Statute 243.886, effective 1982*

As compensation, each wholesaler required to pay and report the wholesale sales tax is permitted to deduct on each report 1 percent of the tax due.

FY 2006	FY 2007	FY 2008
\$730,000	\$750,000	\$780,000

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# CIGARETTE TAX

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## Background

Kentucky was the twentieth state to enact a tax on cigarettes, which became effective in 1936. The original cigarette excise tax rate was one cent per 10 cents of the sales price. Over time, the “two-cents-per-package” tax gradually became a three-cent levy as more and more retailers began to charge above 20 cents per pack of cigarettes.

On July 1, 1960, a proportionate rate of two and one-half cents on each twenty (20) cigarettes sold within the Commonwealth was assessed.

In 1970 General Assembly created the Tobacco Research Trust Fund. The legislation increased the cigarette excise tax by one-half cent per pack, to three cents per pack. The revenue generated by this tax increase was earmarked for the Tobacco Research Trust Fund.

In 1982, the General Assembly provided for a cigarette enforcement fee, in an amount calculated annually by Revenue, to recover applicable costs of enforcing the fair trade law and administering the cigarette tax law. The present rate is one-tenth of one cent per package of twenty cigarettes.

In 1994, the General Assembly enacted the Teen Tobacco Education Fund and provided that one-twentieth of one cent (\$0.0005) of the three cents per pack revenue be used to offset the cost of the education efforts.

In 2000, the General Assembly enacted the Teen Tobacco Enforcement Fund and provided that one-twentieth of one cent of the three cents per pack revenue be deposited in a trust and agency account to offset the costs of enforcement.

In 2005, the General Assembly enacted a cigarette surtax of a proportionate rate of twenty-six (26) cents on each twenty (20) cigarettes. An additional one-cent was enacted and dedicated to the Cancer Research Matching Fund. The two additional surtaxes bring Kentucky’s total tax on a pack of 20 cigarettes to 30 cents.

For FY05, cigarette tax collections of \$33.7 million were 0.44 percent of total General Fund tax receipts.

**Current Rate Structure**

The tax rate, including both the cigarette excise tax and the cigarette surtax, is thirty (30) cents per package of twenty cigarettes.

**Tax Base**

Both the cigarette excise and the cigarette surtax are paid through the purchase of stamps or meter units from the Department of Revenue. These stamps must be placed on each package of cigarettes as evidence that the tax has been paid. For affixing the tax evidence, the wholesaler is generally allowed the equivalent of a 9.09 percent discount when the evidence is purchased. However, for the six-month period of June 1, 2005 through November 30, 2005, the compensation to wholesalers is increased to the equivalent of a 12.28 percent discount against only the cigarette excise tax when the evidence is purchased during that time.

**Tax Due**

The wholesaler pays the tax at the time the tax stamps or meter units are purchased from the Department of Revenue. A monthly report is required by the twentieth of each month reflecting purchases and trafficking of cigarettes for the preceding month.

**Table 2. Total Cigarette Tax Expenditures**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$24.5 million	\$24.2 million	\$24.2 million

**Tax Expenditures**

**1. Compensation Allowed Wholesaler**

*Kentucky Revised Statute 138.146, effective 1982*

For affixing the tax evidence to each package of cigarettes, the cigarette wholesaler is allowed an amount of tax evidence equal to thirty cents for each three dollars of tax evidence purchased. This converts to a 9.09 percent discount on the purchase of tax evidence.



<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.0 million	\$2.0 million	\$2.0 million

## 2. U.S. Government Purchases

*Regulation 103 KAR 41:130, effective 1975*

Cigarettes sold to the United States or any of its instrumentalities for resale to and consumption by members of the armed services of the United States and cigarettes sold to the Veterans Canteen Service of the Department of Veterans' Affairs for resale to and consumption by veterans hospitalized or domiciled in facilities of the Department of Veterans' Affairs do not require Kentucky cigarette tax evidence and are therefore exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$22.2 million	\$22.2 million	\$22.2million

## Cigarette Surtax Tax Expenditures

### 1. Compensation Allowed Wholesaler

*Kentucky Revised Statute 138.146 (4)(b) 1, effective June 1, 2005*

For the purpose of offsetting the costs associated with paying the Cigarette Surtax, cigarette wholesalers are allowed an additional amount of compensation equal to twelve cents for each three dollars of tax evidence purchased on or after June 1, 2005 and before December 1, 2005. This converts to a 12.28 percent discount on the purchase of tax evidence.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$300,000	\$0	\$0

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# **COAL SEVERANCE AND PROCESSING TAX**

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**Background**     **T**he coal severance tax was enacted in 1972. The tax base was increased in 1978 to tax both the severance and processing of coal in Kentucky. Transportation expense is an allowable exclusion from the gross value. A deduction from gross value is also allowed for coal purchased for the purpose of processing if the coal was purchased from a taxpayer registered with the Commonwealth for coal tax purposes. The 1974 session of the General Assembly provided for a portion of the severance tax to be refunded to the counties in which the coal was severed. The Governor’s Office for Local Development administers the local refund program.

During FY05, the coal tax produced \$184.4 million, which accounted for 2.4 percent of total General Fund receipts.

**Current Rate Structure**     The severance and processing tax rate is 4.5 percent of gross value with a minimum tax of fifty cents per ton. The minimum tax does not apply in the case of taxpayers who only process coal. For coal used for burning solid waste the tax is limited to the lesser of 4 percent of the selling price or fifty cents per ton.

**Tax Base**     The tax is levied on the gross value of the coal. Gross value is the amount received or receivable for the coal, or market value if the coal is consumed and not sold, less transportation expense.

In instances where coal is purchased for processing, the processor is taxed on the final sales price, or market value, in the case of consumption, reduced by the amount paid for the coal and transportation expense.

**Tax Due**     The tax return and payment is due on the twentieth day of the month following the close of the taxable period.

**Table 3. Total Coal Severance and Processing Tax Expenditures**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$18.1 million	\$18.4 million	\$17.3 million

**Tax Expenditures**

**1. Transportation Expense**

*Kentucky Revised Statute 143.010(6)(11), effective 1978*

Transportation expense incurred in transporting coal from the mine mouth or pit to a processing plant, tipple, loading dock, or customer is deductible in computing gross value.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$17.7 million	\$18.0 million	\$16.9 million

**2. Coal Used to Burn Solid Waste**

*Kentucky Revised Statute 143.023, effective 1991*

Tax is limited to fifty cents per ton or 4 percent of the selling price, whichever is less, on coal used for burning solid waste.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$0	\$0	\$0

### 3. Thin Seam Tax Credit

*Kentucky Revised Statute 143.021, effective 2000*

A non-refundable tax credit is allowed for mining coal from thin seams or from areas with a high mining ratio. The credit is on a sliding scale from 2.25 percent to 3.75 percent of the value of the severed coal, based on the thickness of the seam, the ratio of overburden removed to coal severed, or the sulfur content of the coal.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$400,000	\$400,000	\$400,000

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# **CORPORATION INCOME & LICENSE TAXES**

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**Background** The corporation license tax was first enacted in 1906 at the rate of 30 cents per \$100 on the value of capital, represented by property owned and business transacted in the state. This annual tax is for the privilege of operating as a corporation in Kentucky. In the Extraordinary Session of 1985, the General Assembly increased the rate to \$2.10 from the rate of seventy cents (\$.70) on each one thousand dollars (\$1,000) of capital employed in the business. A credit of \$1.40 per \$1,000 was allowed for the first \$350,000 of capital employed for corporations with a gross income of \$500,000 or less. The minimum annual license tax is \$30. The 2005 General Assembly repealed the corporation license tax for taxable years ending on or after December 31, 2005.

The corporation income tax was first levied in 1936. The rate was 4 percent of net income assigned to Kentucky after the deduction of federal income tax. In 1972 the deduction of federal income tax was removed and several rate changes have occurred, including increasing the top rate of the graduated scale to 7.25 percent and 8.25 percent in 1985 and 1990, respectively.

The 2005 General Assembly made significant changes to the corporation income statutes by:

- including limited liability entities within the definition of corporation, except that publicly traded partnerships are not included;
- providing an alternative minimum calculation with two optional calculations;
- reducing the top rate of the graduated scale to seven percent (7%) for taxable years beginning on or after January 1, 2005 and prior to January 1, 2007 and six percent (6%) for taxable years beginning on or after January 1, 2007; and
- closing multiple loopholes in order to provide a broader base accompanied by the lower rate.

Corporate license tax receipts for FY05 were \$134.1 million and accounted for 1.75 percent of total General Fund tax receipts.

Corporate income tax receipts for FY05 were \$478.5 million and accounted for 6.3 percent of total General Fund tax receipts.

**Current  
Rate  
Structure**

The corporation income tax rates are graduated as shown in the following table:

**Table 4. Corporation Income Tax Rates**

For taxable years beginning after December 31, 1989 and before January 1, 2005:

First	-	\$25,000	4.00%
\$25,001	-	\$50,000	5.00%
\$50,001	-	\$100,000	6.00%
\$100,001	-	\$250,000	7.00%
Over	-	\$250,000	8.25%

For taxable years beginning after December 31, 2004 and before January 1, 2007:

First	-	\$50,000	4.00%
\$50,001	-	\$100,000	5.00%
Over	-	\$100,000	7.00%

For taxable years beginning after December 31, 2006:

First	-	\$50,000	4.00%
\$50,001	-	\$100,000	5.00%
Over	-	\$100,000	6.00%

**Tax Base**

The tax base for the corporation income tax is taxable net income. Taxable net income is essentially gross income minus allowable deductions, with apportionment and allocation provisions for multistate corporations.



For corporations taxable only in Kentucky, taxable net income is the same as “net income”. For corporations taxable both within and without Kentucky, taxable net income is “net income” after apportionment and allocation. The total of the corporation’s net income, after direct allocation of income not resulting from activities that are integral parts of the corporation’s business, is apportioned using the following apportionment formula:

$$\left[ \frac{\text{KY Property}}{\text{Total Property}} + \frac{\text{KY Payroll}}{\text{Total Payroll}} + \left( \frac{\text{KY Sales}}{\text{Total Sales}} \times 2 \right) \right] / 4$$

Kentucky “double weights” the sales factor in the above formula, which is common practice for most states that impose corporate income tax.

**Taxable Unit**

Every corporation doing business in this state must pay an annual tax. The term “doing business” is defined to include, but is not limited to:

- Being organized under the laws of this state;
- Having a commercial domicile in this state;
- Owning or leasing property in this state;
- Having one or more individuals performing services in this state;
- Maintaining an interest in a general partnership doing business in this state;
- Deriving income from or attributable to sources within this state, including deriving income directly or indirectly from a trust doing business in this state; or
- Directing activities at Kentucky customers for the purpose of selling them goods or services.

The following corporations are specifically exempted from the license tax:

- (a) State and national banks and trust companies;
- (b) Savings and loan associations organized under the laws of Kentucky and under the laws of the United States and making loans to members only;

- (c) Banks for cooperatives;
- (d) Production credit associations;
- (e) Insurance companies, including farmers' or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;
- (f) Corporations or other entities exempt under Section 501 of the IRC;
- (g) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit; and
- (h) Corporations whose only owned or leased property located in this state is located at the premises of a printer with which it has contracted for printing, provided that
  - (1) the property consists of the final printed product, or copy from which the printed product is produced; and
  - (2) the corporation has no individual receiving compensation in this state as provided in KRS 141.120(8) (b).

**Tax Due**

The taxable period for income tax is one year (or less in limited circumstances). Corporations must use the same accounting period as is used for federal income tax purposes. Corporations with an anticipated liability in excess of \$5,000 for the year must file declarations of estimated tax and make estimated tax payments.

The tax return and payment of any remaining tax liability are due on the fifteenth day of the fourth month following the close of the taxable period, April 15 for calendar-year corporations. Extensions of time within which to file the return are available in certain circumstances.

**Table 5. Total Corporation Income and License Tax Expenditures**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$416.5 million	\$414.0 million	\$402.9 million

## Tax Expenditures

### 1. Net Operating Loss Deduction

*Kentucky Revised Statute 141.010(13), 141.011, effective 1980*

In calculating Kentucky taxable income, a corporation may carry forward a net operating loss for twenty years, in order to reduce taxable income in profitable years. The net operating loss carryback deduction is not allowed for losses incurred in tax years beginning on or after January 1, 2005.

FY2006	FY2007	FY2008
\$172.3 million	\$171.6 million	\$166.5 million

### 2. Exemption of Dividend Income

*Kentucky Revised Statute 141.010(12)(b), effective 1969*

Dividend income (domestic and foreign) is excluded from gross income.

FY2006	FY2007	FY2008
\$67.7 million	\$58.0 million	\$49.0million

### 3. Exclusion of 50 Percent of Coal Royalties

*Kentucky Revised Statute 141.010(12)(d), effective 1962*

Corporations owning an economic interest in coal land may exclude 50 percent of any royalties received from such land if it does not deduct certain expenses related to the production of the royalty income, including percentage depletion.

FY2006	FY2007	FY2008
Minimal	Minimal	Minimal

**4. Deductibility of the Excess of Percentage Over Cost Depletion**

*Kentucky Revised Statute 141.010(13), IRC Sec. 611 through 614, effective 1954*

A percentage of the gross income from mining or drilling for natural resources may be deducted as a percentage depletion allowance, even if the cost basis has been reduced to zero.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$900,000	\$950,000	\$980,000

**5. Deduction for Charitable Contributions**

*Kentucky Revised Statute 141.010(13), IRC Sec. 170, effective 1954*

Charitable donations of up to 10 percent of taxable income are deductible from net income. A carryover of excess contributions is allowed for up to five years.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$29.5 million	\$29.0 million	\$28.5 million

**6. Deductibility of Patronage Dividends**

*Kentucky Revised Statute 141.010(13), IRC Sec. 521, effective 1954*

Dividends paid to members or patrons of incorporated cooperatives, such as farmer cooperatives, are deductible.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$15.4 million	\$14.5 million	\$14.2 million

**7. Unemployment Tax Credit**

*Kentucky Revised Statute 141.065, effective 1982*

Corporations hiring persons who have been unemployed for 60 days and who remain employed for 180 days, are allowed a \$100 tax credit for each qualified person.

FY2006	FY2007	FY2008
\$5,000	\$5,000	\$5,000

**8. Exemption for Credit Unions**

*Kentucky Revised Statute 290.115, effective 1954*

Credit unions are exempt from corporation income tax.

FY2006	FY2007	FY2008
\$17.5 million	\$16.4 million	\$16.1 million

**9. Coal Conversion Credit**

*Kentucky Revised Statute 141.041, effective 1984*

Corporations may claim an income tax credit equal to 4.5 percent of the purchase price, minus transportation costs, of coal consumed or substituted in heating facilities that are currently using a different source of energy.

FY2006	FY2007	FY2008
\$200,000	\$200,000	\$200,000

**10. Double Weighted Sales Factor**

*Kentucky Revised Statute 141.120(8), effective 1985*

Double weighting of the sales factor for multistate corporations.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$69.7 million	\$65.5 million	\$64.2 million

### 11. Recycling Credit

*Kentucky Revised Statute 141.390, effective 1991*

A credit of 50 percent of the installed cost of recycling or composting equipment, used exclusively in this state, for post consumer waste.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.4 million	\$9.1 million	\$9.3million

### 12. Enterprise Zone Credit

*Kentucky Revised Statute 154.45-090, effective 1992*

A corporation whose business is located in an enterprise zone may claim a credit of 10 percent of the wages paid to each employee, who has been unemployed for at least ninety days, or has received public assistance benefits for at least ninety days prior to employment. The credit is limited to \$1,500 per qualified employee.

Enterprise Zones expire on December 31st of the twentieth year following designation as a zone. The following list shows the year in which each enterprise zone expired or will expire.

Louisville .....	2003	Lexington .....	2005
Hickman .....	2003	Knox County .....	2006
Ashland .....	2004	Campbell County .....	2006
Covington .....	2004	Paducah .....	2006
Owensboro .....	2005	Hopkinsville .....	2007

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$50,000	\$50,000	\$50,000

**13. (KREDA) Economic Development Credit**

*Kentucky Revised Statute 141.347, effective 1988*

A 100 percent credit is allowed against the income of an approved company generated by or arising out of the economic development project. The credit can be carried forward for up to fifteen years, but cannot exceed the authorized cumulative approved costs under the respective financing agreement.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$13.4 million	\$14.5 million	\$14.8 million

**14. (KIDA) Economic Development Credit**

*Kentucky Revised Statute 141.400, effective 1992*

A 100 percent credit is allowed against the income of an approved company generated by or arising out of the economic development project. The credit can be carried forward for up to ten years, but cannot exceed, in any fiscal year, the authorized cumulative approved costs paid in the three-year period commencing with the date of final approval of the economic development project.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$12.6 million	\$13.0 million	\$13.5 million

**15. (KIRA) Economic Development Credit**

*Kentucky Revised Statute 141.403, effective 1992*

A 100 percent credit is allowed against the income of an approved company generated by or arising out of the economic development project. The credit can be carried forward for up to ten years, but cannot exceed 50 percent of the approved costs of the project.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.5 million	\$1.5 million	\$1.5 million

**16. (KJDA) Economic Development Credit**

*Kentucky Revised Statute 141.407, effective 1992*

A 100 percent credit is allowed against the income of an approved company generated by or arising out of the economic development project. The credit can be carried forward for up to ten years, but cannot exceed 50 percent of the total approved start-up costs plus 50 percent of the annualized rental payments connected to the project.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$8.9 million	\$9.5 million	\$9.8 million

**17. Kentucky Investment Fund Tax Credit**

*Kentucky Revised Statute 154.20, effective 1998*

An investor making a cash contribution to a qualified investment fund is allowed a credit equal to 40 percent of the contribution against the corporate income or license tax liability. The credit may be carried forward for 15 years, but cannot exceed 50 percent of the initial aggregate credit amount approved for the investment fund, which would be proportionally available to investors.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$50,000	\$50,000	\$50,000

**18. Skills Training Investment Tax Credit**

*Kentucky Revised Statute 154 - 12.2088, effective 1998*

A credit of 50 percent of the approved cost of a company’s skills training program is allowed against the corporate income tax liability.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$300,000	\$300,000	\$300,000



**19. Real Estate Investment Trust**

*Kentucky Revised Statute 141.010(14), effective 1998*

REIT's are allowed the dividend paid deduction for corporation income tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**20. (KEOZ) Economic Development Credit**

*Kentucky Revised Statute 154.23, effective 2000*

A 100 percent credit is allowed against the income tax liability of an approved company generated by or arising out of the economic development project within the Kentucky Economic Opportunity Zone. Significant restrictions apply to the location of the zone and the qualifications for employees.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$50,000	\$50,000	\$50,000

**21. Coal Incentive Credit**

*Kentucky Revised Statutes 141.0405, effective 2000*

A credit is allowed to any electric power company or any entity that operates a coal fired electric generation plant. The credit is equal to \$2 multiplied by the increase in tons burned in the tax year over the tons burned in the base year.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$100,000	\$100,000	\$100,000

**22. Environmental Remediation Tax Credit**

*Kentucky Revised Statutes 141.418, effective 2005*

Taxpayers who agree to clean up or develop an existing abandoned brownfield area may qualify for a credit against corporation income taxes in a maximum amount of \$150,000.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.0 million	\$1.0 million	\$1.0 million

**23. Biodiesel Tax Credit**

*Kentucky Revised Statutes 141.423, effective 2005*

A credit of up to \$1 per gallon may be claimed for producing or blending biodiesel fuels.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.5 million	\$1.5 million	\$1.5 million

**24. Environmental Stewardship Tax Credit**

*Kentucky Revised Statutes 141.430, effective 2007*

A credit is available for a taxpayer undertaking an environmental stewardship project with a minimum investment of at least \$5 million. The credit covers 100 percent of eligible skills upgrade training costs and up to 25 percent of eligible equipment costs. The Cabinet for Economic Development approves a project producing a new or improved manufactured product that has a lesser or reduced adverse effect on human health or the environment for a taxpayer meeting certain wage requirements.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$0	\$5.0 million	\$5.0 million

**25. Clean Coal Incentive Credit**

*Kentucky Revised Statutes 141.428, effective 2007*

A credit is available to an electric generation facility investing more than \$150 million and certified by the Environmental and Public Protection Cabinet as using clean coal equipment and technology and burning coal subject to Kentucky’s severance tax at a rate of \$2 per ton of qualifying coal burned.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$0	\$0	\$4.2 million

**26. Exclusion of Publicly Traded Partnerships**

*Kentucky Revised Statutes 141.010 (24), effective 2005*

The term “corporation” does not include a publicly traded partnership or its publicly traded partnership affiliates that are treated as a partnership for federal tax purposes.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.4 million	\$2.2 million	\$2.1 million

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# GASOLINE TAX

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**Background** In 1920, Kentucky levied a tax at the rate of 1 cent per gallon of gasoline. It was the fifth state to implement such a tax. In 1980, because the price of gasoline had increased so rapidly and was projected to continue to increase, the legislature changed the tax base to the average wholesale price per gallon and the rate to 9 percent of the average wholesale price per gallon. As designed, if the price of gasoline increased, the tax increased proportionally. At the same time, a minimum wholesale price of \$1.00 per gallon was established, thus creating a “floor”, or minimum tax, of 9 cents per gallon. In 1982, the minimum wholesale price was increased to \$1.11 per gallon, increasing the “floor” to 10 cents per gallon. In 1986, the “supplemental highway user tax”, at the rate of 5 cents per gallon, was enacted. This raised the minimum tax to 15 cents per gallon. In 2005, the minimum wholesale price was increased to \$1.22, raising the minimum tax to 16 cents per gallon.

Pursuant to the provisions of Section 230 of the Kentucky Constitution, the receipts generated by the tax are deposited in the Road Fund to be used for the construction and maintenance of Kentucky’s roads.

For FY05, gasoline tax collections totaled \$351.1 million. This accounted for 31.2 percent of total Road Fund tax receipts.

**Current Rate Structure** The tax rate is 9 percent of the average wholesale price per gallon. A supplemental highway user tax is also levied. The rate for the supplemental tax is variable, based on changes in wholesale prices, and has a ceiling of 5 cents per gallon.

**Tax Base** The tax is levied on the average wholesale price per gallon with a minimum wholesale price of \$1.11 per gallon. The tax becomes a liability of the dealer when the gasoline is received or enters the dealer’s storage facility. In reporting and paying the tax, the dealer is allowed a deduction to cover evaporation, shrinkage, unaccountable losses, collection costs, bad debts, and handling and reporting the tax. An exemption is allowed for sales to the federal government, transfers to other licensed dealers, and for amounts exported out of state or lost through ac-

countable losses. Refunds or exemptions are allowed for amounts used in agriculture, aircraft, motorboats, city and suburban buses and taxicabs, senior citizen transportation programs, and non-profit buses.

**Tax Due** Returns and payments of the tax are due monthly and are to be submitted by the twenty-fifth day of the following month.

**Table 6. Total Gasoline Tax Expenditures**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$10.1 million	\$10.7 million	\$10.8 million

**1. Dealer’s Monthly Reporting Allowance**

*Kentucky Revised Statute 138.270(1)(b), effective 1936*

A gasoline dealer is allowed a 2.25 percent credit of the net tax due when timely filing and paying a monthly tax return.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$8.7 million	\$9.2 million	\$9.3 million

**2. U.S. Government Exemption**

*Kentucky Revised Statute 138.240(2), effective 1956*

Gasoline sold to the U.S. Government is exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$150,000	\$150,000	\$160,000

**3. Agricultural Exemption**

*Kentucky Revised Statute 138.344(1), effective 1946, revised 2002*

The gasoline is sold tax free if the gasoline is used exclusively in tractors or stationary engines for agricultural purposes.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$60,000	\$70,000	\$70,000

**4. Aircraft Refund**

*Kentucky Revised Statute 138.341, effective 1942*

100 percent of the tax paid is refunded to qualified purchasers if the gasoline is used in aircraft engaged in the transportation of persons or property.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$230,000	\$240,000	\$240,000

**5. Watercraft Refund**

*Kentucky Revised Statute 138.445, effective 1960*

The entire tax paid is refunded to qualified boat dock operators if the gasoline is used to operate or propel watercraft.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$700,000	\$740,000	\$745,000

**6. Bus, Taxicab and Certain Senior Citizen’s Programs Refunds**

*Kentucky Revised Statute 138.446, effective 1978*

Seven-ninths of the tax paid is refunded if the gasoline is used in regularly scheduled operations of the city and suburban buses, taxicabs, senior citizen transportation and non-profit buses.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$300,000	\$300,000	\$300,000



# INDIVIDUAL INCOME TAX

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**Background** The individual income tax was first imposed in Kentucky in 1936. From 1943 to 1960, it was the most productive General Fund revenue source. From 1960 through 1986, it was second only to the sales and use tax. In 1987, it again became the most productive revenue source and continues so today. In FY88 the individual income tax became Kentucky's first billion-dollar tax. Collections from the tax totaled \$3,036 million in FY05, a growth of 8.6 percent over the prior year. This amount accounted for 39.7 percent of total General Fund receipts for the year.

In 1954, Kentucky became the fourth state to adopt a general withholding system. Previously, the law provided for withholding on nonresidents only. The 1954 law also adopted the federal definition of net income, using the Internal Revenue Code as a base, with minor exceptions.

Prior to 1954, Kentucky's income tax was quite different from the federal tax in many ways. The first adoption of the federal code provided uniformity in determining income and itemized deductions and in certain definitions. For example, nothing exists in Kentucky law about such basic elements as medical expenses, most business expenses, and qualifications for dependents. Such items are included by reference to the federal code.

As a legal and revenue precaution, Kentucky does not automatically adopt changes in the federal code, except for changes in accounting provisions and methods. Any adoption of changes made in the federal code require ratification by the General Assembly. Many times the impacts of adopting changes in the federal code on Kentucky taxpayers and General Fund receipts can only be made after extensive studies of the changes. Kentucky's method of adoption helps prevent unanticipated and undesirable results from occurring.

Kentucky income tax law provides for tax rates, credits, a standard deduction, interest and penalties, withholding

procedures, and certain other items, independent of the federal law. It encourages husbands and wives to file separately on a combined return because usually a tax savings is involved. The individual income tax return is filed by individuals, including sole proprietors, shareholders in an S corporation, partners in a partnership, and individual members of a limited liability company.

### **Actions Taken by the 2005 Kentucky General Assembly**

**Reference to the Internal Revenue Code (IRC)**—(Effective for tax periods beginning on or after January 1, 2005, except where otherwise indicated.) This bill updates the IRC reference date to December 31, 2004, as the basis for Kentucky income taxes, with three exceptions. The three exceptions are:

- (1) For property placed in service after Sept. 10, 2001, only the depreciation and expense deductions allowed under Sections 168 and 179 of the IRC in effect on December 31, 2001, exclusive of any amendments made subsequent to that date, shall be allowed;
- (2) The provisions of the Military Family Tax Relief Act of 2003, Pub. L. No. 108-121, are effective on the dates specified in that act; and
- (3) Kentucky will not allow the deduction for sales and use taxes in lieu of state income taxes.

By updating the reference date, Kentucky's tax laws conform more closely with federal laws, providing ease of filing for taxpayers.

**Expanded Low Income Tax Credit**—(Effective for tax periods beginning on or after January 1, 2005.) Most low-income taxpayers will have increased relief. The low income tax credit is repealed for taxable years beginning on or after January 1, 2005. The new expanded credit is based on modified gross income (MGI) and size of the family household up to four members. Single and married taxpayers whose MGI is at or below federal poverty level for the family size will receive 100 percent tax credit. For 2005, MGI levels that qualify for the 100 percent tax credit are as follows:

<u>Size of Family Unit</u>	<u>Amount</u>
1	\$ 9,570
2	\$12,830
3	\$16,090
4	\$19,350

The Expanded Low Income Tax Credit provides benefit to individuals and families at incomes up to 133 percent of the federal poverty level, through a phase out of the credit.

**Rate Reduction**—(For taxable years beginning after December 31, 2004.) The tax rate for taxable income between \$8,000 and \$75,000 drops to 5.8 percent with taxable income over \$75,000 continuing to be taxed at 6 percent.

**Net Operating Losses (NOL)**—(Effective for tax periods beginning on or after January 1, 2005.) Individuals may no longer carry NOLs back to previous years.

**Phase II Tobacco Payments**—(Effective for tax periods beginning on or after January 1, 2005.) State funds that may be paid out as an addition to or a replacement of Phase II tobacco payments are exempt from individual income tax.

**Pensions**—(Effective January 1, 2005.) The pension exclusion is capped at \$41,110, the 2005 amount. KRS 141.105, which provided for the cost of living adjustment, is repealed.

**Education Tuition Tax Credit**—(Effective for tax periods beginning on or after December 31, 2004.) A credit equal to 25 percent of the amount of the federal Hope Scholarship and the Lifetime Learning Credit is available. The credit applies only to undergraduate studies, phases out for higher incomes and applies to most higher education opportunities within Kentucky.

**Health Savings Accounts**—(Effective for tax periods beginning on or after January 1, 2005.) As a part of the IRC update, Kentucky allows the same tax advantages currently available at the federal level for health savings accounts. Benefits include permitting pretax treatment of contributions to health savings accounts and more potential uses of funds than are allowed with flexible spending accounts.

**Refund Designation**—Taxpayers may now contribute all or a portion of their individual refund to the Breast Cancer Research and Education Trust Fund. The fund replaces the Bluegrass State Games and U.S. Olympic Committee Fund on the Kentucky individual income tax return.

**Current Rate Structure** The following rates are currently in effect, for both separately and jointly filed returns.

**Table 7. Individual Income Tax Rates**

<u>Taxable Income</u>		<u>Rate</u>
First	- \$3,000	2%
\$3,001	- \$4,000	3%
\$4,001	- \$5,000	4%
\$5,001	- \$8,000	5%
\$8,001	- \$75,000	5.8%
Over	- \$75,000	6%

The low income credit was expanded by the 2005 General Assembly, as explained above.

**Tax Base** The individual income tax is levied on taxable income. Taxable income is computed by reducing gross income by trade or business expenses and the standard deduction (\$1,870 for 2004) or, at the option of the taxpayer, itemized deductions. Gross income is defined as gross income under the 2001 federal Internal Revenue Code with certain adjustments.

Kentucky residents are taxed on their net income from all sources with no allocation or apportionment for out-of-state income, but are allowed a limited credit on their return for income taxes paid to other states on income taxed by Kentucky. Nonresidents are taxed on income from sources within Kentucky, from business carried on within Kentucky, and for the performance of services in Kentucky. This includes income from business conducted through partnerships, S corporations and limited liability companies.

**Taxable Unit** Each individual is taxed on his or her separate income. Married couples may choose to file a joint return. The income of estates, trusts, and receivers is, with minor exceptions, subject to the same provisions as individuals.

**Tax Due** The taxable period is one year (or less in limited circumstances), usually a calendar year. Taxpayers must use the same accounting period as is used for federal purposes. Taxpayers with income from sources not subject to withholding must, in most cases, file tax liability declarations and pay estimated tax.

The tax return and payment of any remaining tax liability are due on the fifteenth day of the fourth month following the close of the taxable period, April 15 for calendar-year taxpayers. Extensions of time for filing the return are available under limited circumstances.

**Table 9. Total Individual Income Tax Expenditures**

FY2006	FY2007	FY2008
\$2,890.8 million	\$3,055.2 million	\$3,209.5 million

**Tax Expenditures**

**1. Net Exclusion of Pension Contributions and Earnings**

*Internal Revenue Code Section 401 and 414, effective 1983*

An employer or self-employed taxpayer can deduct contributions made to retirement plans for employee or self. Plans include pensions, profit sharing, or stock bonus plans.

FY2006	FY2007	FY2008
\$325.8 million	\$342.8 million	\$340.5 million

**2. Personal and Dependent Tax Credits**

*Kentucky Revised Statute 141.020(3), effective 1961*

A credit against tax of \$20 is allowed for taxpayers and dependents, plus \$40 if age 65 or older or blind, and \$20 if a member of the Kentucky National Guard.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$83.2 million	\$84.7 million	\$86.2 million

**3. Standard Deduction**

*Kentucky Revised Statutes 141.081, effective 1946, various amendments*

A taxpayer who does not itemize deductions is permitted a deduction of a predetermined amount, referred to as the ‘standard deduction’. The amount of the deduction has been amended several times; under current law it increases based on growth in inflation. For 2005, the standard deduction was \$1,910 per taxpayer.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$91.7 million	\$93.6 million	\$95.5 million

**4. Deductibility of Home Mortgage Interest**

*Internal Revenue Code Section 163(a), effective 1954*

An itemized deduction is allowed for all interest paid or accrued, on owner-occupied homes, during the taxable year.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$182.2 million	\$193.8 million	\$203.9 million

**5. Deductibility of State and Local Taxes Other Than Home Property Taxes**

*Internal Revenue Code Section 164(a), effective 1979 and 1990*

A taxpayer who itemizes may deduct a nonbusiness state or local personal property tax, a windfall property tax, and a local occupational tax.

FY2006	FY2007	FY2008
\$28.4 million	\$27.0 million	\$26.2 million

**6. Exclusion of Employer Contributions for Medical Insurance Premiums and Care**

*Internal Revenue Code Section 105(b) and 106, effective 1954*

Employer contributions for medical insurance premiums and reimbursements for medical care are not included in the income of the employee and are deductible by the employer.

FY2006	FY2007	FY2008
\$412.9 million	\$456.8 million	\$501.1 million

**7. Exclusion of Social Security Benefits: OASI for Retirees Disability Insurance Survivors' Benefits**

*Revenue Ruling 70-217, effective 1954*

Social Security benefits paid to retired workers and their dependents, to persons who are survivors of deceased workers, and to disabled workers and their dependents are not taxed. Kentucky has not adopted IRC Sec. 86 which taxes a portion of these payments if the taxpayer's income is above a certain level.

FY2006	FY2007	FY2008
\$308.2 million	\$325.0 million	\$339.0 million

**8. Deductibility of Property Tax on Owner-Occupied Homes**

*Internal Revenue Code Section 164(a), effective 1954*

State, local, and foreign real property taxes are deductible as itemized deductions.

FY2006	FY2007	FY2008
\$48.7 million	\$46.4 million	\$44.0 million

**9. Deductibility of Charitable Contributions**

*Internal Revenue Code Section 170(c)(b), effective 1978*

The deduction ceiling for most charitable contributions is 50 percent of Kentucky adjusted gross income, computed without regard to any net operating loss deduction. Gifts to private nonprofit organizations are limited to 20 percent of AGI. Some capital gain property is limited to 30 percent of AGI.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$67.4 million	\$69.0 million	\$71.0 million

**10. Exclusion of Interest on Life Insurance Savings**

*Internal Revenue Code Section 101(a), effective 1978*

Interest received on life insurance savings because of death is exempt. Interest income that accrues within an insurance policy and passes to beneficiaries as part of the life insurance policy is exempt from income tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$71.6 million	\$77.6 million	\$85.0 million

**11. Exclusion of Capital Gains at Death**

*Internal Revenue Code Section 1014, effective 1954*

No tax is imposed on capital gains resulting from the transfer at death of appreciated property. The appreciation that accrued during the lifetime of the transferor is never taxed as income.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$94.5 million	\$103.9 million	\$114.3 million



**12. Deductibility of Individual Retirement Account Contributions***Internal Revenue Code Section 219 (a)(b), effective 1982*

Employees and self-employed persons receiving compensation can establish their own IRA even if they are already covered by a tax-qualified retirement plan, with certain limitations.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$24.0 million	\$23.0 million	\$21.9 million

**13. Deductibility of Keogh Plan Contributions***Internal Revenue Code Section 404(a)(8), effective 1963*

A sole proprietor or a partnership can set up a qualified retirement plan known as a Keogh plan to cover themselves as an employee or other employees.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$32.8 million	\$35.0 million	\$38.1 million

**14. Exclusion of Federal and Military Retirement Income Received***Kentucky Revised Statute 141.021, effective 1990*

A total exclusion is allowed from gross income for federal and military retirement income.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$68.7 million	\$71.3 million	\$75.9 million

**15. Exclusion of Employee Benefits Premiums on Group Term Life Insurance and Accident and Disability Insurance***Internal Revenue Code Section 79(a) and 106, effective 1955*

Employer payments of employee group term life insurance premiums for coverage up to \$50,000 per employee.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$6.9 million	\$6.9 million	\$7.0 million

Employer contributions for premiums on accidental injury and accidental death insurance are not included in income by the employee and are deductible by the employer.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.0 million	\$1.0 million	\$1.0 million

**16. Exclusion of Worker’s Compensation Benefits**

*Internal Revenue Code Section 104(a), effective 1954*

Worker’s compensation benefits, paid to disabled employees or their survivors for employment-related injuries or diseases, are not taxed.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$18.0 million	\$20.0 million	\$20.7 million

**17. Exclusion of Veteran’s Disability Benefits**

*Internal Revenue Code Section 104(a)(4), effective 1954*

Disability pensions paid to military personnel are fully excluded from gross income. The portion of a regular pension that is paid on the basis of disability may also be excluded.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$12.3 million	\$13.2 million	\$13.8 million

**18. Credit for Child and Dependent Care Expenses**

*Kentucky Revised Statute 141.067, effective 1990*

A credit equal to 20 percent of the federal child care credit amount is allowed.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$7.1 million	\$7.1 million	\$7.2 million

## **19. Health Savings Account Deduction**

*Internal Revenue Code Section 223, effective January 1, 2005*

Employee contributions to a Health Savings Account are deductible within the same limitations provided for federal purposes.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.6 million	\$3.0 million	\$3.4 million

## **20. Exclusion of Income Earned Abroad by U.S. Citizens**

*Internal Revenue Code Section 911(a)(1) and 911(b)(2), effective 1985*

A qualifying individual who works and receives earned income from foreign sources may elect to exclude up to \$72,000 of foreign earned income attributable to the period of residence in a foreign country.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$9.2 million	\$9.7 million	\$10.2 million

## **21. Deductibility of Excess of Percentage Over Cost Depletion**

*Internal Revenue Code Section 613, effective 1981*

When property is entitled to either cost or percentage depletion, the deduction is whichever is larger. Percentage depletion continues to be deductible as long as there is gross income, even after the taxpayer's basis for property has been reduced to zero.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$360,000	\$360,000	\$390,000

**22. Deductibility of Medical Expenses**

*Internal Revenue Code Section 213, effective 1990*

Medical and dental expenses in excess of 7.5 percent of Kentucky Adjusted Gross Income are deductible when itemizing deductions.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$30.0 million	\$32.8 million	\$36.5 million

**23. Deductibility of Net Operating Losses**

*Kentucky Revised Statute 141.010(11) and 142.011, effective 1980*

The Kentucky net operating loss deduction is permitted in computing adjusted gross income. Beginning in 2005, taxpayers are no longer allowed to carry back a net operating loss but may continue to carry forward any net operating loss.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Substantial	Substantial	Substantial

**24. Exclusion of Employee Meals and Lodging on Employer Premises**

*Internal Revenue Code Section 119, effective 1978*

The value of meals and lodging, furnished to the employee by the employer on the business premises for the employer’s convenience, is not included in the income of the employee and is deductible by the employer.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.9 million	\$3.0 million	\$3.2 million

## 25. Exclusion of Railroad and Supplemental Railroad Retirement System Benefits

*45 USCA Section 228L and Kentucky Revised Statute 141.010(10)(b), effective 1970*

All Railroad Retirement Board benefits and supplemental railroad retirement benefits are not taxed. Kentucky has not adopted IRC Sec. 86, which taxes some of these benefits if a taxpayer's income is above a certain level.

FY2006	FY2007	FY2008
\$11.3 million	\$12.0 million	\$12.6 million

## 26. Exclusion of State Employee Pension Benefits and Contributions

*Kentucky Revised Statute 141.010(10)(d), effective various dates*

Benefits received from state employee, county and local government employee, judicial, teacher, and state legislator retirement systems are totally exempt from tax if the recipient retired before December 31, 1997. Persons retiring after December 31, 1997 may be taxed on a portion of the benefits.

FY2006	FY2007	FY2008
\$49.1 million	\$57.0 million	\$66.1 million

## 27. Exclusion of Private Pensions and Individual Retirement Accounts

*Kentucky Revised Statute 141.010(10)(i), effective 1995; and Kentucky Revised Statute 141.0105, effective 1995*

An exemption is allowed for benefits received from private pensions and Individual Retirement Accounts including Roth IRAs. The exclusion was \$35,000 for tax year 1998, and is increased for inflation each year. The exclusion for tax year 2005 is \$41,110. The 2005 General Assembly repealed KRS 141.105, which provided for the cost of living adjustment. Therefore the exclusions capped at the 2005 amount.

FY2006	FY2007	FY2008
\$158.9 million	\$167.2 million	\$172.4 million

**28. Exclusion of Scholarship and Fellowship Income**

*Internal Revenue Code Section 117, effective 1954*

Students can exclude scholarship and fellowship income, limited to amounts received for tuition, fees, and supplies, if the amounts are not for compensation for services. Only candidates for degrees qualify for the exclusion.

FY2006	FY2007	FY2008
\$4.8 million	\$5.0 million	\$5.3 million

**29. Exclusion of Public Assistance Benefits**

*Internal Revenue Code Section 61, et. al.*

Public assistance or welfare benefits are not taxed. These include Temporary Assistance for Needy Families (TANF) and Supplemental Security Income (SSI) benefits.

FY2006	FY2007	FY2008
\$1.5 million	\$1.5 million	\$1.6 million

**30. Credit for Hiring Unemployed**

*Kentucky Revised Statute 141.065, effective 1982*

A credit of \$100 is allowed for each qualifying unemployed person hired.

FY2006	FY2007	FY2008
Minimal	Minimal	Minimal

**31. Exclusion of Special Benefits for Disabled Coal Miners**

*Internal Revenue Code Section 104 and 192, effective 1981*

Coal miners or their survivors may exclude payments for disability or death from black lung disease.

FY2006	FY2007	FY2008
\$1.13 million	\$1.13 million	\$910,000

**32. Exclusion of GI Bill Benefits**

*Internal Revenue Code Section 72(n), 104, and 112, effective 1966*

GI bill benefits are excluded from gross income.

FY2006	FY2007	FY2008
\$500,000	\$600,000	\$600,000

**33. Deductibility of Expenses of Certain Capital Outlays**

*Internal Revenue Code Section 179 and 175(a), effective 1980*

Taxpayers may elect to treat the cost of qualifying property, up to \$25,000, as an expense rather than a capital expenditure subject to depreciation. Soil and water conservation expenditures can be expensed limited to 25 percent of gross farm income.

FY2006	FY2007	FY2008
\$3.6 million	\$3.6 million	\$3.6 million

**34. Expanded Low Income Tax Credit**

*Kentucky Revised Statute 141.066, effective 1990*

Kentucky residents are allowed a low income tax credit based on modified adjusted gross income (MGI) which is equal to federal adjusted gross income plus any interest income from other states' municipal bonds and pension income from a qualifying lump-sum distribution. Single individuals whose MGI and married couples whose combined MFI is at or below federal poverty level for their family size will receive a 100 percent tax credit. The 2005 MGI levels that qualify for the 100 percent tax credit are:

<u>Size of Family Unit</u>	<u>Amount</u>
1	\$ 9,570
2	\$ 12,830
3	\$ 16,090
4	\$ 19,350

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$69.1 million	\$69.7 million	\$70.3 million

**35. Exclusion of Miscellaneous Fringe Benefits**

*Internal Revenue Code Section 132, effective 1992*

Any fringe benefit which qualifies as a no-additional-cost service, a qualified employee discount, a working condition fringe, or a de minimis fringe is excluded from income.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$10.8 million	\$11.5 million	\$12.3 million

**36. Deductibility of Casualty and Theft Losses**

*Internal Revenue Code Section 165, effective 1954*

Any losses incurred by the taxpayer during the tax year as a result of a casualty or theft that were not covered by insurance are deductible as an itemized deduction.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$890,000	\$920,000	\$950,000

**37. Credit for Recycling and/or Composting Equipment**

*Kentucky Revised Statute 141.390, effective 1991*

A credit is allowed for 50 percent of the installed costs of recycling or composting equipment used exclusively in this state for recycling or composting postconsumer waste.



<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.2 million	\$1.2 million	\$1.2 million

### **38. Job Development Credit**

*Kentucky Revised Statute 154.22-070, 154.24-110, 154.26-100, effective 1992*

A job development assessment fee of 6 percent, a job creation assessment fee of 5 percent, or a job revitalization assessment fee of 6 percent may be collected from employees under several economic development plans. A portion of these fees may be claimed as credits on the employees' income tax returns.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$49.8 million	\$54.0 million	\$59.0 million

### **39. Exclusion of Untaxed Medicare Benefits: Hospital Insurance & Supplementary Medical Insurance**

*Internal Revenue Code Sections 61 and 138*

Medicare benefits received for hospital insurance and supplementary medical care insurance are not taxed.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$180.2 million	\$187.0 million	\$199.0 million

### **40. Deductibility of Moving Expenses**

*Internal Revenue Code Section 217, effective 1964*

Some of the expenses incurred when moving to a new home, as the result of a job location change or a new job, can be deducted in computing adjusted gross income if certain conditions are met.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$10.5 million	\$11.5 million	\$12.5 million

**41. Gain on the Sale of a Personal Residence**

*Internal Revenue Code Section 121, effective 1997*

Taxpayers may exclude from income the capital gain on the sale of a personal residence (up to \$500,000 for married taxpayers and \$250,000 for single taxpayers).

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$119.1 million	\$131.5 million	\$145.3 million

**42. Health Insurance Premiums Paid by Self-Employed**

*Internal Revenue Code Section 162(l), effective 1997*

A percentage of the health insurance premiums paid by a self-employed individual are an allowable deduction. The percentage gradually increases from 45 percent in 1998 to 100 percent in 2007 and after.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$14.2 million	\$15.8 million	\$17.3 million

**43. Health Insurance Premiums**

*Kentucky Revised Statute 141.010(10), effective 1999*

Premiums paid by the taxpayer for health insurance coverage for the taxpayer, a spouse or dependents are an allowable deduction.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Substantial	Substantial	Substantial

**44. Interest on Educational Loans**

*Internal Revenue Code Section 62(a), effective 1997*

Up to \$1,000 of interest paid on qualified educational loans is deductible.

FY2006	FY2007	FY2008
\$2.6 million	\$2.7 million	\$2.7 million

**45. Precinct Workers**

*Kentucky Revised Statute 141.010(10), effective 1997*

Income earned by precinct workers for election training or work at election booths is exempt from income tax.

FY2006	FY2007	FY2008
\$100,000	\$100,000	\$100,000

**46. Tobacco Settlement**

*Kentucky Revised Statute 141.010(10), effective 1998*

Income received by a producer of tobacco or a tobacco quota owner from a tobacco settlement is exempt from tax.

FY2006	FY2007	FY2008
\$15.4 million	\$9.5 million	\$9.5 million

**47. Capital Gains - Eminent Domain**

*Kentucky Revised Statute 141.010(10), effective 1998*

Capital gains on property taken by eminent domain are exempt from individual income tax.

FY2006	FY2007	FY2008
Minimal	Minimal	Minimal

**48. Long-Term Care Insurance**

*Kentucky Revised Statute 141.010(10), effective 1998*

Premiums paid for long-term care insurance are excludable from gross income if not previously excluded under the Internal Revenue Code.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**49. Financial Institutions Structured as S Corporations**

*Kentucky Revised Statute 141.010(10), effective 1997*

Distributive shares of income from financial institutions structured as S Corporations are excludable from gross income for individual taxpayers.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**50. Credit for Postsecondary Education Tuition**

*Kentucky Revised Statute 141.069, effective for tax years beginning on or after January 1, 2005*

A credit equal to 25 percent of the amount of the federal Hope Scholarship and the lifetime learning credit is available. The credit applies only to undergraduate studies, phases out for higher incomes and applies to most higher education opportunities within Kentucky.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$16.0 million	\$16.9 million	\$17.9 million

**51. Historic Preservation Tax Credit**

*Kentucky Revised Statute 171.397, effective for tax years beginning on or after January 1, 2005*

A credit is allowed against individual income tax for a portion of the cost of restoring a qualified residential structure listed on the National Registry of Historic Places. The credit is equal to 30 percent of the rehabilitation expenses, in the case of owner-occupied residential property, and 20 percent of the rehabilitation expenses, in the case of all other property. The total credit available is capped at \$3 million annually, with each individual owner-occupied property receiving no more than \$60,000.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$3.0 million	\$3.0 million	\$3.0 million

**52. Member, Shareholder, or Partner Credit**

*Kentucky Revised Statute 141.420, effective for tax years beginning on or after January 1, 2005*

Individual partners, members or shareholders of pass-through entities subject to corporation income tax will receive credit for tax paid at the entity level.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$236.6 million	\$245.0 million	\$249.4 million

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# INHERITANCE AND ESTATE TAX

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**Background** Inheritance and estate taxes are two separate taxes that are often referred to as death taxes since both are occasioned by the death of a property owner. The amount due from each tax is determined by the value of property transferred, but they are imposed on different aspects of the transfer.

The inheritance tax is a tax on the right to receive property from a decedent's estate; both the tax and exemptions are based on the relationship of the beneficiary to the decedent. The estate tax, or "pickup tax", is a tax on the estate, equal to the amount by which the credit for state death taxes allowable under the federal estate tax law exceeds the Kentucky inheritance tax, less any discount allowed for early payment.

The Kentucky inheritance tax was adopted in 1906, making it the second oldest General Fund tax. The estate tax that currently exists was enacted in 1936, and has seen several significant changes since that time.

The most recent change occurred in 1995, when a total exemption for Class A beneficiaries was phased-in. The definition of Class A beneficiaries was expanded at that time to include brothers, sisters, half-brothers and half-sisters.

The 2001 Federal Tax Act increased the exemption from federal estate tax allowed to an estate. From \$1 million in 2002, the exemption increased to \$3.5 million in 2009, with a complete repeal of the tax in 2010. Additionally, the highest rate dropped to 50 percent in 2002 and decreases to 45 percent by 2007 before the repeal of the tax in 2010. The credit allowed at the federal level for death taxes paid to a state being phased out in 25-percent increments from 2002 to 2004. The increase in the federal exemption and the removal of the credit for state death taxes will decrease and then eliminate the amount of state revenues from estate tax. Dates of death occurring in FY06 and thereafter are no longer allowed a state death tax credit for federal purposes; therefore, no Kentucky estate tax is due.

During FY05, the inheritance and estate taxes produced \$63.2 million in General Fund revenues. This was a 4.4 percent decrease from the prior year and accounted for 0.8 percent of the total General Fund tax receipts.

**Tax Base**

The tax base for the inheritance tax is the fair cash value of a Kentucky domiciled decedent's property. For decedents domiciled outside Kentucky, the base is the fair cash value of real property located in Kentucky, tangible personal property that has acquired a situs in Kentucky and is not taxed elsewhere, and intangible personal property with a business situs in Kentucky.

Transfers giving rise to an inheritance or estate tax liability include transfers by will, intestate succession, deed, grant, bargain, sale or gift made in contemplation of death or intended to take effect in possession or enjoyment at or after the death of the grantor or donor. The tax is based on the net amount transferred to the beneficiaries, heirs, or donees which is the value of the distributive shares reduced by administration expenses, funeral expenses, debts, mortgages and liens, federal estate taxes and the personal exemption.

**Taxable Unit**

The inheritance tax is an excise tax on a beneficiary's privilege of receiving property from a decedent by reason of death. Beneficiaries are divided into three classes, with Class A beneficiaries being totally exempt:

- (a) Class A includes parents, the surviving spouse, children by blood, stepchildren, children adopted during infancy, children adopted during adulthood who were reared by the decedent during infancy, grandchildren who are the issue of children by blood, of stepchildren, or of children adopted during infancy, and, as of July 1, 1995, brothers, sisters, half-brothers, and half-sisters;
- (b) Class B includes nephews, nieces, nephews and nieces of the half-blood, daughters-in-law, sons-in-law, aunts, uncles, and great-grandchildren who are grandchildren of children by blood, stepchildren, or children adopted during infancy; and,



- (c) Class C includes all beneficiaries not included in classes A or B.

The inheritance tax is imposed at graduated rates from 4 to 16 percent for Class B beneficiaries, and 6 to 16 percent for Class C beneficiaries. The statutory exemptions are charges against the lowest brackets in applying the rates to the base.

**Current  
Rate  
Structure**

The estate tax has no fixed rate structure. It is dependent on the amount of Kentucky's share of the state death tax credit for federal purposes and the amount of the Kentucky inheritance tax. When all the taxable property is not located in Kentucky, the state tax credit is prorated based on the net estate in Kentucky subject to federal estate tax over the total net estate subject to federal estate tax.

**Tax Due**

The inheritance and estate taxes are levied at the decedent's death, with payment of the taxes due eighteen months thereafter. If the inheritance tax is paid within nine months after the death, a 5 percent discount is allowed. No discount is allowed on estate tax.

**Table 10. Total Inheritance And Estate Tax Expenditures**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$79.0 million	\$82.5 million	\$86.1 million

**Tax Expenditures**

**1. Class A Beneficiaries**

*Kentucky Revised Statute 140.080(1)(b) and (c), effective 1990, revised 1995*

For dates of death on or after July 1, 1998, class A beneficiaries are totally exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$64.1 million	\$66.9 million	\$69.9 million

**2. Transfers to Educational, Religious, Charitable, or Certain Governmental Organizations**

*Kentucky Revised Statute 140.060, effective 1916*

Transfers to these types of organizations are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$13.6 million	\$14.2 million	\$14.8 million

**3. Discount for Early Payment of Tax**

*Kentucky Revised Statute 140.210(1), effective 1924*

A 5 percent discount is allowed on inheritance tax paid within nine months of the date of death.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.3 million	\$1.4 million	\$1.4 million

**4. Class B Beneficiaries**

*Kentucky Revised Statute 140.080(1)(d), effective 1948*

Class B beneficiaries receive an exemption of \$1,000.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**5. Class C Beneficiaries**

*Kentucky Revised Statute 140.080(1)(e), effective 1948*

Class C beneficiaries are granted a \$500 exemption.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**6. Life Insurance Proceeds**

*Kentucky Revised Statute 140.030(2), effective 1944*

Life insurance proceeds payable to a designated beneficiary, other than the insured or his estate, are tax-free. The proceeds payable under a U.S. Government Life Insurance Policy or National Service Life Insurance Policy are tax free, regardless of to whom paid.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Substantial	Substantial	Substantial

**7. Assessment of Land at its Agricultural or Horticultural Value\*\***

*Kentucky Revised Statute 140.300 .360, effective 1978*

In lieu of the fair cash value, agricultural or horticultural land that is qualified real estate and passes to qualified heirs may be reported in a decedent's estate at its agricultural or horticultural value. The assessed value for ad valorem purposes is presumed to be its value for inheritance tax purposes.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**8. Certificates of Deposit Exempt from the Contemplation of Death Rule\*\***

*Kentucky Revised Statute 140.020(3), effective 1978*

All certificates of deposit jointly owned are exempt from the possibility of inclusion at 100 percent of their value regardless of when placed in joint names.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**9. Annuities Under Qualified Retirement Plans\*\***

*Kentucky Revised Statute 140.063, effective 1974*

The decedent’s gross estate does not include the value of an annuity or other payment to the extent attributable to the employer’s contribution receivable by any beneficiary other than the executor or equivalent.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**10. Individual Retirement Accounts\*\***

*Kentucky Revised Statute 140.063(3) and (4), effective 1982*

The decedent’s gross estate does not include an annuity receivable by a beneficiary (other than the executor) over a period of at least thirty-six months after the decedent’s death from certain qualified retirement accounts.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

\*\* These types of properties are usually left to class A beneficiaries, which are totally exempt from the tax.

**11. Recurring Tax Credits**

*Kentucky Revised Statute 140.095, effective 1948*

A credit is allowed against the tax imposed if the property is subjected to the tax twice within five years.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**12. Benefits Paid to a Beneficiary of Military Personnel Under Certain Retirement Plans**

*Kentucky Revised Statute 140.015(2), effective 1980*

Payments to a beneficiary of the Retired Serviceman’s Family Protection Plan or Survivor Benefit Plan are not considered taxable transfers.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**13. Benefits Paid by the Federal Government Due to Service in Time of War**

*Kentucky Revised Statute 140.015(1), effective 1944*

Any benefit paid by the federal government to the surviving spouse or heirs of any person by reason or arising out of service in the armed forces of the United States in time of war is not considered a taxable transfer.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

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# LIQUEFIED PETROLEUM GAS TAX

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**Background** The term “liquefied petroleum gas” includes any material which is composed predominantly of any of the following hydrocarbons, or mixtures of them, whether in the liquid or gaseous states, and which are used to propel vehicles of any kind upon the public highways: propane, propylene, butane (normal butane and isobutane), and butylene.

A tax on liquefied petroleum gas was first levied in 1960. In 1980, like gasoline and special fuels, the base was changed to the average per gallon wholesale price of gasoline. The “supplemental highway user tax” became effective July 1, 1986.

The tax is imposed for the privilege of using the highways of the state. Consequently, the tax proceeds are deposited in the Road Fund. For FY05, the liquefied petroleum gas collections were \$242,405 which accounts for 0.022 percent of total Road Fund tax receipts.

**Current Rate Structure** The tax is 9 percent of the average wholesale price of a liquid petroleum gas rounded to the third decimal place. In no case can the “average wholesale price” be deemed to be less than \$1.22 per gallon. Consequently, the tax rate can be no less than 11 cents per gallon. The “supplemental highway user tax” rate is 5 cents per gallon.

**Tax Base** Unlike the gasoline tax, the tax is applicable to liquefied petroleum gas when use is determined. If the fuel is used to propel motor vehicles on the public highways, the tax applies, but if used for non-highway purposes, the fuel is not subject to tax. The dealer is allowed a deduction to cover unaccountable losses, bad debts, and handling and reporting the tax.

**Taxable Unit** The unit for levying the liquefied petroleum gas tax is a “per gallon” basis.

**Tax Due** The tax must be remitted to the Department of Revenue on or before the twenty-fifth day of the month immediately following the month it is collected.

**Table 11. Total Liquefied Petroleum Gas Tax Expenditures**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$12,000	\$13,000	\$13,000

**Tax Expenditures**

**1. Dealer’s Monthly Reporting Allowance**

*Kentucky Revised Statute 234.320(1), effective 1972*

An allowance of 1 percent of the net tax due is allowed a dealer on a timely filed and paid monthly return. This allowance is given to offset the costs of unaccountable losses, bad debts and handling and reporting the tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1,000	\$1,000	\$1,000

**2. Approved Carburetion Systems**

*Kentucky Revised Statute 234.321(1), effective 1972*

The tax is not collected when the motor vehicles using the liquefied petroleum gas are equipped with carburetion systems approved by the Environmental and Public Protection Cabinet.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$11,000	\$12,000	\$12,000



# MOTOR VEHICLE USAGE TAX

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**Background** Motor vehicles were originally taxed under the 3 percent gross receipts tax that was repealed in 1936. After the repeal of that tax, a special 3 percent tax on motor vehicles was enacted. Effective April 1, 1968, the rate was increased to 5 percent. Effective July 1, 1990, the rate was increased to 6 percent.

Since 1936, the tax was paid to the county clerk when a vehicle is first registered in the owner's name. In 2005, the General Assembly changed the incidence of taxation to the time when the vehicle is titled instead of when it is registered. The proceeds derived from the tax are deposited in the Road Fund to be used in the construction and maintenance of Kentucky's roads.

During FY05, motor vehicle usage tax collections were \$407.5 million, a decrease of 5.1 percent from the previous year. These receipts constituted 36.2 percent of total Road Fund tax receipts.

**Current Rate Structure** The motor vehicle usage rate is calculated at 6 percent of the retail price. A credit against the tax is allowed for substantially identical taxes paid to another state or foreign country on vehicles previously registered in such state or country, provided that the other state or country grants a similar credit for taxes paid in Kentucky.

**Tax Base** The retail price for new motor vehicles is defined as the actual selling price as provided in a notarized affidavit signed by both the buyer and seller. If an affidavit is not submitted, 90 percent of the Manufacturer's Suggested Retail Price, including all standard and optional equipment, and transportation charges, is used. No trade-in allowance is permitted in determining the retail price of a new vehicle. In the case of trucks with gross weight in excess of 10,000 pounds, the tax base is 81 percent of MSRP.

For used vehicles, the retail price is the total consideration paid. A trade-in credit is allowed. The total consideration paid must be disclosed in a notarized affidavit signed by both buyer and seller. If an affidavit is not submitted, the price is defined as the value appearing in the automotive reference manual prescribed

by the Department of Revenue. For an older used vehicle whose value no longer appears in the reference manual, the retail price is as stated in a signed affidavit or at a minimum of \$100.

Persons holding a certificate to operate as a U-Drive-It may elect to pay the motor vehicle usage tax based on gross rental or lease charges instead of the retail price of the vehicles. Gross rental charges include only time and mileage charges.

**Taxable Unit** The tax is levied on the privilege of using a motor vehicle on the public highways of Kentucky, based on the vehicle’s retail price.

**Tax Due** The tax is paid to the county clerk when the vehicle is titled. The clerk deposits the tax in a Department of Revenue bank account on a daily basis and makes reports to the Department of Revenue on a weekly basis.

**Table 12. Total Motor Vehicle Usage Tax Expenditures**

FY2006	FY2007	FY2008
\$90.4 million	\$99.7 million	\$109.4 million

**Tax Expenditures**

**1. Trade-In Allowance on Used Vehicles**

*Kentucky Revised Statute 138.450(4), effective 1976*

For used vehicles previously registered in Kentucky and subsequently sold in Kentucky, a trade-in allowance is allowed in an amount equal to the statutory retail price of the vehicle taken in trade. The allowance is deducted in computing the retail price of the vehicle sold.

FY2006	FY2007	FY2008
\$31.8 million	\$33.6 million	\$35.6 million

**2. Immediate Family Member**

*Kentucky Revised Statute 138.470(6),and (14), effective 1976, 1992, and 1994*

Motor vehicles previously registered in Kentucky and transferred between husband and wife, parent and child, stepparent and stepchild, or grandparent and grandchild are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$15.3 million	\$16.2 million	\$17.1 million

**3. Governmental Exemption**

*Kentucky Revised Statute 138.470(1), effective 1968*

Motor vehicles sold to the U.S. government or to Kentucky or any of its political subdivisions are exempt from the usage tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$10.2 million	\$10.6 million	\$11.0 million

**4. Enterprise Zone Exemption**

*Kentucky Revised Statute 154.45-090(4)and (5), effective 1982*

Qualified businesses located within an “enterprise zone” are exempt from the usage tax on vehicles purchased solely for business purposes.

Enterprise Zones are scheduled to expire 20 years after initial designation as a zone. (Refer to schedule on page 60.)

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$300,000	\$100,000	\$40,000

**5. Military Exemption**

*Kentucky Revised Statute 138.470(4), effective 1968*

Motor vehicles (both new and used) sold by or transferred from Kentucky dealers to nonresident members of the armed forces on duty in this state are exempt from usage tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$5.7 million	\$6.2 million	\$6.8 million

**6. Repossessed Exemption**

*Kentucky Revised Statute 138.470(13), effective 1972*

Motor vehicles that are repossessed by a secured party are exempt provided that the reposessor has acted in accordance with all statutory requirements and the vehicle is held for resale only.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$700,000	\$900,000	\$1.1 million

**7. Transfers by Will or Court Order**

*Kentucky Revised Statute 138.470(9), effective 1970, 1990*

Motor vehicles transferred by will, court order, or transferred under the statutes covering descent and distribution of property are exempt if previously registered in Kentucky.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.7 million	\$2.8 million	\$2.9 million

**8. Educational & Charitable Organizations**

*Kentucky Revised Statute 138.470(2), effective 1968*

Motor vehicles sold to institutions of purely public charity and institutions of education, not used or employed for gain, are exempt.

FY2006	FY2007	FY2008
\$1.0 million	\$1.2 million	\$1.4 million

**9. Enterprise Zone Exemption – U Drive-It Tax**

*Kentucky Revised Statute 154.45-090(6), effective 1982*

This provision exempts receipts derived from short-term rentals of motor vehicles by qualified businesses within an enterprise zone.

FY2006	FY2007	FY2008
\$1.0 million	\$900,000	\$800,000

**10. Commercial Motor Vehicle Exemption**

*Kentucky Revised Statute 138.470(5), effective 1968*

An exemption is provided commercial motor vehicles, excluding passenger vehicles having a seating capacity of nine persons or less, owned by nonresidents, used primarily in interstate commerce, and based in another state, which are required to be registered in Kentucky by reason of operational requirements or fleet proration agreements, and which are registered pursuant to the forced registration provisions.

FY2006	FY2007	FY2008
Minimal	Minimal	Minimal

**11. Change in Business Structure**

*Kentucky Revised Statute 138.470(8), effective 1980 and 1998*

Motor vehicles transferred to a corporation from a proprietorship or limited liability company, to a limited liability company from a corporation or proprietorship, or from a corporation or limited liability company to a proprietorship, within six (6) months from the time that the business is incorporated, organized, or dissolved are exempt.

FY2006	FY2007	FY2008
\$200,000	\$200,000	\$200,000

**12. Transfers Between a Limited Liability Company and its Members**

*Kentucky Revised Statute 138.470,(11), effective 1998*

Motor vehicles transferred between a limited liability company and any of its members when there is no consideration, nominal consideration, or in sole consideration of the cancellation or surrender of stock are exempt.

FY2006	FY2007	FY2008
\$400,000	\$600,000	\$1.0 million

**13. Transfers Between a Subsidiary and a Parent Corporation**

*Kentucky Revised Statute 138.470(10), effective 1970*

Motor vehicles transferred between a subsidiary corporation and its parent when there is no consideration, nominal consideration, or in sole consideration of the cancellation or surrender of stock are exempt.

FY2006	FY2007	FY2008
\$100,000	\$100,000	\$100,000

**14. Partnership Interests**

*Kentucky Revised Statute 138.470(12), effective 1970*

The interest of a partner in a motor vehicle is exempt when the interests of other partners are transferred to him.

<b>FY 2006</b>	<b>FY 2007</b>	<b>FY 2008</b>
\$70,000	\$100,000	\$200,000

**15. Insurance Company Transfers**

*Kentucky Revised Statute 138.470(14), effective 1976*

Motor vehicles transferred to an insurance company to settle a claim are exempt. However, such vehicles must be junked or held for resale only.

<b>FY 2006</b>	<b>FY 2007</b>	<b>FY 2008</b>
\$100,000	\$100,000	\$100,000

**16. Adapted Equipment for Physically Handicapped Persons**

*Kentucky Revised Statute 139.450(4)(a), effective 1992*

“Retail Price” does not include that portion of the price of a vehicle attributable to equipment or adaptive devices necessary to facilitate or accommodate a physically handicapped operator or passenger.

<b>FY 2006</b>	<b>FY 2007</b>	<b>FY 2008</b>
\$0	\$0	\$0

**17. Large Truck Exclusion**

*Kentucky Revised Statute 138.470, effective October 1, 2003.*

Trucks registered with a gross weight of 44,001 pounds and greater are not subject to the Motor Vehicle Usage Tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$20.8 million	\$26.0 million	\$31.0 million

**18. Charter Bus Exemption**

*Kentucky Revised Statute 138.470, effective July 1, 2005.*

Motor carriers operating under a charter bus certificate issued by the Transportation Cabinet under KRS Chapter 281 are not subject to the Motor Vehicle Usage Tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$50,000	\$50,000	\$50,000



## NATURAL RESOURCES SEVERANCE AND PROCESSING TAX

**Background**      **E**ffective June 1, 1980, the General Assembly levied a 4.5 percent tax on the gross value of all minerals, severed in Kentucky, including natural gas and natural gas liquids. Coal and oil were specifically excluded due to taxation under other statutes. The legislation imposed no minimum rate of tax per unit as is the case with the coal severance tax.

In 1984, the General Assembly exempted fluorspar, lead, zinc, barite, and tar sands from the tax. In addition, taxpayers who sever or process limestone through the rip-rap, construction aggregate, or agricultural limestone stages, and who sell at least 60 percent of such stone in interstate commerce, are entitled to a tax credit.

KRS 42.450(2) and 42.470(2) require that one-half of the taxes collected on the sale of minerals, other than coal, be distributed among the mineral producing counties. In FY05 the total tax of \$43.5 million represented 0.6 percent of total General Fund tax receipts.

**Current Rate Structure**      The natural resources severance and processing tax rate is 4.5 percent of the gross value. Effective in 1991, the tax on severing clay was limited to twelve cents per ton. Taxpayers who sever or process clay within the state, which is sold to and used as a component of landfill construction by an approved waste management or waste disposal facility in Kentucky, are entitled to a credit equal to the tax paid.

**Tax Base**      The base for this tax is gross value, the amount received or receivable from the sale of the mineral after it is processed and loaded for shipment. The base for natural gas and natural gas liquids is the sales price or market value in the immediate vicinity of the well. The amount of transportation expense incurred in transporting the natural resource to the customer is deductible in arriving at gross value.

When resources are purchased for processing, gross value is the amount received or receivable reduced by the amount paid for the natural resource and the transportation expense.

**Taxable Unit** The tax is levied on taxpayers engaged in the business of severing or processing natural resources in Kentucky, except that no tax is levied on the processing of ball clay.

**Tax Due** The tax must normally be reported and remitted on a monthly basis. The Department of Revenue may permit or require returns or tax payments for periods other than monthly. The tax return and payment are due on the last day of the month following the close of the tax period.

**Table 13. Total Natural Resources Severance & Processing Tax**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$6.3 million	\$6.3 million	\$6.3 million

**Tax Expenditures**

**1. Transportation Expense**

*Kentucky Revised Statute 143A.010(5)(9), effective 1980*

Expenses incurred in transporting minerals are excluded from gross value.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$4.3 million	\$4.3 million	\$4.3 million

**2. Limestone Sold in Interstate Commerce**

*Kentucky Revised Statute 143A.035, effective 1984*

A credit is allowed equal to the tax on the gross value of limestone sold in interstate commerce. The credit extends only to those taxpayers who sever or pro-

cess limestone through the rip-rap, construction aggregate, or agricultural limestone stages, and who sell at least 60 percent of such stone in interstate commerce.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.0 million	\$1.0 million	\$1.0 million

**3. Limestone Sold or Used for Agricultural Purposes**

*Kentucky Revised Statute 143A.030, effective 1984*

Limestone sold or used for agricultural purposes is exempt if such sale or use qualifies from exemption for sales and use tax under KRS 139.480.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$200,000	\$200,000	\$200,000

**4. Ball Clay, Fluorspar, Lead, Zinc, Tar Sands, Barite, and Stone Used for Privately Maintained but Publicly Dedicated Roads**

*Kentucky Revised Statute 143A.020 and 143A.030, effective 1980, 1984*

The severing or processing of these minerals, for any purpose, is exempt from the tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$450,000	\$450,000	\$450,000

**5. Limit on Tax from Clay**

*Kentucky Revised Statute 143A.037, effective 1991*

The tax on clay is limited to twelve cents per ton.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$150,000	\$150,000	\$150,000

**6. Clay Used in Landfill Construction**

*Kentucky Revised Statute 143A.037, effective 1991*

A credit is allowed against the tax on clay severed or processed within this state and sold to and used as a component of landfill construction by an approved waste management or waste disposal facility within this state. The credit is equal to the tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$100,000	\$100,000	\$100,000

**7. Inactive Crude Oil and Natural Gas Wells**

*Kentucky Revised Statute 143A, effective 1998*

A credit equal to 4.5 percent of the total tax is allowed for natural gas and oil produced from recovered inactive wells.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$100,000	\$100,000	\$100,000

# PROPERTY TAXES

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**Background** Kentucky has had a tax on property since becoming a state on June 1, 1792. The original method of taxation began with a set levy for each item of tangible property owned in the state. It was not until 1814 that the standard for establishing the tax liability was changed to the ad valorem, or fair value approach, which taxes property at its fair market value. This approach remains the standard today.

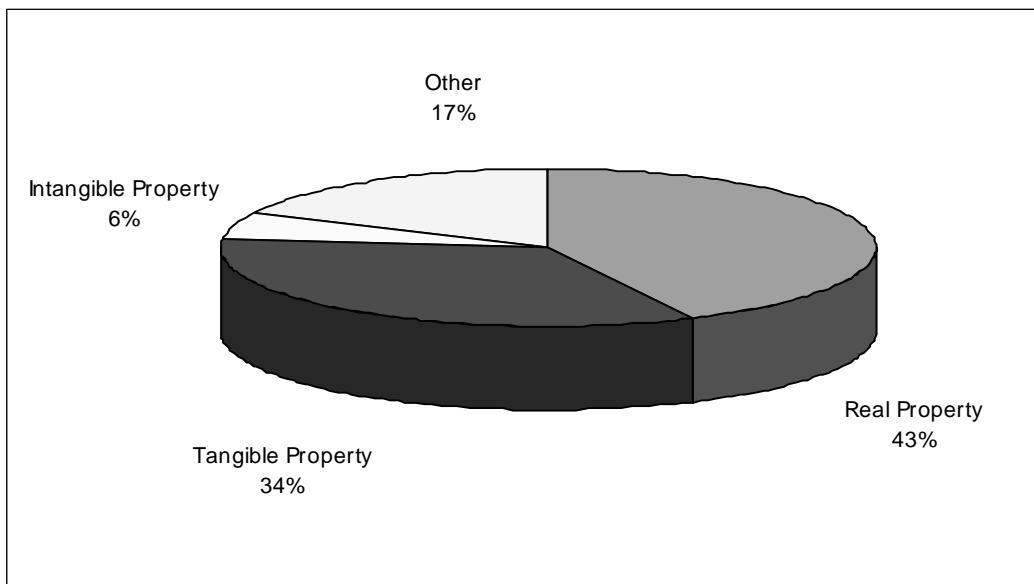
In 1793, the property tax represented over 86 percent of all state government receipts. That percentage has declined dramatically over the past 200 plus years. Much of the recent decline can be attributed to legislation passed during the 1979 Special Session of the General Assembly. House Bill 44, enacted during that session, generally limited growth from the tax levied on real property to 4 percent per year. The high rate of inflation was causing property values, and the resulting tax, to rise too dramatically. To compensate for rapidly growing values, the tax rate is adjusted annually to ensure that the growth in tax receipts does not exceed the legal limits. This restriction remains in effect at the present time. House Bill 272, passed by the 2005 General Assembly, altered the rate setting mechanism by excluding new property when the 4 percent growth limit is calculated.

The voters amended section 172 of the Kentucky Constitution in 1998 to give the General Assembly the authority to exempt any class of personal property. Personal property includes both tangible and intangible property. Real property, not specifically exempted by the constitution, must be assessed for taxation at its fair cash value and taxed accordingly.

In FY05 total property tax collections of \$472.6 million accounted for 6.2 percent of total General Fund tax receipts. The chart on the following page shows the allocation between real, tangible, intangible and other property tax receipts.

**Current Rate Structure** The state tax rate for real property must be adjusted annually to comply with the provisions of House Bill 44. For 2005, the rate was set at 13.1 cents per \$100 of assessed value. The rate in effect prior to House Bill 44 was 31.5 cents per \$100 of assessed

**Figure 3. Allocation of Property Taxes**



value. It must be noted that an increase in the tax base may necessitate a corresponding decrease in the rate. Consequently, any estimates of the cost of exemptions in the real property area are based on the assumption that House Bill 44 would not affect the outcome. The normal state rates applicable to tangible and intangible personal property are 45 cents and 25 cents per \$100 of assessed value, respectively. The General Assembly has reduced the rates for some classes of tangible and intangible personal property over the years. These reduced rates give rise to many of the expenditures detailed later. Legislation enacted in 2005 repealed the intangible property tax effective January 1, 2006. Therefore, the tax expenditures for intangibles are \$0 for FY2007 and beyond.

**Tax Base**

The property tax is levied on the fair cash value of all real, tangible, or intangible property unless a specific exemption exists in the Kentucky Constitution or in the case of personal property, has been granted by the General Assembly. Taxpayers who are 65 years of age or older or are classified as totally disabled qualify for a Homestead Exemption. This exemption, applied

against the assessed value of a qualifying single-unit residential property, is adjusted every two years in accordance with the cost of living index. The homestead exemption amount for 2005 and 2006 is \$29,400.

**Tax Due**

In general, property is assessed at its fair cash value as of January 1 of each year. Real property must be listed for assessment with the property valuation administrator (PVA) between January 1 and March 1. Tangible and intangible personal property may be listed either with the PVA or the Department of Revenue and must be listed by May 15.

When the Department of Revenue certifies the assessment and the amount of taxes due to the county clerk, the clerk prepares the tax bills for delivery to the sheriff of the county, not later than September 15. The sheriff mails a notice to each taxpayer reflecting the total tax, date due, any discount, and the discount period. The tax becomes delinquent if not paid before the following January 1.

An exception to the usual method of paying property taxes involves motor vehicles. The appropriate property tax is due and payable to the county clerk on or before the last day of the month in which registration renewal is required for the vehicle.

**Legislation Enacted During Fiscal Years 2004 and 2005**

The 2004 General Assembly enacted **House Bill 292** which provided a revised method for calculating taxable capital of Agricultural Credit Associations.

The 2005 General Assembly enacted **House Bill 272** which provides several revisions to the property tax statutes. Most notably, effective January 1, 2006, most classifications of intangible property are exempted from assessment. Some institutional intangible personal property taxes remain, including the tax on deposits in banks and savings and loan associations. With the repeal of the majority of the intangible tax, the associated tax expenditure of the tax will no longer apply in Fiscal Year 2007 and thereafter.

**House Bill 272** also reforms the assessment of telecommunication companies, which were formerly assessed as public service companies under KRS 136.120. The real property of these companies is subject to assessment by PVAs and the personal property will now be assessed directly by the Department of Revenue.

As part of an effort to clean up environmentally contaminated areas, **House Bill 272** contains an incentive for property tax purposes. Properties may qualify to receive the leasehold rate structure of 1.5 cents per \$100 of value when the owners enter into a covenant with the Environmental and Public Protection Cabinet to remediate the properties. This rate is in effect for only three years.

**House Bill 267** exempts the real and personal property of a local government in neighboring states with a Kentucky situs, if that state has a reciprocal agreement with Kentucky.

**House Bill 308** amends KRS 132.200 to exempt biotechnology products from local property taxes on inventories. This is an exclusive category, limited to those biotechnology products that are being held in a warehouse for distribution, and are derived from living organisms and used in the treatment, prevention or cure of a disease.

**Table 14. Total Property Tax Expenditures**

FY2006	FY2007	FY2008
\$1,014.9 million	\$709.4 million	\$741.8 million

The property tax expenditures have been categorized between real property, tangible personal property and intangible personal property.

**Real Property Tax Expenditures**

(Real property is defined as land and improvements and all rights inherent in real estate.)

**1. State Real Property Tax Yearly Revenue Ceiling**

*Kentucky Revised Statute 132.020(7), effective 1979*

Prior to the passage of House Bill 44 in 1979, the real property tax rate was 31.5 cents per \$100. The adjusted rate for tax year 2003 is 13.3 cents per \$100 of assessment.



<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$331.1 million	\$352.3 million	\$374.1 million

**2. Alcohol Production Facilities**

*Kentucky Revised Statute 132.020(1), effective 1980*

Alcohol production facilities are taxed at a reduced rate of 1/10 of a cent per \$100 of value.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$0	\$0	\$0

**3. Leasehold Interests in Buildings Financed with Industrial Revenue Bonds**

*Kentucky Revised Statute 132.020(1), effective 1978*

Leasehold interests privately held in industrial buildings owned and financed by tax-exempt governmental units are taxed at a reduced rate of 1.5 cents per \$100 of value. Note: This is the real estate portion only.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.8 million	\$3.0 million	\$3.2 million

**4. Homestead Exemption**

*Section 172 of the Kentucky Constitution and KRS 132.810, effective 1972, revised 1992, 1999*

A taxpayer 65 years of age or older or totally disabled is allowed an exemption against the assessed value of a single-unit residence. In 2005 and 2006 this exemption is \$29,400.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$13.3 million	\$14.1 million	\$15.0 million

**5. Agricultural and Horticultural Land Assessment Protection**

*Kentucky Revised Statute 132.450, effective 1999*

This land will not lose its agricultural and horticultural assessment if it fails to meet the minimum acreage requirement due to the fact a portion of the land has been acquired for public purposes.

Note: This does not include the tax reduction due to valuing agricultural land at its farming or agricultural value instead of its fair cash value. This “agricultural value” decrease is contained in the Kentucky Constitution, not in statute, and accordingly is not considered a tax expenditure because it is not contained in the tax base.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$100,000	\$100,000	\$100,000

**6. Intrastate Railroads and Railway Companies**

*Kentucky Revised Statute 132.020(10), effective 1990*

Railroads or railway companies operating solely within the Commonwealth, are taxed at a reduced rate of 10 cents per \$100 on their operating real property.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$30,000	\$30,000	\$30,000

**7. Property of Local Governments in Neighboring States**

*Kentucky Revised Statute 132.192, effective 2005*

All real property owned by another state or a political subdivision of another state that is used exclusively for public purposes is exempt from taxation if a comparable exemption is provided in that state or political subdivision for property owned by the Commonwealth or its political subdivisions.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$20,000	\$20,000	\$20,000

**8. Environmental Remediation Property**

*Kentucky Revised Statute 132.020, effective 2005*

The owner of all qualifying voluntary environmental remediation property pays tax at the rate of one and one-half cents upon each one hundred dollars of value for this property.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2,000	\$2,000	\$2,000

**Tangible Property Tax Expenditures**

(The normal tangible rate is 45 cents per \$100 of value)

**9. Business Inventories**

*Kentucky Revised Statute 132.020(9), effective 1990*

Business inventories are taxed at a reduced rate of 5 cents per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$60.0 million	\$62.9 million	\$66.1 million

**10. Leasehold Interests**

*Kentucky Revised Statute 132.020(1), effective 1990*

Leasehold interests privately held in industrial buildings owned and financed by tax-exempt governmental units are taxed at a reduced rate of 1.5 cents per \$100 of value. Note: This is the tangible personal property portion only.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.4 million	\$2.4 million	\$2.4 million

**11. Manufacturing Machinery, Pollution Control Equipment and Radio Television and Telephonic Equipment**

*Kentucky Revised Statute 132.020(1), effective 1977, revised 1998*

Machinery, regardless of ownership, used in the manufacturing process is taxed at a reduced rate of 15 cents per \$100. Pollution control equipment is taxed at a reduced rate of 15 cents per \$100. Radio, television and telephonic equipment are taxed at a reduced rate of 15 cents per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$64.6 million	\$68.0 million	\$71.6 million

**12. Livestock and Machinery Used in Farming, Livestock and Poultry**

*Kentucky Revised Statute 132.020(1), effective 1917*

Machinery used in farming and the value of all livestock and domestic fowl is taxed at a reduced rate of 1/10 of a cent per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$22.5 million	\$22.5 million	\$22.5 million

**13. Agricultural Products**

*Kentucky Revised Statute 132.020(1), effective 1950*

Agricultural products are taxed at a reduced rate of 1.5 cents per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$360,000	\$360,000	\$360,000

**14. Foreign Trade Zone**

*Kentucky Revised Statute 132.020(1), effective 1982*

Property located in an activated foreign trade zone is taxed at a reduced rate of 1/10 of a cent per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$22.1 million	\$22.1 million	\$22.1 million

**15. Historic Vehicles**

*Kentucky Revised Statute 132.020(1), effective 1984*

Historic vehicles are taxed at a reduced rate of 25 cents per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$100,000	\$100,000	\$100,000

**16. Intrastate Railroads and Railway Companies**

*Kentucky Revised Statute 132.020(10), effective 1990*

Railroads or railway companies operating solely within the Commonwealth are taxed at a reduced rate of 10 cents per \$100 on their operating tangible property.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$180,000	\$180,000	\$180,000

**17. Interstate Trucks, Tractors, Semi-Trailers and Buses**

*Kentucky Revised Statute 136.1873, effective 1990*

Commercial vehicles that have routes or systems partly within this state and partly within another state or states are taxed at a reduced rate. This rate is computed annually. The rate in effect January 1, 2002 was 23.49 cents per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$3.3 million	\$3.5 million	\$3.7 million

**18. Carlines**

*Kentucky Revised Statute 136.120, effective 1990*

Any company, other than a railroad company, which owns, uses, furnishes, leases, rents, or operates to, from, through, in, or across this state or any part thereof, any kind of railroad car is taxed at a reduced rate. The rate is computed annually. The rate in effect January 1, 2005 was 23.5 cents per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$3.8 million	\$3.8 million	\$3.8 million

**19. Aircraft**

*Kentucky Revised Statute 132.020(12), effective 1999*

Airplanes, not used in the business of transporting persons or property for compensation or hire, are taxed at the reduced state rate of 1.5 cents per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.3 million	\$1.3 million	\$1.3 million

**20. Federally Documented Vessels**

*Kentucky Revised Statute 132.020(13), effective 1999*

Documented boats, not used in the business of transporting persons or property for compensation or hire, are taxed at a reduced rate of 1.5 cents per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**21. Floor Plan Machinery and Equipment**

*Kentucky Revised Statute 132.020(10), effective 1999*

Machinery and equipment held in inventory in the regular course of business for sale or lease and originating under a floor plan financing arrangement is taxed at a reduced state rate of 5 cents per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**22. In-Transit Goods**

*Kentucky Revised Statute 132.095(1), effective 1999*

Goods shipped into Kentucky and placed in a warehouse or distribution center with the purpose of continued shipment outside of Kentucky within six months are exempt from property tax at the state level.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$16.8 million	\$16.8 million	\$16.8 million

**23. Motor Vehicles With a Salvage Title**

*Kentucky Revised Statute 134.810, effective 1999*

Motor vehicles with a salvage title and held by an insurance company on January 1 are taxed at a reduced rate of 5 cents per \$100 of value. This provision allows salvage vehicles held by an insurance company to be taxed in the same manner as motor vehicle dealers' inventory.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

**24. Property of Local Governments in Neighboring States**

*Kentucky Revised Statute 132.192, effective 2005*

All personal property owned by another state or a political subdivision of another state that is used exclusively for public purposes is exempt from taxation if a comparable exemption is provided in that state or political subdivision for property owned by the Commonwealth or its political subdivisions.

FY2006	FY2007	FY2008
\$2.7 million	\$2.7 million	\$2.7 million

**Intangible Property Tax Expenditures**

(The normal intangible rate is 25 cents per \$100 of value)

**NOTE: The 2005 General Assembly repealed the majority of the property tax on intangibles. Only some of the intangible taxes paid by financial institutions and other businesses remain effective after FY06.**

**25. Certain Classes of Intangible Properties at a 1.5 Cent Rate**

*Kentucky Revised Statute 132.020(2), effective 1968*

Accounts receivable, notes, bonds, credits, and other property rights arising from regular out of state business, patents, trademarks, copyrights, licensing or royalty agreements, other intercompany intangible personal property and tobacco base allotments are taxed at a reduced rate of 1.5 cents per \$100.

FY2006	FY2007	FY2008
\$31.6 million	\$0	\$0

**26. Bank Deposits**

*Kentucky Revised Statute 132.030(1), effective 1917*

Bank deposits are taxed at a reduced rate of 1/10 of a cent per \$100.



<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$117.2 million	\$119.8 million	\$122.4 million

## 27. Exemption of Stock from Intangible Tax

*Kentucky Revised Statute 136.030(1), effective 1924*

*Herschel St. Ledger, et al. V. Commonwealth of Kentucky Revenue Cabinet, et al.*

The Kentucky Supreme Court declared unconstitutional KRS 136.030 (1), which exempted stock of companies in which the corporation paid taxes to Kentucky on a least 75 percent of its property. As a result, all stock is exempt from intangible property tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$180.4 million	\$0	\$0

## 28. Retirement Plans

*Kentucky Revised Statute 132.043, effective 1966*

Retirement plans are taxed at a reduced rate of 1/10 of a cent per \$100.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$51.8 million	\$0	\$0

## 29. Banks for Cooperatives, Production Credit and Domestic Savings and Loans Associations

*Kentucky Revised Statute 136.300(1), effective 1917*

A tax of 10 cents per \$100 is levied on the value of capital stock. This is in lieu of all taxes for state purposes on property. Individual shareholders are not required to list their shares for taxation.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$4.5 million	\$4.1 million	\$4.0 million

**30. Certain Classes of Intangible Property at One-Tenth Cent Rate, Including Annuities and Rights to Receive Income**

*Kentucky Revised Statute 132.215(2), effective 1972*

These items are taxed at a reduced rate of 1/10 of a cent per \$100.

Note: This includes certain bank holdings that were previously not reported.

FY2006	FY2007	FY2008
\$71.2 million	\$0	\$0

**31. Credit Union Accounts and Shares**

*Kentucky Revised Statute 290.635, effective 1984*

Deposits and shares are totally exempt from tax.

FY2006	FY2007	FY2008
\$8.5 million	\$8.5 million	\$8.5 million

**32. Broker's Accounts Receivable**

*Kentucky Revised Statute 132.050, effective 1948*

Broker's accounts receivable are taxed at a reduced rate of 10 cents per \$100.

FY2006	FY2007	FY2008
\$500,000	\$0	\$0

**33. Reserves and Capital of Domestic Life Insurance Companies**

*Kentucky Revised Statute 136.320(3), effective 1990*

Reserves of domestic life insurance companies are taxed at a reduced rate of 1/10 of a cent per \$100.

FY2006	FY2007	FY2008
\$900,000	\$0	\$0

**34. Taxable Capital of Agricultural Credit Associations**

*Kentucky Revised Statute 136.300, effective 2004*

A reduction in tax is realized by Agricultural Credit Associations by allowing a revised method of calculating taxable capital.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$800,000	\$800,000	\$800,000

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# SALES AND USE TAX

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## Background

Kentucky's first entry into the sales tax field occurred in 1934 when the General Assembly enacted a tax of 3 percent on general retail gross receipts. The tax was subsequently repealed by the 1936 General Assembly.

Kentucky again enacted a sales and use tax effective on July 1, 1960. The sales tax is imposed upon all retailers for the privilege of making retail sales in Kentucky. The retailer must pass the tax along to the consumer as a separate charge. The use tax is imposed on the storage, use, or other consumption of tangible personal property in Kentucky. Tangible personal property, the sale of which is subject to Kentucky sales tax, is not subject to the use tax.

From its inception in 1960 until 1986, the sales and use tax was the most productive tax in the General Fund. In 1986, it was surpassed by the individual income tax and continues to be the second most productive today. Receipts for FY05 totaled \$2,595.0 million, which was a growth of 6.0 percent over the prior year. This tax represented 33.9 percent of total General Fund tax receipts in FY05.

## Current Rate Structure

Sales and use taxes are imposed at the rate of 6 percent of gross receipts or purchase price.

## Tax Base

The tax base for the sales tax is gross receipts derived from both retail sales of tangible personal property and sales of certain services to the final consumer in Kentucky. Retail sales are defined as any sales other than sales for resale. The lease and rental of tangible personal property for a consideration is considered a sale or purchase, the receipts of which are subject to the sales and use tax.

The tax base for the use tax is the purchase price of tangible personal property purchased for storage, use, or other consumption in Kentucky. The use tax is a "back stop" for sales tax and generally applies to property purchased outside the state for storage, use, or consumption within the state. The purchaser's li-

ability for the use tax is not extinguished until the tax has been paid to the state, either by the purchaser or by the retailer from whom the property was purchased. However, the purchaser will not be held liable for the tax provided a receipt is obtained from a retailer engaged in business in this state, or from a retailer authorized to collect Kentucky use tax, showing that the tax was collected by the retailer as a separately stated charge and the receipt is maintained in the purchaser's files.

**Taxable Unit**

The sales tax is imposed on gross receipts from the sale, lease, or rental price of retail sales of tangible personal property and certain services in Kentucky. The use tax is imposed on the storage, use, or other consumption of tangible personal property in Kentucky, measured by the purchase price.

**Tax Due**

The tax must normally be reported and remitted on a monthly basis. In some cases, the taxpayer may be permitted to file on a quarterly or annual basis. For most taxpayers, the tax return and payment of the tax liability are due on the twentieth day of the month following the close of the tax period. Large taxpayers must file monthly returns and include an estimate of the first fifteen days of the following calendar month. The return is due on the twenty-fifth day following the close of the calendar period. The Department of Revenue notifies taxpayers required to file on this alternate basis of their obligation.

**Legislation Enacted During Fiscal Years 2004 and 2005**

The following changes were enacted by the 2005 General Assembly:

**Donated Goods** – (Effective August 1, 2005) A sales tax refund equal to 25 percent (up to \$1 million) of the tax collected on sales of donated goods by resident nonprofit educational, charitable or religious institutions is available, if the entity uses the refund exclusively as reimbursement for capital construction costs of additional retail locations in this state.

**Repair and Replacement Parts for Charter Buses** – (Effective August 1, 2005) Repair and replacement parts are exempt for operating and maintaining a charter bus certified by the Transportation Cabinet.

**Commercial Printers or Mailers** – (Effective July 1, 2005) Commercial printers or mailers engaged in business in this state are not required to collect use tax on sales of printing or direct mail advertising materials that are both printed out of state and delivered out of state to the postal service for mass mailing to third-party Kentucky residents who do not purchase the advertising materials.

**Water Withdrawal Fees** – (Effective July 1, 2005) Water withdrawal fees imposed by the Kentucky River Authority may not be subjected to state and local taxes.

**Breeder Incentives** – (Effective June 1, 2005) Sales tax receipts from stud fees for breeding of horses in this state are earmarked for use in creating breeder incentives. The sales tax will be deposited into special funds for future disbursement by the Kentucky Horse Racing Authority.

**Streamlined Sales Tax Agreement** – (Effective July 1, 2005) KRS 139.472 was amended to exempt mobility enhancing equipment from sales and use tax.

**County Fair Admissions** – The first \$50,000 in county fair admissions are exempt from sales and use tax.

**Telephones/Pay Phones** – (Effective January 1, 2006) Switch access and pay phone receipts are no longer subject to sales tax.

**Table 15. Total Sales And Use Tax Expenditures**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$5,257.4 million	\$5,399.7million	\$5,578.7million

The total sales and use tax exemptions do not include the cost of excluding services from the sales tax. These sales were never included in the tax base, are generally not part of most states' sales tax base and therefore do not meet the technical qualifications of a tax expenditure. We have continued to estimate the amount of lost revenue from excluding certain services from the tax and have listed these on pages 154-156 in the back of this section. They are not considered tax expenditures for the purpose of this publication.

### Tax Expenditures

#### 1. Food Items

*Kentucky Revised Statute 139.485, effective 1972, revised 1986*

Food for human consumption is exempt from sales and use tax. The exemption does not apply to meals served in restaurants, to meals served on or off the premises, or to meals sold on a "take out" or "to go" basis. This exemption does include purchases made with food stamps and the exemption for baked goods which became effective July 1, 2004.

FY2006	FY2007	FY2008
\$371.5 million	\$379.3 million	\$395.7 million

#### 2. Non-profit Educational, Charitable and Religious Institutions

*Kentucky Revised Statute 139.495, effective 1976*

Sales to resident, nonprofit educational, charitable, and religious institutions qualified for exemption from federal income taxation under Section 501(c)(3) of the Internal Revenue Code, for use solely within their exempt function, are exempt.

FY2006	FY2007	FY2008
\$264.3 million	\$269.9 million	\$281.5 million



### 3. Labor or Services Used in Property Sold

*Kentucky Revised Statute 139.050(3)(c), effective 1960*

A separately stated price received for labor or services used in installing or applying property sold is exempt from sales and use tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$212.9 million	\$217.3 million	\$226.7 million

### 4. Residential Utilities

*Kentucky Revised Statute 139.470(8), effective 1979*

Sales of electricity, sewer services, water, and fuel to Kentucky residents for use in heating, cooking, lighting, and other residential uses are exempt from sales and use tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$187.1 million	\$183.7 million	\$182.9 million

### 5. Prescription Medicine, Prosthetic Devices and Physical Aids

*Kentucky Revised Statute 139.472, effective 1971*

Prescription medicine, prosthetic devices, and physical aids are exempt from sales and use tax. Prosthetic devices include artificial limbs, artificial eyes, hearing aids, crutches, and wheelchairs.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$274.5 million	\$280.2 million	\$292.3 million

**6. Machinery for New and Expanded Industry and Certain Industrial Machinery**

*Kentucky Revised Statute 139.170 and 139.480(10), effective 1960*

Machinery for new and expanded industry that is used directly in manufacturing or processing and is incorporated for the first time into plant facilities in this state, and does not replace machinery in such plant, is exempt.

*Kentucky Revised Statute 139.487, effective 1982*

Industrial machinery manufactured in Kentucky is exempt from sales tax when the industrial machinery is delivered to a manufacturer or processor or their agent for use out-of-state.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$65.2 million	\$65.7 million	\$66.3 million

**7. Coal Used in the Manufacture of Electricity**

*Kentucky Revised Statute 139.480(2), effective 1960*

Coal used in the manufacturing of electricity is exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$78.7 million	\$80.2 million	\$75.2 million

**8. Energy and Energy Producing Fuels**

*Kentucky Revised Statute 139.480(3), effective 1960*

Energy and energy producing fuels used in manufacturing, processing, mining, or refining, to the extent that the cost of the energy or energy producing fuels used exceeds 3 percent of the cost of production, are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$20.8 million	\$21.4 million	\$22.1 million

## 9. Retailers' Compensation for Collecting and Remitting the Tax

*Kentucky Revised Statute 139.570, effective 1960*

As reimbursement for the cost of collecting and remitting tax, the retailer shall deduct 1.75 percent of the first \$1,000 of tax due and 1 percent of the tax due in excess of \$1,000 if the amount due is not delinquent at the time of payment.

**NOTE: The 2005 General Assembly capped the compensation allowed for any retailer in any month at \$1,500. This cap is effective for periods after June 30, 2005, but before July 1, 2006.**

FY2006	FY2007	FY2008
\$12.0 million	\$19.8 million	\$20.7 million

## 10. Enterprise Zones

*Kentucky Revised Statute 154.45-090(2)(3), effective 1992*

Building materials used in remodeling, rehabilitation, or new construction in a qualified enterprise zone and new and used equipment and machinery purchased by a qualified business for use in the enterprise zone are exempt.

Enterprise Zones are scheduled to expire 20 years after initial designation as a zone. (Refer to schedule on page 60.)

FY2006	FY2007	FY2008
\$7.9 million	\$6.9 million	\$700,000

## 11. State, Cities, Counties and Special Districts

*Kentucky Revised Statute 139.470(1)(7), effective 1960 and 1976*

Sales to any cabinet, department, bureau, commission, board, or other statutory or constitutional agency of the state, and to cities, counties, and special districts defined in KRS 65.005 are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$117.8 million	\$120.2 million	\$125.4 million

**12. Textbooks**

*Kentucky Revised Statute 139.480(17), effective 1978*

Textbooks, related workbooks, and other course material purchased for use in a course of study conducted by an institution qualified as a non-profit educational institution are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.4 million	\$2.4 million	\$2.5 million

**13. Recycling Machinery and Equipment**

*Kentucky Revised Statute 139.170, 139.480(23), effective 1991*

Replacement machinery that will increase the consumption of recycled materials by not less than 10 percent and machinery and 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 that machinery or equipment is primarily used for recycling purposes, are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$4.6 million	\$6.4 million	\$6.4 million

**14. Pollution Control Facilities**

*Kentucky Revised Statute 139.480(12), effective 1974*

Property certified as a pollution control facility as defined by KRS 224.01-300 is exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$21.0 million	\$21.3 million	\$21.6 million

**15. Tombstones and Other Grave Markers***Kentucky Revised Statute 139.480(13), effective 1976*

Tombstones and other grave markers are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$3.7 million	\$3.8 million	\$3.9 million

**16. Lodgings of Thirty Days or More***Kentucky Revised Statute 139.100(2)(a), effective 1992*

Rooms, lodging or accommodations supplied for a continuous period of 30 days or more to an individual are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Substantial	Substantial	Substantial

**17. Garage or Yard Sales***Kentucky Revised Statute 139.496, effective 1976*

Sales and use tax does not apply to the first \$1,000 of sales made in any calendar year by an individual or nonprofit organization not engaged in the business of selling.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.0 million	\$2.0 million	\$2.0 million

**18. Semi-Trailers and Trailers***Kentucky Revised Statute 139.050(3)(f), effective 1978*

The sales of semi-trailers and trailers as defined by KRS 189.010(12) and KRS189.010(17) are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$150,000	\$150,000	\$150,000

## 19. Vessels and Maritime Supplies

*Kentucky Revised Statute 139.483, effective 1966*

Ships and vessels, including their repair and construction, supplies and fuel used in their operation and supplies consumed by crew members aboard such ships and vessels, used principally in transporting property for hire are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$3.4 million	\$3.4 million	\$3.4 million

## 20. Sales by Elementary and Secondary Nonprofit, School-Sponsored Clubs and Organizations

*Kentucky Revised Statute 139.497, effective 1984*

Sales made by elementary and secondary schools, nonprofit elementary or secondary school-sponsored clubs and organizations and nonprofit elementary or secondary school affiliated groups such as parent-teacher organizations and booster clubs are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$5.9 million	\$5.9 million	\$5.9 million

## 21. Interstate Cargo and Passenger Aircraft, Parts and Supplies

*Kentucky Revised Statute 139.480(19), effective 1982*

Aircraft and their repair and replacement parts and supplies for the direct operation of aircraft in interstate commerce and used exclusively for the conveyance of property or passengers for hire are exempt from sales and use tax. Nominal intrastate use will not subject the property to sales and use tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$9.6 million	\$9.6 million	\$9.6 million

## **22. Sales by Nonprofit Higher Educational School-Sponsored Clubs and Organizations.**

*Kentucky Revised Statute 139.495(4), effective 1980*

Sales made by nonprofit school-sponsored clubs and organizations, provided such sales do not include tickets for athletic events, are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.3 million	\$1.3 million	\$1.3 million

## **23. Sales to Motion Picture Companies**

*Kentucky Revised Statute 139.538-.5386, effective 1986*

Motion picture production companies filming or producing motion pictures in Kentucky are exempt from the tax. The exemption is accomplished by granting a refundable credit of taxes paid on purchases made in Kentucky in connection with the filming or producing of a motion picture in this state.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Minimal	Minimal	Minimal

## **24. Admissions to and Purchases by Historical Sites**

*Kentucky Revised Statute 139.482, effective 1976*

Sales of admissions and purchases made by an historical site operated by a non-profit corporation, society, or organization and listed by the United States Department of Interior in the National Register of Historic Places are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Substantial	Substantial	Substantial

**25. Credit Unions***Kentucky Revised Statute 290.365, effective 1984*

Sales to credit unions organized under Kentucky law are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.3 million	\$1.3 million	\$1.3 million

**26. Coin-Operating Bulk Vending Machines***Kentucky Revised Statute 139.470(6), effective 1966, revised 1998*

Vending machine sales of 50 cents or less are exempt from tax. Prior to the 1998 legislative change the amount exempt was 25 cents or less.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$85,000	\$85,000	\$85,000

**27. Non-returnable and Returnable Containers***Kentucky Revised Statute 139.470(2), effective 1960*

Non-returnable and returnable containers sold without contents to persons who place the contents in the containers and sell contents and containers together, and returnable containers sold with the contents at retail or sold for refilling are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.2 million	\$1.2 million	\$1.2 million

**28. Occasional Sales***Kentucky Revised Statute 139.070, 139.470(4), effective 1960*

Casual or isolated sales of property not held or used by a seller in the course of an activity for which he is required to hold a seller's permit are exempt.



<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Substantial	Substantial	Substantial

### **29. Locomotives and Rolling Stock**

*Kentucky Revised Statute 139.480(1), effective 1960*

Locomotives or rolling stock, including materials for their construction, repair, or modification, or fuel and supplies for the direct operation of locomotives and trains used in interstate commerce are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Substantial	Substantial	Substantial

### **30. Procurement, Processing, or Distribution of Blood or Human Tissue**

*Kentucky Revised Statute 139.125, effective 1968*

Whole blood, plasma, blood products, tissues such as corneas, bones, or organs for the purpose of injecting, transfusing, or transplanting any of them into the human body are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.7 million	\$1.7 million	\$1.78million

### **31. Rate Increase for School Taxes added to Residential Telephone Bills**

*Kentucky Revised Statute 139.470(9), effective 1979*

Any rate increase for school taxes and any other charges or surcharges added to the total amount of a residential telephone bill is exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$5.2 million	\$5.4 million	\$5.6 million

**32. Raw Materials and Industrial Supplies***Kentucky Revised Statute 139.470(11), effective 1990*

Raw materials and industrial supplies are exempt from sales and use tax if they enter into and become an ingredient or component part of the manufactured product or they are directly used in manufacturing or industrial processing.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$3,378.0 million	\$3,450.0 million	\$3,584.0 million

**33. Federal Taxes Imposed on Sales of Tangible Personal Property***Kentucky Revised Statute 139.050(3)(d), 139.130(3)(d), effective 1960*

Taxes (not including any manufacturer's excise or import duty) imposed by the United States upon or with respect to retail sales are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$6.6 million	\$6.6 million	\$6.7 million

**34. Sales to Common Carriers Under a Bill of Lading***Kentucky Revised Statute 139.470(5), effective 1960*

Gross receipts from sales of tangible personal property to a common carrier, shipped by the seller via the purchasing carrier under a bill of lading, whether the freight is paid in advance or the shipment is made freight charges collect, to a point outside this state and the property is actually transported to the out-of-state destination for use by the carrier in the conduct of its business as a common carrier are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$0	\$0	\$0

**35. Lease or Rental of Films by Commercial Theaters***Kentucky Revised Statute 139.484, effective 1990*

The lease or rental of films by commercial motion picture theaters, when the lease or rental is for the sole purpose of use in the normal course of business, if an admission fee is charged and if the commercial motion picture theater collects and remits all other applicable sales and use taxes, is exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.8 million	\$1.9 million	\$1.9 million

**36. Tourism Attraction Project Credit/Refund***Kentucky Revised Statute 139.536, effective 1996 – Kentucky Revised Statute 154, effective 1998, amended 2001*

A credit is allowed against the sales tax generated by or arising from a tourism attraction project. The amount of the credit is calculated and refunded on an annual basis.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$7.1 million	\$7.5 million	\$7.4 million

**37. Alcohol Production Facilities***Kentucky Revised Statute 139.480(18), effective 1980*

Any sale, use, storage or consumption of tangible property certified as an alcohol production facility as defined in KRS 247.910 is exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$0	\$0	\$0

**38. Property Certified as a Fluidized Bed Energy Production Facility**

*Kentucky Revised Statute 139.480(20), effective 1986*

Any sale, use, storage or consumption of tangible property that has been certified as a fluidized bed energy production facility, as defined in KRS 211.390, is exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$0	\$0	\$0

**39. Catalogs and Newspaper Inserts Shipped Outside Kentucky**

*Kentucky Revised Statute 139.470, effective 1988*

Catalogs and newspaper inserts purchased for storage, use or other consumption outside this state and delivered by the seller’s own vehicle, postal service, common carrier or contract carrier to a location outside this state are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
Substantial	Substantial	Substantial

**40. 4-H Sales**

*Kentucky Revised Statute 139.497, effective 1998*

Sales made by nonprofit educational youth programs affiliated with a land grant university cooperative extension service are exempt if the net proceeds from the sales are used solely for the benefit of the affiliated programs.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$100,000	\$100,000	\$100,000

**41. Jet Fuel***Kentucky Revised Statute 144.132, effective July 1, 2000*

Certified air carriers are allowed a credit after payment of the first \$1.0 million in sales and use tax on the purchase of aircraft fuel including jet fuel.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$23.0 million	\$23.5 million	\$24.5 million

**42. Repair Parts for Large Trucks***Kentucky Revised Statute 139.480, effective January 1, 2004*

Repair parts for those trucks and their towed units over 44,001 pounds that are used exclusively in interstate commerce are exempt from sales tax for purchases on or after January 1, 2004.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.6 million	\$1.6 million	\$1.7 million

**43. Donated Goods***Kentucky Revised Statute 139.495, effective August 1, 2005*

A sales tax refund equal to 25 percent (up to \$1 million) of the tax collected on sales of donated goods by resident nonprofit educational, charitable or religious institutions is allowed, if the entity uses the refund exclusively as reimbursement for capital construction costs of additional retail locations in this state.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$500,000	\$500,000	\$500,000

**44. Kentucky Enterprise Initiative**

*Kentucky Revised Statute 154-20.204, effective January 1, 2006*

A new statewide tax incentive program replaces the Enterprise Zone program as the current zones expire. It extends to eligible companies the opportunity to receive refunds of sales and use tax paid on the purchase of building materials and research and development materials of expenditure for tourist attractions, services, technology, manufacturing and company headquarters for any industry. The program gives preference to companies in existing enterprise zones. The minimum investment is \$100,000 for companies within the enterprise zone boundaries, \$500,000 elsewhere. It also creates a statewide cap in each year of \$20 million for building materials and \$5 million for research and development on all approved projects.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$5.6 million	\$30.4 million	\$25.0 million

**45. Internet Tax Nondiscrimination Act**

*47 U.S.C. section 151 and Kentucky Revised Statute 136.602 (6), effective January 1, 2006*

Kentucky’s statutes conform to the federal requirement that access to the internet not be taxed. The ban is limited to three types of taxes: Internet access, double taxation of a product or service bought over the Internet, and discriminatory taxes that treat Internet purchases differently from other types of sales. Many telecommunications services that were previously taxed have been exempted due to the use of Internet service providers. However, the ban was not extended to affect Voice Over Internet Protocol (VOIP) technology.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$9.4 million	\$16.1 million	\$16.3 million

**46. Charter Bus Repair and Replacement Parts***Kentucky Revised Statute 139.480, effective August 1, 2005*

Repair and replacement parts for directly operating and maintaining a charter bus certified by the Transportation Cabinet are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$100,000	\$100,000	\$100,000

**47. County Fair Admissions***Kentucky Revised Statute 139.470, effective June, 2005*

The first \$50,000 in county fair admissions are exempt from sales and use tax.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$100,000	\$100,000	\$100,000

## Sales Tax Exemptions for Farmers

The following tax expenditures pertain to the farming industry.

### 48. Livestock, Poultry, Ratite Birds, Embryos and Semen, Alpacas, Llamas, Buffalo, Farm Work Stock and Feed, Seeds and Fertilizers

*Kentucky Revised Statute 139.480(4),(5), (6),(7),(9), (24), (25), (26), and (29) effective 1960, 1994,1996*

Livestock that ordinarily constitutes food for human consumption, provided the sales are made for breeding or dairy purposes and by or to a person regularly engaged in the business of farming; poultry for use in breeding or egg production; ratite birds and eggs to be used in an agricultural pursuit for the breeding and production of ratite birds, feathers, hides, breeding stock, eggs, meat, and ratite by-products; embryos and semen used in the reproduction of livestock; llamas and alpacas used as beasts of burden or in the breeding and production of hides, breeding stock, fiber and wool products, meat, and llama and alpaca by-products; and farm work stock for use in farming operations are exempt from the tax. Seeds, feed, and fertilizer, the products of which ordinarily constitute food for human consumption or which are to be sold in the regular courses of business are exempt.

FY2006	FY2007	FY2008
\$67.9 million	\$69.8 million	\$71.6 million

### 49. Horses Purchased for Breeding

*Kentucky Revised Statute 139.531(2)(a), effective 1976*

The sales and use tax does not apply to horses, interests in horses, or shares in horses, provided the purchase or use is made for breeding purposes only.

FY2006	FY2007	FY2008
\$12.3 million	\$12.4 million	\$12.5 million



**50. Farm Machinery, Attachments, and Replacements, On-Farm Grain Storage Facilities, and On-Farm Facilities for Raising Chickens, Livestock, Ratite Birds, Llamas and Alpacas, and Buffalo**

Farm machinery and repair and replacement parts for the operation of farm machinery are exempt. *Kentucky Revised Statute 139.480(11), effective 1968*

On-farm facilities used exclusively for grain or soybean storing, drying, processing or handling, including all construction, renovation, or repair materials, parts, and equipment, are exempt. *Kentucky Revised Statute 139.480(14), effective 1978*

On-farm facilities used exclusively for raising chickens and livestock, ratite birds, and llamas and alpacas, the products of which ordinarily constitute food for human consumption, including equipment, machinery, attachments, repair and replacement parts, and any materials incorporated into the construction, renovation, or repair of the facility are exempt. *Kentucky Revised Statute 139.480(15), (24), (26), and (29), effective 1990, 1994, and 1996*

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$35.6 million	\$36.5 million	\$37.5 million

**51. Fuel Used for Farm Purposes**

*Kentucky Revised Statute 139.480(16), effective 1978, revised 1998*

Gasoline, special fuels, and liquefied petroleum gas used to operate or propel stationary engines or tractors for agricultural purposes are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$7.5 million	\$7.7 million	\$7.9 million

**52. Water Used for Farm Purposes***Kentucky Revised Statute 139.480, effective 1998*

Water sold to persons regularly engaged in the business of farming and used in the production of crops, milk for sale, or raising and feeding livestock, poultry, ratites, llamas, alpacas, buffalo or aquatic organisms is exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$56,000	\$57,000	\$59,000

**53. Equine Water***Kentucky Revised Statute 139.470, effective 1998*

Water used in the equine-raising business is exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$56,000	\$57,000	\$59,000

**54. Aquaculture***Kentucky Revised Statute 139.480, effective 1998*

Aquatic organisms sold directly to or raised by a person regularly engaged in the business of producing products of aquaculture for sale and items necessary for the production of aquatic organisms are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$14,000	\$15,000	\$15,000

**55. Twine and Wire***Kentucky Revised Statute 139.480, effective 1998*

Baling twine and baling wire used for the purpose of baling hay and straw are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$33,000	\$34,000	\$35,000

**56. Horses Less Than Two Years of Age**

*Kentucky Revised Statute 139.531(2)c, effective 1976*

Sales of horses less than two years of age at the time of sale, provided the sale is made to a nonresident of Kentucky, and the horse is transported out of state, either immediately following the sale or immediately following training within the state are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$18.6 million	\$18.8 million	\$19.0 million

**57. Farm Chemicals**

*Kentucky Revised Statute 139.480(8),(24) and (26), effective 1992, revised 1994, 1996*

Insecticides, fungicides, herbicides, rodenticides, and other farm chemicals used in the production of crops as a business, or in the raising and feeding of ratite birds, llamas and alpacas, or livestock and poultry, the products of which ordinarily constitute food for human consumption are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$5.2 million	\$5.4 million	\$5.5 million

**Table 16. Subtotal for Farming Tax Expenditures**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$147.3 million	\$150.8 million	\$154.2 million

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### Exclusion of Services

*Kentucky Revised Statute 139.100 and 139.160, effective 1960*

Services are excluded from the sales and use tax by the definition of “retail sale” or “sale at retail” as a sale of tangible personal property.

(a) Personal Services

FY2006 .....	\$55.2 million
FY2007 .....	\$59.1 million
FY2008 .....	\$63.4 million

(b) Business Services

FY2006 .....	\$219.4 million
FY2007 .....	\$238.1 million
FY2008 .....	\$259.7 million

(c) Specialized Design Services

FY2006 .....	\$5.3 million
FY2007 .....	\$5.8 million
FY2008 .....	\$6.3 million

(d) Computer System Designs

FY2006 .....	\$55.3 million
FY2007 .....	\$60.0 million
FY2008 .....	\$65.4 million

(e) Scientific Research and Development

FY2006 .....	\$6.3 million
FY2007 .....	\$6.8 million
FY2008 .....	\$7.4 million

## (f) Advertising

FY2006 .....	\$27.1 million
FY2007 .....	\$29.4 million
FY2008 .....	\$32.1 million

## (g) Other Professional Services

FY2006 .....	\$28.1 million
FY2007 .....	\$30.5 million
FY2008 .....	\$33.3 million

## (h) Health Services

FY2006 .....	\$654.6 million
FY2007 .....	\$704.5 million
FY2008 .....	\$754.0 million

## (i) Legal Services

FY2006 .....	\$80.6 million
FY2007 .....	\$87.5 million
FY2008 .....	\$95.4 million

## (j) Educational Services

FY2006 .....	\$16.5 million
FY2007 .....	\$17.7 million
FY2008 .....	\$19.0 million

## (k) Social Services

FY2006 .....	\$7.6 million
FY2007 .....	\$8.2 million
FY2008 .....	\$8.8 million

(l) Engineering, Accounting, Research, Management

FY2006 .....\$135.8 million  
 FY2007 .....\$147.4 million  
 FY2008 .....\$160.8 million

(m) Automotive and Miscellaneous Repair Services.

FY2006 ..... \$112.0 million  
 FY2007 ..... \$120.0 million  
 FY2008 ..... \$128.7 million

(n) Amusement and Recreational Services

(Taxable amusement and recreational services such as video tape rentals and commercial sports events are not included in this estimate.)

FY2006 ..... \$28.5 million  
 FY2007 ..... \$30.6 million  
 FY2008 ..... \$32.6 million

(o) Other Services

FY2006 ..... \$5.4 million  
 FY2007 ..... \$5.8 million  
 FY2008 ..... \$6.2 million

**Table 17. Total for Excluded Services**

<b>FY 2006</b>	<b>FY 2007</b>	<b>FY 2008</b>
\$1,437.7 million	\$1,551.4 million	\$1,673.1million

## **SPECIAL FUELS TAX**

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**Background**     **T**he term “special fuels” is defined to include all combustible gases and liquids capable of being used in motor vehicles, except gasoline, as defined in KRS 138.210, and liquefied petroleum gas, as defined in KRS 234.100. A tax on special fuels was first enacted in 1952. When the base was changed for gasoline in 1980 to the average per gallon wholesale price, the special fuels tax base was changed accordingly. This change provided that the special fuels rate would be a function of the wholesale price of gasoline, and as the price of gasoline rose, the rate on special fuels would rise proportionately. The “supplemental highway user tax” became effective July 1, 1986.

In 1988, the General Assembly made a major change in the special fuels law. The new law requires that the tax be levied on the dealer at the point of receipt of the fuels (as is the case for gasoline) instead of the point of sale by the dealer. Generally, special fuels used for off-highway purposes are subject to a refund of the tax, provided proper applications are filed and other procedures are followed.

The tax is imposed for the privilege of using the highways of the Commonwealth, therefore, the receipts are deposited in the Road Fund. For FY05, the special fuels tax collections were \$118.3 million, which was 10.5 percent of total Road Fund tax receipts.

**Current Tax Rate**     The current tax rate is a minimum of 11 cents per gallon. As the average wholesale price of the fuel increases above \$1.22 per gallon, the special fuels tax increases accordingly. The current rate for the supplemental highway tax is 2 cents per gallon thereby increasing the total minimum rate on special fuels to 13 cents per gallon.

**Tax Base**     The minimum combined tax rate of 13 cents per gallon of special fuels applies. The tax becomes a liability of the dealer when the special fuel is received or enters the dealer’s storage facility. The dealer is allowed a deduction of 2.25 percent to cover evaporation, shrinkage, unaccountable losses, collection costs, bad debts, and handling and reporting the tax.



**Taxable Unit** The unit for levying the special fuels tax is a “per gallon” basis.

**Tax Due** Returns and payments of the tax are due monthly. The tax must be remitted to the Department of Revenue on or before the twenty-fifth day of the month.

**Table 18. Total Special Fuels Tax Expenditures**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$53.2 million	\$55.3 million	\$57.2 million

**Tax Expenditures**

**1. Non-highway Use**

*Kentucky Revised Statute 138.344(1), effective 1988, revised 2000*

Special fuels used exclusively for non-highway use by qualified purchasers are exempt sales.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$29.0 million	\$30.5 million	\$32.0 million

**2. Railroad Companies**

*Kentucky Revised Statute 138.240(2)(f), effective 1988*

Railroad companies principally engaged in the business of transporting property for others as a common carrier or in the conveyance of persons are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$14.7 million	\$15.0 million	\$15.2 million

### 3. Agricultural Use

*Kentucky Revised Statute 138.358(2), effective 1988*

A credit is allowed for special fuels used for non-highway agricultural purposes.

FY2006	FY2007	FY2008
\$3.7 million	\$3.8 million	\$3.9 million

### 4. Dealer's Monthly Reporting Allowance

*Kentucky revised Statute 138.270(1)(b), effective 1958*

An allowance of 2.25 percent of the net tax due is allowed a dealer on a timely filed and paid monthly return. This allowance is given to offset the costs of evaporation, shrinkage, unaccountable losses, collection costs, bad debts and handling and reporting the tax.

FY2006	FY2007	FY2008
\$3.0 million	\$3.1 million	\$3.1 million

### 5. Residential Heating

*Kentucky Revised Statute 138.358(1), effective 1988*

An exemption is allowed for special fuels used exclusively for heating personal residences.

FY2006	FY2007	FY2008
\$1.4 million	\$1.5 million	\$1.5 million

### 6. Bus, Taxicab and Certain Senior Citizen's Programs Refunds

*Kentucky Revised Statute 138.446, effective 1978*

Seven-ninths of the tax paid is refunded if the special fuels are used in regularly scheduled operations of the city and suburban buses, taxicabs, senior citizen transportation and non-profit buses.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$320,000	\$330,000	\$330,000

**7. State and Local Government Use**

*Kentucky Revised Statute 138.358(3), effective 1988*

An exemption is allowed for sales to qualifying state and local government agencies for non-highway use.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$250,000	\$300,000	\$300,000

**8. Religious, Charitable or Educational Use**

*Kentucky Revised Statute 138.358(3), effective 1988*

An exemption is allowed for sales to qualifying non-profit religious, charitable or educational organizations for non-highway use.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$200,000	\$250,000	\$250,000

**9. Watercraft**

*Kentucky Revised Statute 138.455, effective 1960*

One hundred percent of the tax paid on special fuels to operate or propel watercraft is refunded to qualified boat dock operators.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$45,000	\$46,000	\$47,000

**10. U.S. Government Exemption**

*Kentucky Revised Statute 138.240(2), effective July 1, 1988*

Special fuels sold to the U.S. Government are exempt.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$600,000	\$600,000	\$600,000

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## EARMARKED FUNDS

Earmarked funds are reserved to be spent only on a particular program. The taxpayer is still liable for the tax, and the state is still collecting these revenues. The fact that the revenues are earmarked for special purposes does not qualify them as tax expenditures.

Earmarked funds are included for informational purposes in this report because they do have an impact on the amount of usable funds collected by the General Fund and the Road Fund.

**Table 19. Total Earmarked Funds**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$34.9 million	\$35.2 million	\$35.6 million

### Earmarked Funds

#### 1. Thoroughbred Development Fund - Pari-Mutuel Tax

*Kentucky Revised Statute 138.510, effective 1990*

Three-quarters of one percent (0.75%) of all pari-mutuel wagering at thoroughbred horse tracks under the jurisdiction of the Kentucky Horse Racing Authority and 2 percent of wagering at receiving tracks in intertrack wagering, as well as telephone account wagering is deducted from the pari-mutuel tax and deposited in this fund.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$7.3 million	\$7.3 million	\$7.3 million

## 2. Equine Industry Program Trust and Revolving Fund - Pari-Mutuel Tax

*Kentucky Revised Statute 138.510(3), effective 1990*

One-fifth of one percent (0.2%) of the total amount wagered on live racing in Kentucky and .05 percent of the total amount wagered on intertrack wagering is deducted from the pari-mutuel tax and deposited in this fund. The fund is used for the equine industry program at the University of Louisville.

FY2006	FY2007	FY2008
\$470,000	\$470,000	\$470,000

## 3. Higher Education Equine Trust and Revolving Fund - Pari-Mutuel Tax

*Kentucky Revised Statute 138.510(4), effective 1992*

One-tenth of one percent (0.1%) of the total amount wagered in Kentucky is deducted from the pari-mutuel tax to be deposited in this fund. The fund is used for construction, expansion or renovation of facilities or the purchase of equipment for equine programs at state universities.

FY2006	FY2007	FY2008
\$470,000	\$470,000	\$470,000

## 4. Standardbred Development Fund - Pari-Mutuel Tax

*Kentucky Revised Statute 230.265(3), effective 1990*

One percent of all pari-mutuel wagering at harness host tracks under the jurisdiction of the Kentucky Horse Racing Authority and 2 percent of wagering at receiving tracks in intertrack wagering, as well as telephone account wagering is deducted from the tax and deposited in this fund.

FY2006	FY2007	FY2008
\$100,000	\$100,000	\$100,000

**5. Tobacco Enforcement Program - Cigarette Tax**

*Kentucky Revised Statute 438.335 and 438.337, effective 1996*

One-twentieth of one cent of the three-cent per pack revenue collected from the state excise tax on cigarettes is earmarked for the Department of Agriculture to enforce the laws aimed at the prevention of sales of tobacco products to minors.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$350,000	\$350,000	\$350,000

**6. Kentucky Transportation Center - Motor Fuels Tax**

*Kentucky Revised Statute 177.320(4), effective 1986*

The Kentucky Transportation Center receives 0.1 percent of all revenues arising from the imposition of taxes on gasoline, special fuels and liquefied petroleum gas. The receipts are limited to \$190,000 in any fiscal year.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$190,000	\$190,000	\$190,000

**7. Tobacco Research Trust Fund - Cigarette Tax**

*Kentucky Revised Statute 248.540, effective 1970*

One-sixth of the tax collected is earmarked for the Tobacco Research Trust Fund.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$3.5 million	\$3.5 million	\$3.5 million

**8. Agricultural Diversification and Development Fund - Cigarette Tax**

*Kentucky Revised Statute 248.652, effective 1998*

Any additional increases in the cigarette tax are earmarked for the Agricultural Diversification and Development Council to be distributed to various diversification and health-related programs.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$0	\$0	\$0

## 9. Equine Drug Research - Pari-Mutuel Tax

*Kentucky Revised Statute 230.265(3), effective 1982*

An amount equal to 0.1 percent of the total amount wagered in Kentucky is deducted from the pari-mutuel tax to be used in financing drug research and testing.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$400,000	\$400,000	\$400,000

## 10. Kentucky Aviation Economic Development Fund - Sales Tax

*Kentucky Revised Statute 183.525, effective July 1, 2000*

All sales and use tax collected on the sale of aircraft fuel is deposited in this fund.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$5.1 million	\$4.5 million	\$4.6 million

## 11. Tax Increment Financing - Various Taxes

*Kentucky Revised Statute 65.495, effective July 14, 2000 and  
Kentucky Revised Statute 65.703, effective June 21, 2001*

A locality may create a development area and, with state approval, receive payment of part of the increase in tax revenues within the development area to help offset the cost of development. Potentially all taxes could be involved, although it is expected that sales, property and income taxes would be most utilized because of the dollar volume.

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.0 million	\$2.0 million	\$2.0 million



**12. Equine Breeder Development Funds -Sales Tax**

*Kentucky Revised Statute 230.802 and 230.804, effective June 1, 2005*

Sales tax receipts from stud fees for breeding of horses in this state are earmarked for use in creating breeder incentives. The sales tax will be deposited into special funds for future disbursement by the Kentucky Horse Racing Authority. Eighty percent of the receipts are dedicated to the “Kentucky Thoroughbred Breeders Incentive Fund,” thirteen percent to the “Kentucky Standardbred Breeders Incentive Fund,” and 7 percent to the “Kentucky Horse Breeders Incentive Fund.”

**Kentucky Thoroughbred Breeders Incentive Fund**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$12.0 million	\$12.5 million	\$13.0 million

**Kentucky Standardbred Breeders Incentive Fund**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$2.0 million	\$2.3 million	\$2.1 million

**Kentucky Horse Breeders Incentive Fund**

<b>FY2006</b>	<b>FY2007</b>	<b>FY2008</b>
\$1.0 million	\$1.1 million	\$1.1 million