KRC

ANNUAL

REPORT

1997-98

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1997-98

ANNUAL REPORT

Kentucky Revenue Cabinet
... for the benefit of Kentucky
and its citizens

All information contained in this report is as of June 30, 1998.

PAUL E. PATTON
GOVERNOR

SARAH J. SCHAAF
SECRETARY

REVENUE CABINET
OFFICE OF THE SECRETARY
FRANKFORT, KENTUCKY 40620

October 15, 1998

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

Dear Governor Patton:

Pursuant to Kentucky Revised Statute 12.110, I am pleased to present the Kentucky Revenue Cabinet's (KRC) Annual Report for Fiscal Year 1997-98.

Contained in this report is an analysis of General Fund and Road Fund receipts, a summary of major KRC accomplishments for the fiscal year and a description of our *EMPOWER Kentucky* initiatives including revenue projections and receipts.

KRC is entering a new era in tax administration by implementing an integrated tax system (ITS). Funding of the ITS through your *EMPOWER Kentuck*y program is a testament to the dedicated and hard working staff in KRC. As we modernize our agency for the twenty-first century, our employees will continue to demonstrate their commitment to quality service to the commonwealth. We thank you for your support and confidence in our abilities.

Sincerely,

Sarah Jane Schaaf

Sarah Jane Schaaf, Secretary
Kentucky Revenue Cabinet

KRC Mission

The Cabinet's mission, reflected in its philosophy and general strategy, is central to all of its work. All of the Cabinet's actions should reflect its mission and similarly, those actions should be judged by the extent to which they help the Cabinet carry out its mission.

Within this framework, it is the mission of the Kentucky Revenue Cabinet to:

Provide courteous, accurate and efficient services for the benefit of Kentucky and its citizens, and administer the tax laws of the Commonwealth in a fair and impartial manner.

To achieve its mission, the Cabinet will:

- Promote voluntary compliance with tax laws through educational programs and quality taxpayer services;
- Inform the public of taxpayer rights and responsibilities;
- Establish and maintain clear, concise, accurate and timely communication to foster positive and constructive relations and a better understanding of tax laws;
- Collect and process receipts and returns as cost effectively and efficiently as possible;
- Develop and implement new and innovative programs to minimize noncompliance with tax laws;
- Utilize information resources and expertise to serve in an advisory role;
- Acquire new technologies to implement and maintain a state-of-the-art tax administration system;
- Enforce compliance when there is an intent to defraud or evade the taxes due the Commonwealth; and
- Educate, train, develop and retain the qualified staff necessary to achieve its goals and objectives.

KRC Philosophy

Recognizing that the administration of Kentucky's tax laws is a challenging and sometimes controversial responsibility, the Revenue Cabinet complements its mission with a tax administration philosophy.

The Cabinet's philosophy, drawn from its strategy and mission, represents the fundamental beliefs that shape the approach to policy and operations within a new framework. **IT IS A COMMITMENT TO SERVICE.**

- **Commitment to High Standards of Service.** The Cabinet is committed to raising the standards of tax administration by providing professional, courteous, accurate and efficient service to taxpayers of the Commonwealth as they try to voluntarily comply with Kentucky's tax laws.

  This commitment to service—the core of the Cabinet's tax administration philosophy—is pervasive and long-term, and will be a daily expression of the Revenue Cabinet's value system. The high standards set for the Cabinet on behalf of Kentucky's taxpayers will guide strategies and assist in establishing goals and objectives.

- **Commitment to Employees and the Services they Provide.** The Cabinet recognizes that its employees are its greatest asset and they should be encouraged and empowered to use their creativity and resourcefulness in fulfilling the Cabinet's mission.

  Employees must be dedicated to working not only individually but as a team to fully satisfy the service needs of Kentucky's taxpayers. Only through teamwork, training and education can staff ensure adequate response and efficient delivery of service.

- **Commitment to Flexibility and Effectiveness in Serving Taxpayers.** Flexibility is essential to accommodate today's rapidly changing world. Taxpayers expect greater efficiency and responsiveness from government. Budgetary and efficiency needs as well as expectations from executive, legislative and judicial branches of government demand quicker and more accurate research and data as it impacts the tax structure. In addition, the need to effectively interact with federal, state and local government officials is becoming increasingly important.

- **Commitment to Assisting the Taxpayer.** The Cabinet will improve its efforts to educate and inform taxpayers of their responsibilities to timely file and pay tax obligations. Assistance will be given to facilitate easy and accurate reporting. Constantly striving to modernize and enhance Revenue's tax administration system will enable the Cabinet to utilize more effectively its resources to provide a greater depth and breadth of service.

- **Commitment to Fair and Impartial Administration and Enforcement.** The Cabinet is committed to administering the tax laws of the Commonwealth fairly, equitably and impartially without regard to taxpayers' status, wealth, political affiliation, race, color, creed or disability.

  In its pursuit of fair tax administration for all taxpayers—particularly the vast majority of taxpayers who timely report and pay their Kentucky taxes—the Cabinet will identify and actively pursue those who do not voluntarily comply with their tax reporting and payment responsibilities.

  Thus, in an effort to earn total and absolute confidence of Kentucky's taxpayers regarding its fair administration of the tax laws, the Cabinet will exhibit honesty and integrity in all dealings with taxpayers and avoid any situation or action which could result in the slightest perception of unfair practices or questionable behavior.

Promoting voluntary compliance, educating taxpayers of their responsibilities and quality service will be the Cabinet's daily commitment to Kentucky and its citizens.

The Cabinet will not lose sight of those it serves!

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(Reprinted from the
Finance and Administration Cabinet's 1998
4th Quarter "Quarterly Economic & Revenue Report")

As shown in Table 1, combined tax and nontax receipts for the General and Road Funds increased by 5.5 percent over the combined receipts in FY97. Table 2 compares only tax receipts for the two funds which grew by 5.6 percent. Table 3 compares combined nontax receipts which grew by 13.7 percent over the previous year.

Table 1
Total Receipts
(millions of dollars)

	FY98	FY97	Percent Change
General Fund	$6,011.8	$5,663.6	6.1
Road Fund	1,011.8	960.2	5.4
Combined	**$7,023.6**	**$6,623.8**	**5.5**

Table 2
Tax Receipts
(millions of dollars)

	FY98	FY97	Percent Change
General Fund	$5,722.5	$5,408.8	5.8
Road Fund	942.1	901.2	4.5
Combined	**$6,664.6**	**$6,310.0**	**5.6**

Table 3
Nontax Receipts
(millions of dollars)

	FY98	FY97	Percent Change
General Fund	$284.4	$252.4	12.7
Road Fund	69.4	58.8	18.0
Total	**$353.8**	**$311.2**	**13.7**

General Fund

General Fund receipts for the year rose by 6.1 percent over those reported in FY97. This was aided by strong growth in the individual income tax, the corporate income tax, and the inheritance tax, all of which can be tied to the growth in the economy and the stock market. Total receipts of $6,011.8 million compare to $5,663.6 million collected in FY97.

The sales tax growth rate declined from the previous year for the third year in a row. However, at a growth of 5.2 percent, performance was still healthy. Receipts of $1,981.3 million compare to prior year receipts of $1,882.7 million.

Performance in the individual income tax continued to improve with a strong growth rate of 9.7 percent. The growth experienced from FY96 to FY97 was 6.3 percent. Receipts totaled $2,418.1 million and compare to $2,205.0 million collected last year. This increase comes despite the continued phase-in of the pension exemption and the increase in the standard deduction.

The corporate income tax improved substantially over the growth experienced in the previous fiscal year. Receipts of $333.7 million grew by 14.0 percent over the $292.8 million collected in FY97. FY97 receipts had grown by 2.8 percent from FY96 collections.

Coal severance tax collections increased by 0.1 percent after declining for the past seven years. Receipts totaled $163.7 million and compare to $163.5 million collected during the prior fiscal year.

Total property taxes experienced a loss of 12.6 percent during this fiscal year. This decline was partially anticipated due to the removal of the property tax on certain types of intangible property. In addition, one-time collections in some accounts during FY97 resulted in expected declines in those accounts this year. However, the overall decline was slightly larger than expected. Receipts totaled $362.8 million compared to $414.9 million collected in FY97.

The growth in lottery receipts once again dropped from that experienced in previous years. Receipts of $153 million grew by 1.3 percent over the $151 million remitted to the state last fiscal year.

Although the growth rate in the fourth quarter was the smallest of any quarter during the year, the "all other" category finished the year with growth of 8.2 percent. Receipts of $599.1 million compare to $553.7 million collected in FY97. Accounts with large gains in this category include the inheritance tax and interest on investments.

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

Table 4
General Fund Growth Rates
for the Four Quarters and Full Year, FY98

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY98
Total Receipts	8.5%	5.5%	3.2%	7.4%	6.1%
Sales & Use	3.7	5.6	6.5	5.3	5.2
Individual Income	9.0	8.0	5.8	14.9	9.7
Corporate Income	22.8	39.8	22.5	-1.3	14.0
Coal Severance	-4.1	-0.6	7.2	-1.9	0.1
Property	14.2	-10.6	-26.1	-4.0	-12.6
Lottery	2.9	2.9	2.9	-2.1	1.3
All Other	22.4	7.8	5.2	2.4	8.2

Road Fund

Total Road Fund receipts grew by 5.4 percent during FY98. Total receipts of $1,011.8 million compare to $960.2 million collected in this fund during FY97.

The motor fuels taxes growth rate of 1.4 percent compares to a growth rate of 3.3 percent during FY97. Receipts of $396.1 million compare to $390.7 million collected during the previous fiscal year.

Motor vehicle usage tax receipts of $366.8 million grew by a strong 7.4 percent over the $341.5 million collected in FY97. This compares to a growth rate of 4.2 percent experienced last year.

The performance of the weight distance tax improved during the year and finished with a growth of 5.7 percent. Growth last year was 5.4 percent. Receipts totaled $66.7 million and compare to $63.1 million collected last fiscal year.

The "all other" category grew by 10.4 percent after a 5.4 percent decline last year. This increase is primarily due to motor vehicle license receipts and investment income. Total receipts in this category were $182.2 million, which compares to $165.0 million collected in FY97.

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

Table 5
Road Fund Growth Rates
for the Four Quarters and Full Year, FY98

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	FY98
Total Receipts	0.4%	1.7%	17.4%	2.8%	5.4%
Motor Fuels	-3.2	-16.2	38.7	-7.4	1.4
Motor Vehicle Usage	6.6	4.3	7.9	10.4	7.4
Weight Distance	2.1	9.4	10.7	1.2	5.7
All Other	-5.2	55.3	-2.5	10.5	10.4

EMPOWER Kentucky

The *EMPOWER Kentucky* revenue enhancement initiatives have continued and expanded during FY98. Collections during the fiscal year are shown in Table 6. *EMPOWER Kentucky* is a program that funds, among other things, specific procedures within the Revenue Cabinet. These procedures are designed to collect certain revenues that are owed to the commonwealth but are not voluntarily paid.

Table 6
***EMPOWER Kentucky* Collections During FY 98**
(millions of dollars)

Type Tax	Collections During FY 98
Individual Income	$ 9.0
Corporation Income	1.0
Sales and Use Tax	3.5
Property Tax	5.6
Other (See Note)	4.4
Total	**$23.5**

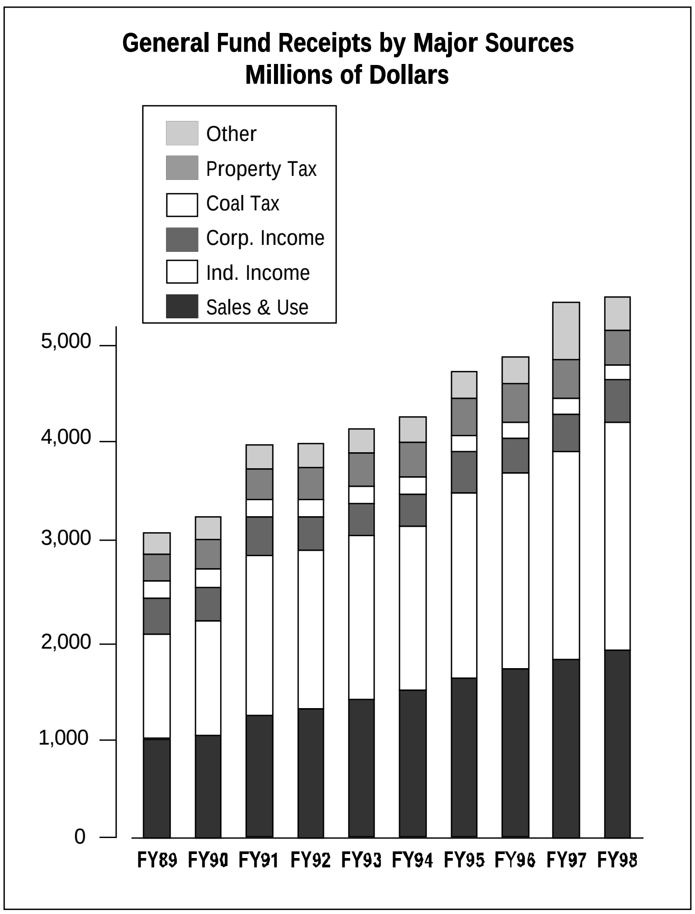
Note: Some revenues were not classified during part of FY98. All unclassified receipts are included in the "other" category.

GENERAL FUND

GENERAL FUND TOTAL RECEIPTS

Fiscal Year	Receipts	Percent Change
1997-98	$6,011,806,561	6.1
1996-97	5,663,553,289	6.1
1995-96	5,336,883,824	3.5
1994-95	5,154,077,980	10.9
1993-94	4,647,078,322	3.0
1992-93	4,511,721,822	3.5
1991-92	4,360,835,365	1.1
1990-91	4,311,675,984[2]	21.1
1989-90	3,560,983,777[1]	8.2
1988-89	3,289,923,473	8.6

[1]Lottery revenues were first deposited in the General Fund.
[2]Total corrected by Finance and Administration Cabinet.



ALCOHOLIC BEVERAGE TAXES

Malt Beverage

Fiscal Year	Receipts	Percent Change
1997-98	$35,937,878	3.2
1996-97	34,830,419	1.0
1995-96	34,489,349	2.0
1994-95	33,812,169	3.9
1993-94	32,553,876	4.4
1992-93	31,172,541	2.5
1991-92	30,404,806	4.8
1990-91	29,002,422	5.9
1989-90	27,376,409	3.4
1988-89	26,484,829	0.2

Distilled Spirits

Fiscal Year	Receipts	Percent Change
1997-98	$20,979,849	2.1
1996-97	20,548,503	0.3
1995-96	20,493,441	3.0
1994-95	19,897,599	-0.3
1993-94	19,960,515	0.2
1992-93	19,923,344	2.2
1991-92	19,485,739	0.9
1990-91	19,314,634	2.8
1989-90	18,789,245	0.8
1988-89	18,634,784	-0.6

Wine

Fiscal Year	Receipts	Percent Change
1997-98	$6,551,316	7.6
1996-97	6,085,828	8.5
1995-96	5,610,308	15.7
1994-95	4,847,726[1]	7.9
1993-94	4,492,841	0.9
1992-93	4,454,161	4.2
1991-92	4,273,359	4.6
1990-91	4,085,329	0.7
1989-90	4,055,763	1.0
1988-89	4,014,466	-1.9

[1]Total corrected by Finance and Administration Cabinet.

Revenue Receipts

CIGARETTE TAX[1]

Fiscal Year	Receipts	Percent Change
1997-98	$15,130,443	-5.7
1996-97	16,044,967	2.3
1995-96	15,680,704	3.7
1994-95	15,126,270	5.9
1993-94	14,285,746	2.1
1992-93	13,994,590	-0.4
1991-92	14,044,608	-1.6
1990-91	14,278,438	2.7
1989-90	13,897,537	-2.1
1988-89	14,193,246	-4.4

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

COAL SEVERANCE TAX

Fiscal Year	Receipts	Percent Change
1997-98	$163,731,038	0.1
1996-97	163,545,844	-5.3
1995-96	166,101,045	-7.3
1994-95	179,116,944	-0.4
1993-94	179,844,327	-0.2
1992-93	180,117,668	-2.7
1991-92	185,102,332	-3.1
1990-91	191,037,171	-2.3
1989-90	195,496,376[1]	8.2
1988-89	180,603,799	-4.6

[1]*Total corrected by Finance and Administration Cabinet.*

CORPORATION INCOME TAX

Fiscal Year	Receipts	Percent Change
1997-98	$333,666,393	14.0
1996-97	292,753,126	2.8
1995-96	284,732,573	-16.5
1994-95	340,912,408	26.7
1993-94	269,067,231	5.6
1992-93	254,775,357	-6.0
1991-92	271,026,952	-15.1
1990-91	319,350,654[1]	14.3
1989-90	279,482,573	-10.1
1988-89	310,803,412	21.5

[1]*Each tax rate increased one percentage point effective January 1, 1990.*

CORPORATION LICENSE TAX

Fiscal Year	Receipts	Percent Change
1997-98	$112,763,161	4.9
1996-97	107,498,746	18.8
1995-96	90,515,391[2]	-7.1
1994-95	97,449,950[1]	18.8
1993-94	82,031,324[1]	-5.8
1992-93	87,061,523	6.3
1991-92	81,926,247	0.3
1990-91	81,709,060	8.5
1989-90	75,328,093	8.7
1988-89	69,271,992	12.5

[1]*Total corrected by Finance and Administration Cabinet.*
[2]*Corrected for posting error by Finance and Administration Cabinet.*

INDIVIDUAL INCOME TAX

Fiscal Year	Receipts	Percent Change
1997-98	$2,418,144,438	9.7
1996-97	2,205,022,964	6.3
1995-96	2,074,572,167	5.6
1994-95	1,964,843,490	13.6
1993-94	1,729,182,293	-0.2
1992-93	1,733,415,059	3.3
1991-92	1,678,525,589	-0.9
1990-91	1,693,338,659[1]	39.9
1989-90	1,210,284,972	8.9
1988-89	1,111,707,645	10.4

[1]*Kentucky income tax law was amended to conform to the Internal Revenue Code in effect on December 31, 1989, and the deduction for federal income tax was repealed.*

INHERITANCE AND ESTATE TAX

Fiscal Year	Receipts	Percent Change
1997-98	$105,538,130	10.8
1996-97	95,287,282	17.0
1995-96	81,441,427[1]	2.4
1994-95	79,511,634	4.4
1993-94	76,135,351	7.3
1992-93	70,965,470	-8.3
1991-92	77,354,648	12.6
1990-91	68,726,903	2.8
1989-90	66,855,011	25.2
1988-89	53,396,904	8.8

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

INSURANCE PREMIUMS TAX

Foreign Life Insurance Companies

Fiscal Year	Receipts	Percent Change
1997-98	$35,116,933	6.1
1996-97	33,086,032	-8.5
1995-96	36,165,049	6.5
1994-95	33,966,941	-10.7
1993-94	38,057,960	11.1
1992-93	34,268,972	1.7
1991-92	33,703,047	15.7
1990-91	29,130,844	1.7
1989-90	28,656,062	-1.8
1988-89	29,168,422	12.5

Insurance Companies Other than Life

Fiscal Year	Receipts	Percent Change
1997-98	$52,600,230	4.5
1996-97	50,318,931	3.4
1995-96	48,687,419	7.0
1994-95	45,515,163	6.5
1993-94	42,720,970	5.1
1992-93	40,631,761	2.1
1991-92	39,781,751	3.3
1990-91	38,529,132	9.6
1989-90	35,164,266	0.0
1988-89	35,165,882	1.2

LOTTERY RECEIPTS

Fiscal Year	Receipts	Percent Change
1997-98	$153,000,000	1.3
1996-97	151,000,000	2.7
1995-96	147,000,000	8.1
1994-95	136,000,000	19.3
1993-94	114,000,000	14.0
1992-93	100,000,000	0.0
1991-92	100,000,000	37.0
1990-91	73,000,000	-18.9
1989-90	90,000,000[1]	
1988-89	0[1]	

[1] *The Kentucky Lottery Corporation began sales on April 4, 1989. All receipts were initially deposited into a trust account. During the first quarter of FY90 all funds were transferred to the General Fund.*

MINERALS AND NATURAL GAS TAX

Fiscal Year	Receipts	Percent Change
1997-98	$20,192,086	0.7
1996-97	20,051,609	15.4
1995-96	17,378,785	17.6
1994-95	14,783,614	-11.6
1993-94	16,718,727	8.1
1992-93	15,463,902	18.0
1991-92	13,105,878	-16.7
1990-91	15,733,934	12.1
1989-90	14,032,659	2.9
1988-89	13,632,519	-17.6

OIL PRODUCTION TAX

Fiscal Year	Receipts	Percent Change
1997-98	$ 2,135,211	-29.9
1996-97	3,044,497	15.1
1995-96	2,644,656	-5.0
1994-95	2,784,562	3.2
1993-94	2,697,560	-38.9
1992-93	4,413,136	-7.2
1991-92	4,756,184	-18.3
1990-91	5,824,523	33.5
1989-90	4,363,731	14.0
1988-89	3,828,984	-9.9

PARI-MUTUEL TAX

Fiscal Year	Receipts	Percent Change
1997-98	$ 4,845,921	-18.0
1996-97	5,911,958	-17.3
1995-96	7,148,951	-1.5
1994-95	7,256,986	18.3
1993-94	6,134,317	-1.8
1992-93	6,247,368	-8.8
1991-92	6,852,421	6.5
1990-91	6,435,598[1]	-42.1
1989-90	11,124,213	6.9
1988-89	10,402,885[2]	59.4

[1] *Tax rate and credit system were restructured, effectively reducing the amount of the pari-mutuel tax.*

[2] *Effective July 15, 1988, intertrack wagering was permitted in Kentucky and subjected to pari-mutuel taxing at the rate of 5 percent on all money wagered at receiving tracks. When acting as receiving tracks, the pari-mutuel tax credits cannot be applied.*

Revenue Receipts

PROPERTY TAXES—REAL ESTATE

Fiscal Year	Receipts	Percent Change
1997-98	$154,245,453	-9.3
1996-97	170,063,059[1]	19.2
1995-96	142,728,406	7.2
1994-95	133,200,108	0.8
1993-94	132,125,477	4.6
1992-93	126,333,184	3.4
1991-92	122,146,269	5.7
1990-91	115,574,669	2.3
1989-90	112,971,186	2.1
1988-89	110,657,160	4.9

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

PROPERTY TAXES—TANGIBLE

Fiscal Year	Receipts	Percent Change
1997-98	$125,753,465	0.9
1996-97	124,637,468[1]	-9.6
1995-96	137,812,773	20.8
1994-95	114,122,717	9.2
1993-94	104,501,822	10.8
1992-93	94,346,047	4.5
1991-92	90,281,298	7.3
1990-91	84,110,969	7.5
1989-90	78,212,759	18.9
1988-89	65,761,650	7.1

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

PROPERTY TAXES—INTANGIBLE

Fiscal Year	Receipts	Percent Change
1997-98	$ 21,129,328[1]	-54.7
1996-97	46,631,437[1]	-29.9
1995-96	66,489,089	-20.4
1994-95	83,479,482	7.9
1993-94	77,393,521	-0.5
1992-93	77,751,342	11.1
1991-92	69,961,863	-2.0
1990-91	71,415,874	12.9
1989-90	63,275,797	10.9
1988-89	57,063,060	3.6
1987-88	55,099,760	19.5

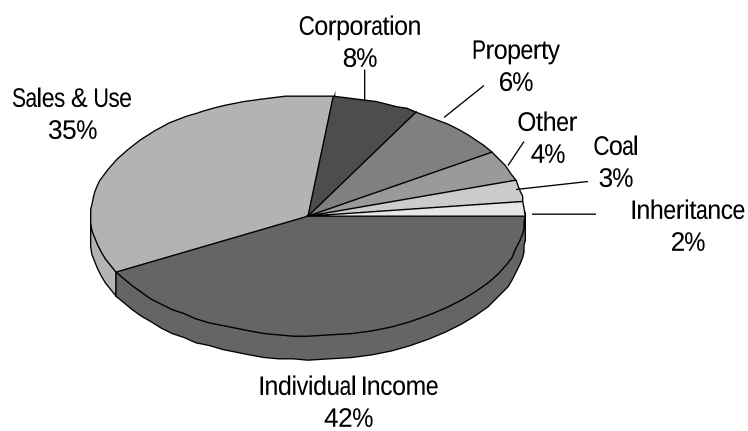
[1] *Property taxes on certain intangible assets, primarily stocks and bonds of most foreign corporations, were exempted from property tax.*

SALES AND USE TAX

Fiscal Year	Receipts	Percent Change
1997-98	$1,981,297,580	5.2
1996-97	1,882,681,995	5.5
1995-96	1,783,881,316	6.2
1994-95	1,680,520,815	7.7
1993-94	1,560,085,519	6.7
1992-93	1,462,251,261	7.2
1991-92	1,363,690,026	5.2
1990-91	1,296,310,445[1]	19.4
1989-90	1,085,822,176	3.9
1988-89	1,045,200,114	9.8

[1] *The tax rate was raised from 5 to 6 percent effective July 1, 1990.*

Makeup of FY 1998 General Fund



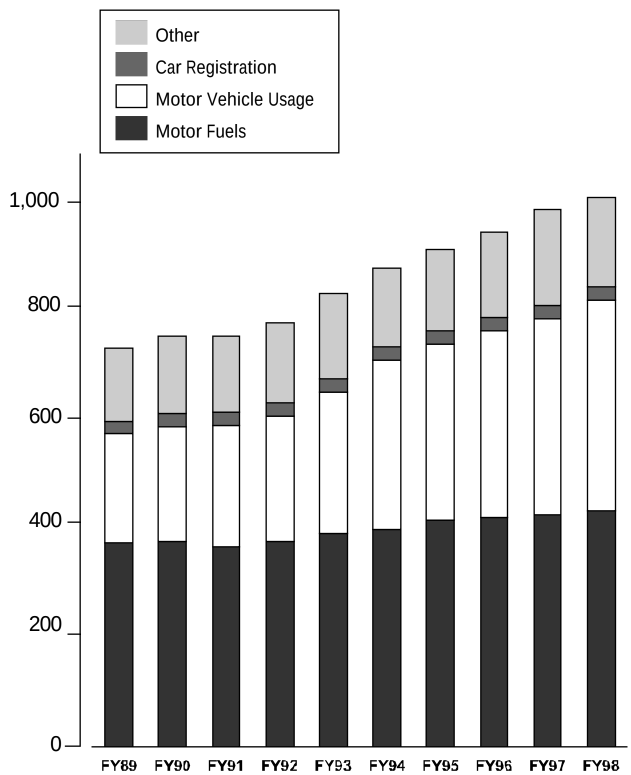
ROAD FUND

ROAD FUND TOTAL RECEIPTS[1]

Fiscal Year	Receipts	Percent Change
1997-98	$1,011,789,675	5.4
1996-97	960,183,780	2.2
1995-96	939,910,490	4.4
1994-95	900,619,387	4.4
1993-94	862,826,425	5.2
1992-93	820,411,480	4.9
1991-92	781,808,152	2.1
1990-91	765,598,232[2]	1.5
1989-90	754,484,154	3.5
1988-89	729,203,981[3]	16.8

[1]Does not include federal grants.
[2]Motor vehicle usage tax rate was increased to 6 percent effective July 1, 1990.
[3]Percent change corrected.

Road Fund Receipts by Major Sources
Millions of Dollars



MOTOR FUELS TAXES

Motor Fuels Normal

Fiscal Year	Receipts	Percent Change
1997-98	$396,123,781	1.4
1996-97	390,688,336	3.3
1995-96	378,142,941	1.3
1994-95	373,316,977	4.2
1993-94	358,435,307	1.4
1992-93	353,651,330	4.5
1991-92	338,517,487	3.4
1990-91	327,467,484	-2.7
1989-90	336,436,477	0.1
1988-89	336,034,614	10.5

Motor Fuels Normal Use and Surtax

Fiscal Year	Receipts	Percent Change
1997-98	$17,473,744	14.1
1996-97	15,316,702	-32.1
1995-96	22,554,473	-2.2
1994-95	23,052,951	7.7
1993-94	21,399,126	3.9
1992-93	20,591,812	-1.9
1991-92	21,000,948	-6.0
1990-91	22,331,775	-2.7
1989-90	22,943,630	5.7
1988-89	21,713,096	20.7

MOTOR VEHICLE OPERATOR'S LICENSE

Fiscal Year	Receipts	Percent Change
1997-98	$ 5,241,595	-2.1
1996-97	5,355,648	4.8
1995-96	5,110,387	-1.2
1994-95	5,170,423	-3.5
1993-94	5,358,710	6.7
1992-93	5,020,733	-3.8
1991-92	5,221,356	3.6
1990-91	5,038,197	-6.0
1989-90	5,361,189	0.7
1988-89	5,325,961	16.6

MOTOR VEHICLE REGISTRATIONS

Passenger Car Registration

Fiscal Year	Receipts	Percent Change
1997-98	$23,604,679	1.4
1996-97	23,276,395	-0.5
1995-96	23,389,132	0.0
1994-95	23,398,303	-0.3
1993-94	23,473,690	1.7
1992-93	23,083,164	0.8
1991-92	22,893,363	1.6
1990-91	22,528,562	0.1
1989-90	22,504,662	3.5
1988-89	21,754,125	0.1
1987-88	21,726,615	5.9

MOTOR VEHICLE USAGE TAX

Fiscal Year	Receipts	Percent Change
1997-98	$325,308,554	6.7
1996-97	304,868,491	2.1
1995-96	298,585,859	5.2
1994-95	283,820,829	2.0
1993-94	278,157,347	19.1
1992-93	233,527,651	11.4
1991-92	209,619,192	2.2
1990-91	205,055,084[1]	5.8
1989-90	193,791,775	6.5
1988-89	182,035,253	0.6

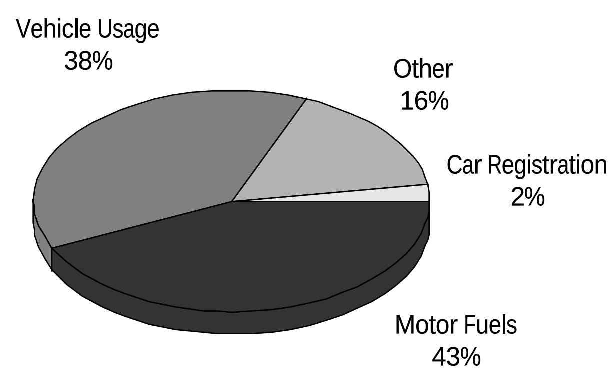
[1] *The tax rate was increased from 5 percent to 6 percent.*

MOTOR VEHICLE RENTAL USAGE TAX

Fiscal Year	Receipts	Percent Change
1997-98	$41,450,720	13.3
1996-97	36,593,748	25.9
1995-96	29,054,964	26.5
1994-95	22,966,441	34.7
1993-94	17,055,319	40.7
1992-93	12,124,476	33.2
1991-92	9,103,767	25.3
1990-91	7,264,932[1, 2]	11.5
1989-90	6,517,199	-9.8
1988-89	7,228,039[3]	-29.2

[1] *Percent change corrected.*
[2] *The tax rate was increased from 5 percent to 6 percent.*
[3] *The tax rate was reduced from 8 percent to 5 percent.*

Makeup of FY 1998 Road Fund



Major KRC Accomplishments in Fiscal Year 1997-98

Accomplishments during Fiscal Year 1997-98 reflect employees' commitment to KRC's goals. These accomplishments emphasize the Cabinet's mission—to provide courteous, accurate, and efficient services for the benefit of Kentucky and its citizens, and administer the tax laws of the commonwealth in a fair and impartial manner.

Specific accomplishments which underscore major progress toward KRC's goals are as follows:

Taxpayer Service

- ♦ Conducted or participated in various taxpayer education programs, seminars, and other tax-related meetings and events.
- ♦ Simplified, and in some cases eliminated, various tax forms, thus easing the filing and compliance burden on taxpayers. Approximately 80 forms were combined with other forms or declared obsolete, while approximately 35 forms were revised.
- ♦ Worked with a liaison group representing business, industry, and tax practitioners to identify issues that should be addressed by KRC or the General Assembly.
- ♦ Responded to numerous requests for Kentucky state tax and economic information from researchers, analysts, taxpayers, think tanks, and other state, local, and federal agencies.
- ♦ Offered extended hours during the period April 1–15, 1998, to better accommodate individual income taxpayers.
- ♦ Conducted and assisted in various taxpayer education programs and seminars, including the KET call-in show, the small business sales tax workshops, and motor vehicle usage law updates for automobile dealers.

- ♦ Worked closely with members of the General Assembly in the development of a major reform to the motor vehicle usage tax statutes. House Bill 74, enacted by the 1998 General Assembly, changed the method of vehicle valuation to total consideration given for a vehicle as attested by the buyer and seller.
- ♦ Worked with representatives from the insurance industry, Department of Insurance, Economic Development Cabinet, and the General Assembly to develop reform legislation for the insurance premiums tax. House Bill 648, as enacted by the 1998 General Assembly, equalized the tax treatment of domestic, foreign, and alien life insurers, and eliminated the tax on annuities.
- ♦ Developed and implemented an administrative procedure for the motor fuel industry to allow certain Tennessee fuel dealers to be licensed in Kentucky. Without the new procedure, fuel imported from Tennessee into Kentucky would have been taxed in both jurisdictions.
- ♦ Developed and implemented a new procedure for the inheritance and estate tax to no longer require prior written consent for a lien release from KRC for the transfer of specific property owned by a decedent at death; or the presence of a KRC representative at the opening of a decedent's safe deposit box.
- ♦ Processed 1,142,556 timely and correctly filed 1997 individual income tax returns requesting refunds by June 1, 1998.
- ♦ Developed a publication, *Understanding the Kentucky Revenue Cabinet Collection Process*, to assist taxpayers in understanding their rights and duties in satisfying their tax obligations to the commonwealth.
- ♦ Revised appropriate collection correspondence to reduce its complexity and make it more understandable to the average taxpayer.
- ♦ Participated in the legislative process during the 1998 General Assembly by proposing

statutory changes to improve and simplify tax administration, by responding to tax proposals made by members of the General Assembly and others, and by working with the legislative branch throughout the session to provide accurate and timely information, impact analysis, and recommendations.

- Issued 104,337 refund checks worth $146,140,560 as a result of the ***St. Ledger v. Revenue Cabinet*** court ruling.

Collection of Tax Revenues

- Generated $23.5 million in revenue for the General Fund through various *EMPOWER Kentucky* initiatives (see page 12 of this report for a detailed summary of individual *EMPOWER Kentucky* programs). In addition, $4.6 million in property tax revenue was generated for local governments through *EMPOWER Kentucky* initiatives.

- From the inception of *EMPOWER Kentucky* through June 30, 1998, collected $28.6 million in total General Fund revenue in *EMPOWER Kentucky* programs, plus $8.2 million in revenue for local governments. This $28.6 million total is nearly 80 percent of the original *EMPOWER Kentucky* funding of $36.1 million.

- Set an all-time record for revenue generated through KRC collection programs, by collecting $90.4 million. This is an increase of nearly 6 percent over last year's collections of $85.3 million. Much of the increase is attributable to *EMPOWER Kentucky* collection initiatives.

- Began working with the Kentucky State Police on *Operation Border Crossing* in conjunction with the *Freddie Freeroader* vehicle registration compliance program. Both programs are aimed at detecting Kentucky residents who attempt to evade motor vehicle taxes.

- Collected and distributed $45,392,415 in local property tax revenues.

- Registered 108 new taxpayers through the Voluntary Disclosure Program and generated nearly $3.6 million.

Business Practices

- Restructured warehouse operations in accordance with an *EMPOWER Kentucky* initiative sponsored by the Finance and Administration Cabinet. KRC eliminated all supply items from its inventory and fully implemented a *just-in-time* supply system under the commonwealth's Prime Vendor Contract. This resulted in a staff reduction of seven full-time employees with no corresponding decrease in the quality of service.

- Implemented use of the Procurement Card in support of the Finance and Administration Cabinet's *EMPOWER Kentucky* initiatives. Authorized employees in each division now order their own supplies directly from the prime vendor and pay for the order out of their account. This has streamlined the purchasing process, improved customer service, and simplified accounting procedures across state government.

- Participated in a pilot project with the Personnel Cabinet to implement a new personnel imaging system, allowing images of job applications and other personnel documents to be transmitted, viewed, and stored electronically.

- Reorganized KRC's organizational structure in accordance with Governor Paul Patton's executive order.

- Processed 3.8 million documents with $6.8 billion in receipts, and made timely deposits into all funds.

- Participated as a member in the National American Collectors Association to improve the skills and professionalism of KRC collection officers.

- Established an interagency agreement with the Kentucky Lottery Corporation whereby KRC collected outstanding liabilities owed by retailers to that quasi-governmental corporation.

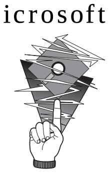
Technological Advances

- Implemented the first Kentucky state agency agreement with the U.S. Postal Service's Address Change Service. This allows KRC to receive electronic updates of new address information into the Compliance and Receivables System, eliminating the need for employees to manually update a tax notice with new address information.

- Actively pursued the impact assessment and required modifications for Year 2000 on KRC applications, and formulated a proactive schedule to replace or repair all hardware and software identified as noncompliant for Year 2000.

- Continued conversion of KRC workstations and servers to the Windows NT 4.0 operating system, which has been identified as the standard operating system. More than 50 percent of the KRC workforce now uses NT workstations and KRC's standard desktop.

- Installed and implemented the Microsoft Systems Management Server to provide some network management functions including hardware and software inventory, software distribution, and help desk functions.



- Upgraded the network infrastructure with switching technology at the Fair Oaks sites to unite the two buildings into a single campus, enabling KRC employees to use available resources within a more responsive local area network (LAN) environment.

- Obtained the hardware and software to provide network connections to four additional KRC taxpayer service centers (TSCs). Completed the first installation at the Northern Kentucky TSC by establishing a Windows NT LAN and a connection to the Kentucky Information Highway.

- Upgraded the telephone system at the Perimeter Park location to provide more efficient communication with taxpayers and increase KRC employees' productivity. The new system consolidated three phone systems into one, enhanced paging functions, and provided voice mail.

- Began performing sales and use tax and property tax audits using data in an electronic format.

- Processed 216,032 electronically filed individual income tax returns, representing a 35 percent increase over the previous year.

- Automated the processing of payments received on accounts receivable.

- Implemented a Mosaix Dialer System which electronically establishes a telephone collections campaign based upon a record selection and phone strategy entered into the system by a supervisor.

- Installed a telephone computer system which electronically matches collection cases maintained in KRC's accounts receivable system with incoming telephone calls so that the collection case history can be transferred to the responsible collector when the telephone call is transferred.

- Funded $228,562 worth of innovative technology projects in property valuation administrators' offices, including geographic information systems, electronic commerce, digital photography, office automation, and database enhancement.

EMPOWER Kentucky

KRC Makes Great Strides in Implementing *EMPOWER Kentucky* Initiatives

In the 18 months since KRC's *EMPOWER Kentucky* initiatives were approved, great strides have been made in implementing these projects. In many cases, programs are already underway and generating revenue. For those programs requiring a great deal of long-range planning, Fiscal Year 1997-98 was a period of significant activity in progressing toward establishing these new systems.

EMPOWER Kentucky is Governor Paul E. Patton's initiative to achieve operational efficiencies, cost reductions, and improved service delivery through new technology and training. The 1996 General Assembly set aside a pool of money to fund major modernization efforts. Agencies developed detailed business cases to present their initiatives to a selection panel and compete for funding. On Jan. 15, 1997, Governor Patton announced that KRC's proposals were approved for full funding.

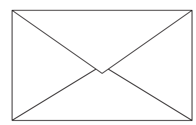
Five specific KRC projects were funded through *EMPOWER Kentucky*. Foremost is a complete modernization of KRC's tax administration systems. This modernization is referred to as an *Integrated Tax System* or *ITS*. Also included are the Tax Gap project, an improved Corporate Officer Assessment Program, an improved Vendor Offset Program, and an expanded Bank Levy Source Program. While the ITS is the major initiative, all five programs will result in processing efficiencies, improved service, and significant increases in tax collection.

Following is more detailed information on the progress of each of KRC's *EMPOWER Kentucky* initiatives during Fiscal Year 1997-98:

☞ **Integrated Tax System**—This project is comprised of three individual components or subprojects: mail processing equipment; *modernized front-end* (MFE); and the ITS. Each of these subprojects is an integral part of the overall ITS project but each is monitored separately under its own project life cycle. The ITS will improve taxpayer service and reduce the cost of taxpayer compliance. It will provide KRC employees efficient and effective access to a complete view of a tax entity's data, thereby improving overall communications with taxpayers as well as improving accounting and audit controls.

The ITS will consolidate major KRC business functions into one common database using a commonwealth-standard client server architecture. The ITS will provide improved and expanded functionality in areas of registration, accounting, taxpayer assistance, compliance, collection, and research. This improved functionality will provide a much more efficient and effective means of tax administration. An ITS *request for proposal* (RFP) was released Jan. 30, 1998. As of June 30, 1998, vendor responses were being evaluated and vendor presentations were being conducted in preparation for the scoring and selection phases of the evaluation process.

The mail processing equipment strengthens the capacity for sorting incoming mail via custom programming, improves the speed of mixed mail handling and extraction, and provides remittance detection for staging work more efficiently for remittance processing. The mail processing equipment *invitation for bid* (IFB) was released in January 1998 to potential vendors, to establish a state price contract for mail processing equipment. The proposals were evaluated and a vendor was selected in March 1998. A purchase order for the mail processing equipment was authorized on April 1, 1998. The equipment is scheduled to be delivered and functional by the end of calendar year 1998.



The MFE process includes wholesale hardware and software upgrades that support functions related to electronic data capture (i.e., scanning), workflow for automated data correction/verification (i.e., electronic worklists), electronic remittance processing, and image storage and retrieval. This process will provide a much more efficient and effective method of capturing and transmitting data to the appropriate host systems. More dependable and timely data updates will reduce the amount of nonvalue-added activities and improve overall staff efficiencies. Electronic images of paper documents will provide immediate desktop access to documents as needed to satisfy, verify, or validate information requests, which will improve overall taxpayer assistance. While the MFE began as a KRC initiative, it has since evolved into a commonwealth-wide initiative. As of June 30, 1998, a partnership was established with counterpart agencies, resulting in a cooperative agreement to jointly pursue an enterprise-wide MFE solution. KRC plans to partner with the Workforce Development Cabinet, and discussions are ongoing to include the Transportation, Natural Resources and Environmental Protection, and Health Services Cabinets in the partnership. An MFE RFP is targeted for release in August of 1998.

Tax Gap Project—The term *tax gap* refers to the difference between the amount of taxes due and the amount actually paid or collected. The program will identify sources of the gap and decrease its size.

The Tax Gap project consists of a new discovery and compliance section for business nonfilers and beneficiaries of income from pass-through entities. Other programs included in the Tax Gap initiative are the Simplified Tax and Wage Reporting System, also known as the W-2 Demonstration Project; improvements in the Federal-State Match Program, a program to close the tax gap from beneficiaries of partnerships and S-corporations (the Pass-Through Entity program), and a property tax program.

In Fiscal Year 1997-98, the W-2 Demonstration Project exceeded its revenue estimates by 42 percent. The project registered 1,003 nonfilers and collected $3.5 million.

The Tax Gap Discovery Section was created to administer the nonfiler discovery program. The program registered 371 businesses and collected more than $1.75 million.

The Federal-State Match Program generated $1.2 million, exceeding revenue projections of $750,000.

The Pass-Through Entity Program was implemented in February 1998. The automated procedure generated $534,702 in five months of operation.

The property tax program resulted in nearly $4.6 million in revenue for local governments and taxing districts, and nearly $5.3 million in state revenue.

Corporate Officer Assessment Program—KRC has the authority to assess corporate officers personally for past due tax obligations for withholding, sales and use, coal severance, health care provider, and controlled substance taxes. This initiative will enhance the system used to generate officer assessments.

The Corporate Officer Assessment Program was presented in three segments. The first segment dealt with modifying KRC's receivable system and collection system so that the current manual process could be altered so officer assessments could be created and monitored online. After the project was funded, the Department of Information Systems reviewed and revised its original estimates of cost and time needed to implement the project. The revisions caused the projected implementation date to be moved forward from June 1998 to June 1999. Because of the delay, the technology enhancements were incorporated into KRC's ITS. However, revenue projections will be met by using additional staff for the current manual process until the system is implemented. Although no revenue was projected for Fiscal Year 1997-98 for this portion of the initiative, the new positions have resulted in more than $500,000 in revenue.

The second segment involved capturing a backlog of cases within the collection system which had not been assessed, and hiring a seasonal task force to reduce the backlog. This process was scheduled to begin as of June 1, 1997, but actually began April 1, 1997. More than $2.9 million was generated in Fiscal Year 1997-98, exceeding revenue projections of $1.5 million.

The third part of the initiative involved hiring additional permanent staff to handle ever-increasing caseloads. Two new positions were added for Fiscal Year 1997-98, and the staff exceeded revenue projections of $1.1 million in revenue by collecting $1.3 million.

In total, the Officer Assessment initiative was projected to generate $2.6 million for Fiscal Year 1997-98. The initiative exceeded its revenue estimates by 80 percent by collecting more than $4.7 million.

☞ **Vendor Offset Program**—The purpose of the Vendor Offset Program is to apply funds owed by the commonwealth to vendors for services rendered to any outstanding overdue tax bills owed to the commonwealth.

The system went into production in October 1997. The program exceeded revenue estimates of $4.1 million by collecting $4.2 million in Fiscal Year 1997-98, despite a two-month delay in implementation due to the identification of additional system modification requirements.

☞ **Bank Levy Source**—This initiative seeks to enhance the bank levy process. It enables KRC to gather banking data electronically from information supplied by taxpayers. This information is used to identify assets when enforced collection actions become necessary.

The program nearly doubled its revenue estimates for Fiscal Year 1997-98. Revenues were projected to be $1.2 million, but more than $2.1 million was actually collected.

KRC is sharing information with other state agencies, including the Workforce Development Cabinet, which collected nearly $15,000 in levies as a result of information provided by KRC. KRC is also developing an interagency agreement with the Cabinet for Families and Children to share bank account information.

KRC also participated in *EMPOWER Kentucky* projects with other agencies. For example, KRC's Human Resources Branch participated in a pilot project with the Personnel Cabinet. KRC staff members are able to request merit registers online, review scanned electronic copies of applications, and print selected applications for further review. KRC's Support Services Branch also participated in several *EMPOWER* initiatives sponsored by the Finance and Administration Cabinet.

EMPOWER KENTUCKY

Standard Deduction Increased for 1997 Tax Year

Kentucky's standard deduction for individual income tax increased for the first time in approximately 30 years in the 1997 tax filing season. The standard deduction is claimed by persons who choose not to itemize deductions on their individual income tax return. A large percentage of low income taxpayers use the standard deduction.

The standard deduction was $650 since the 1960s. It increased to $900 for the 1997 filing year. For the 1998 tax year, the deduction increases to $1,200; for 1999 to $1,500; and for 2000 to $1,700. After 2000, the deduction will be indexed for inflation.

Also for the 1997 tax year, the pension exclusion for private pensions increased to 75 percent of private pension income, limited to $18,750. This is the third year of a four-year phase-in for this exclusion. Private pensions include any source of pension or retirement income other than Kentucky or federal public pensions, which are already exempt.

Office of Taxpayer Ombudsman

The Office of Taxpayer Ombudsman continues to be a highly visible and effective resource within KRC, as well as throughout other agencies of state government and most importantly, with taxpayers. The Office of Taxpayer Ombudsman serves as an advocate for taxpayers whenever a taxpayer or his representative requests assistance with the resolution of a complaint or problem. It is the mission of the Ombudsman's Office to ensure that tax matters are handled in a fair and equitable manner for both the taxpayer and the commonwealth.

Many different individuals contact the Office of Taxpayer Ombudsman. In addition to direct calls from taxpayers or their representatives, the office received frequent referrals on behalf of taxpayers from fellow KRC employees, local officials, and other state or federal agencies. In addition, the office serves as liaison to both the executive and legislative branches of government, and routinely works with the Office of Constituent Services both in the Governor's Office and the Legislative Research Commission.

Referrals to the Ombudsman's Office include requests for general information as well as specific information. Routine activity includes providing assistance for obtaining a payment plan to pay delinquent tax liabilities; processing of intangible personal property tax refund claims and protests of refund denials as a result of the ***St. Ledger*** court case; refund of monies offset in error to delinquent tax bills; release and removal of tax liens from taxpayer records when the lien was improperly filed; expedition of unresolved protests; assistance in getting a business back into operation after a collection action to close the business; and offers in settlement.

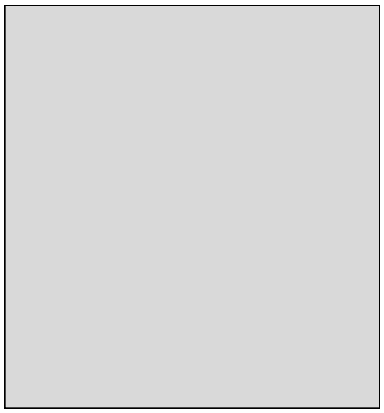
The Ombudsman staff was instrumental in developing guidelines to enable county clerks to resolve motor vehicle property tax disputes at the local level whenever possible. The Ombudsman's Office worked in partnership with county attorneys, county clerks, property valuation administrators, sheriffs, and KRC staff to settle real and tangible property tax controversies in a fair and equitable manner.

The Ombudsman staff led roundtable discussions on taxpayers' rights and the role of the Office of Taxpayer Ombudsman at the 1997 Department of Property Valuation Annual Conference; served on the individual income tax forms and legislative committees; participated in the KRC/large employer electronic filing project; and served as an EEO counselor for KRC.

To enhance the operation of the Office of Taxpayer Ombudsman, the Problem Resolution Tracking system was upgraded to enable staff to more effectively and efficiently track and monitor cases.

Bowling Green TSC Hit Hard by April Storm

A severe thunderstorm the afternoon of Thursday, April 16, dropped more than five and a half inches of rain on the Warren County area, flooding the Bowling Green Taxpayer Service Center (TSC). Large hail, high winds, and a possible tornado accompanied the storm which hit at 3:45 p.m. Central time.



One window was broken at the building, but the majority of the damage came from ankle-deep water which flooded the office and the accompanying mud.

When the water began rushing in, the employees in the office began moving items off the ground to protect them. All KRC property, including tax manuals and office supplies, was safeguarded.

“I appreciate the quick action of our employees to protect our property,” said Charles Owens, manager of the Bowling Green TSC.

KRC Secretary Sarah Jane Schaaf praised the employees for their quick action during the storm, and for their dedication to taxpayer service afterwards.

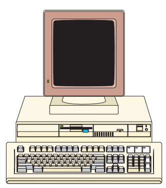
“Because of your combined efforts, the amount of damage was limited,” Schaaf wrote in a commendation memo for the Bowling Green employees. “Just as important, the taxpayers of your district continued to receive the same level of service they are accustomed to receiving, and at a critical time in tax preparation. Each of you rose to the occasion and we are truly appreciative. It is gratifying to know the Cabinet has employees willing to assume control and act responsibly in an emergency situation.”

Six Counties Receive Grants from Innovative Technology Fund

Six counties received grants from the Innovative Technology Fund Grant Program during Fiscal Year 1997-98. This fund was established in 1996 as a joint effort of the Property Valuation Administrators (PVA) Association and KRC's Department of Property Valuation. Under the program, PVAs are encouraged to submit proposals for technological innovations which improve efficiency and provide models from which other counties can learn. The program provides at least 80 percent of the funds needed, and the PVA office provides the remaining 20 percent.

The winning counties were:

Boyle County: PVA Eddie Tamme proposed to implement a complete office automation project. Prior to this project, the Boyle County PVA office had only one laptop computer. The fund provided $18,917 toward the purchase of computer hardware, including a file server with six workstations, to provide the means for assessment administration, computer-assisted mass appraisal, and digital photography.



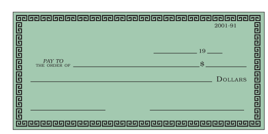
Clark County: PVA Karen Bushart proposed to establish *geographic information systems* (GIS) capability in Clark County. The fund provided $36,800 for the purchase of computer hardware and software, *global positioning system* (GPS) equipment, and map conversion. The Clark County PVA office formed a consortium with several other local agencies to implement the GIS project, with Bushart serving as consortium chair.

Jefferson County: PVA Denise Harper-Angel proposed to acquire digital photography equipment and establish a wide area network connection. The fund provided $11,370 for the purchase of digital cameras and connectivity software. Jefferson County is now the first PVA office on the Kentucky Information Highway. Already a pioneer with its mobile video laser disc system, Jefferson County will acquire digital photography technology for more rapid and inexpensive maintenance of real property improvement images.

Lee County: PVA Gary Lutes proposed to establish a GIS-based mapping system. A technology fund grant of $32,049 was awarded for the purchase of hardware, software, and training. The Lee County PVA office will provide the parcel conversion labor. GPS technology will be used to ensure positional accuracy of parcel boundaries and improvements.

Montgomery County: PVA Jeff Garrison proposed to connect his office to the Kentucky Information Highway as part of the *EMPOWER Kentucky* Model Courthouse Project. The amount of the grant was $47,500.

Warren County: PVA Bill Carter proposed to convert his office from a minicomputer to a microcomputer environment. The fund provided $31,926 toward the purchase of hardware, software, and support. In addition to converting the existing assessment administration system, this project will include the collection of digital photography and the scanning of the current property record cards, as well as an AutoCad mapping system.

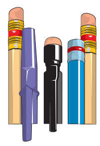


Checks were presented in April at a series of regional PVA meetings held across the state. During those meetings, KRC representatives discussed legislation passed earlier this year by the Kentucky General Assembly, and its effect upon property taxation matters and PVAs.

Taxpayer Service

Administrative Change Made for Inheritance Taxes

In June, KRC announced that it will no longer require prior written consent for a lien release from KRC for transfer of specific property owned by a resident or nonresident decedent at death. In addition, a KRC representative will no longer be required to be present at the opening of a decedent's safe deposit box. These *taxpayer-friendly* changes were scheduled to take effect on July 1, 1998.



These actions, pursuant to the authority granted to KRC in Chapter 140 of the Kentucky Revised Statutes, were taken to make it easier to administer estates and comply with inheritance tax laws. This is a logical result of the phase-out of inheritance tax on Class A beneficiaries which was scheduled to occur on July 1, 1998.

Calling it a step in the right direction for *EMPOWER Kentucky* initiatives, Governor Paul Patton praised KRC for lessening the burden on Kentucky inheritance taxpayers. "The goal of *EMPOWER Kentucky* is to make government operate more efficiently and effectively. Making the inheritance tax procedures more user friendly is a win-win situation—less red-tape and bureaucracy for state government and all Kentuckians."

According to KRC Secretary Sarah Jane Schaaf, "This change is just another way for the Revenue Cabinet to improve our service and lessen the burden of tax filing procedures for Kentucky taxpayers."

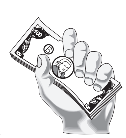
KRC Nears Completion of Intangible Refund Project

With the impending completion of the task of processing and mailing intangible personal property tax refunds, KRC nears the end of an odyssey which began in July 1990 with the filing of a lawsuit in Jefferson Circuit Court.

St. Ledger v. Revenue Cabinet eventually reached the United States Supreme Court, and an ultimate decision was not made until Sept. 10, 1997, when a settlement regarding interest payments and attorneys' fees was reached.

Although the settlement cleared the way for the issuance of refunds, there was no delay between the conclusion of the case and the calculation and issuance of the refunds. Acting proactively in anticipation of the U.S. Supreme Court's May 20, 1996, ruling, KRC began preparing for refunding intangible property taxes to applicants who had submitted claims.

By late May 1996, seasonal employees were hired and claims processing was in progress. Development of a case management system to process the refunds was also underway. Entry of data into the case management system began on Sept. 19, 1996. The first 20,000 refund checks were mailed on Sept. 20, 1997, just 10 days after the settlement agreement ended litigation in the case.



To accomplish this achievement, KRC employees worked diligently to process refund claims and authorize refund checks. For several months, employees worked 12 hours per day, six days per week. As a result, more than 104,000 checks totaling $146,140,560 had been mailed as of June 30, 1998.

KRC anticipates that the Intangible Refund Project team will continue working until the end of 1998, preparing the few remaining refund checks and working on a *cleanup* phase of the project. This includes reviewing claims for refunds made on omitted audits, processing responses on requests for itemizations needed to determine eligibility for refunds, handling clerical errors and protests on refund amounts and denials of refunds for various reasons, reviewing new claims for the 1996 tax year, and cleaning up the refund database.

"This case has been in the court system for seven years and we are delighted it is finally over. It is my intent to see that the Revenue Cabinet issues these refunds as expeditiously as possible," Governor Paul E. Patton stated when the settlement agreement was announced in September 1997. The fact that Governor Patton's directive was successfully met so quickly is a product of the hard work and dedication of the staff for the past two years.

Court Decisions and Developments

The Division of Legal Services handles a substantial number of cases presenting a variety of issues arising under and concerning Kentucky's tax laws. During the 1997-98 fiscal year, the division was involved in more than 220 cases. The division continues to experience an increase in both the complexity of the issues and amounts of money at stake in these cases. The division's responsibilities have been expanded in recent years to include litigation and other legal services relating to the ad valorem taxation of intangible and tangible property and unmined minerals.

The division represents KRC in all cases and appeals other than bankruptcy and collection cases before the Kentucky Board of Tax Appeals (KBTA), the Kentucky Personnel Board, and other administrative tribunals of the state, and before the state and federal courts. This representation includes handling all phases and levels of litigation, including trials, hearings, and appeals.

In addition to its litigation responsibilities, the Division of Legal Services performs a number of other duties and functions. These duties and functions include providing legal advice, rendering written legal opinions, participating in protest conferences, and the review and drafting of proposed legislation and regulations and documents implementing or explaining KRC policy and the tax laws of the state.

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

St. Ledger v. Revenue Cabinet, **Ky., 912 S.W.2d 34 (1995),** ***cert. granted, judgment vacated and case remanded,*** **____ U.S. ____, 116 S.Ct. 1821, 134 L.Ed.2d 927, (1996),** ***on remand,*** **Ky., 942 S.W.2d 893 (1997),** ***cert. dism'd,*** **____ U.S. ____, 118 S.Ct. 27, 138 L.Ed.2d 1057, 66 U.S.L.W. 3108, 66 U.S.L.W. 3203 (Sept. 22, 1997)**

This case presented constitutional challenges to KRS 132.020 and 132.030, which applied a one-tenth of 1 cent per $100 property tax rate to bank deposits "in any bank, trust company, or combined bank and trust company organized under the laws of this state, or in any national bank of this state" and a 25 cent per $100 property tax rate to all other bank deposits; and KRS 136.030, which exempted from property tax shares of stock in corporations that paid property taxes to Kentucky on at least 75 percent of their total property, wherever located. The taxpayers in this class action invoked various state and federal constitutional provisions in support of their claims, including the U.S. Constitution's commerce and equal protection clauses and §§ 3 and 171 of the Kentucky Constitution.

The Kentucky Supreme Court held that the bank deposits property tax system created by KRS 132.020 and 132.030 was unconstitutional under the commerce clause. The court rejected the contentions that this system was invalid under the equal protection clause or §§ 3 and 171 of the Kentucky Constitution. Disagreeing with the Court of Appeals, which had upheld these statutes, the court held that out-of-state bank deposits were interstate commerce and protected by the commerce clause. The court further held that KRS 132.020 and 132.030 foreclosed tax-neutral decisions and created both an advantage for Kentucky banks and a discriminatory burden on commerce (i.e., banks) of Kentucky's sister states. The court further held that the taxpayers were "entitled to apply for refunds pursuant to KRS 134.590."

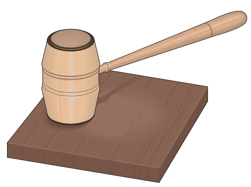
The Kentucky Supreme Court upheld KRS 136.030, however. The court specifically relied upon the U.S. Supreme Court's decision in ***Darnell v. Indiana***, 226 U.S. 390, 33 S.Ct. 120, 57 L.Ed. 267 (1912).

The taxpayers petitioned the U.S. Supreme Court for review of the Kentucky Supreme Court's decision on KRS 136.030. The U.S. Supreme Court on May 20, 1996, granted certiorari, vacated the Kentucky Supreme Court's judgment, and remanded the case to the Kentucky Supreme Court for reconsideration of its decision in light of ***Fulton Corp. v. Faulkner***, 516 U.S. ___, 116 S.Ct. 858, ___L.Ed.2d____, 64 U.S.L.W. 4088 (1996).

The Kentucky Supreme Court issued a decision on remand from the U.S. Supreme Court on January

30, 1997. KRC had conceded the unconstitutionality of KRS 136.030 due to the recent change in the law as set forth in ***Fulton Corp. v. Faulkner, supra***, and had conceded that refunds were due for back years. KRC had argued, however, that in light of the requirement of the Kentucky Constitution that all property must be subjected to property tax unless exempted by the constitution, the proper remedy for future years for the invalidity of KRS 136.030 would be that only that statute would be nullified, leaving all corporate shares to be taxed under the relevant provision of KRS 132.020. The Kentucky Supreme Court instead ruled that KRS 136.030 and the portion of KRS 132.020 taxing corporate shares of stock could not be severed from each other, the result being that both statutory provisions were stricken as unconstitutional, thereby effectively leaving Kentucky without an intangible property tax on corporate stock.

Agreeing with KRC, the court further held that under KRS 134.590, applications for refunds of intangible property taxes paid on corporate shares and bank deposits had to be filed with KRC within two years of payment. In addition, the court rejected the taxpayers' contention that they should be awarded their attorney fees and costs under KRS 453.260 or 42 U.S.C. § 1988.



Advocating a common fund theory, the taxpayers subsequently filed various motions with the Jefferson Circuit Court seeking an award of attorney fees to be taken out of the tax refunds issued pursuant to the Kentucky Supreme Court's decisions and to direct KRC to withhold a percentage of these tax refunds to satisfy this award. A temporary injunction was sought and obtained by the taxpayers that prevented KRC from issuing refunds pending resolution of the attorney fee issue. This temporary injunction was upheld by the Kentucky Court of Appeals, ***Revenue Cabinet v. St. Ledger***, Ky. App., 955 S.W.2d 539 (1997) and review of this decision was sought by KRC from the Kentucky Supreme Court.

The taxpayers also again petitioned the United States Supreme Court for review of the Kentucky Supreme Court's January 30, 1997, opinion. The particular issue for which review was sought was whether the Kentucky Supreme Court's decision that refund applications had to be filed within two years of payment violated the U.S. Constitution.

This litigation finally ended with the entry of an agreed judgment of satisfaction and resolution on September 10, 1997, by the Jefferson Circuit Court. This agreed judgment terminated all pending litigation in the case, including the proceedings in the U.S. Supreme Court and the Kentucky Supreme Court.

Under this agreed judgment, KRC began making refunds of the corporate shares tax and the bank deposits tax to those taxpayers making timely refund requests pursuant to KRS 134.590 (i.e., within two years of the date of payment). The agreed judgment also provided that KRC withhold from each refund an amount equal to 6 percent of the tax to be refunded, exclusive of interest, to be paid to the taxpayers' counsel as an award of attorney fees.

Since the entry of the agreed judgment, the Division of Legal Services has continued to handle a substantial number of issues and matters, including further litigation before the KBTA, relating to the issuance of the refunds and the impact of the court decisions rendered in this case.

***Revenue Cabinet v. Gillig*, Ky.,**
957 S.W.2d 206 (1997)

In this case, the taxpayers filed an action in the Franklin Circuit Court questioning the constitutionality of the method of assessing unmined coal for property taxation purposes employed by KRC for 1989, 1990, and 1991. This method was an interim one, to be used pending the implementation of a Geographic Information System based approach. The interim method utilized information self-reported by owners of unmined coal, coal operators, lessees, and permit holders on informational returns sent to them by the Department of Property Taxation.

Invoking Kentucky Constitution § 172 and relying on ***Dolan v. Land***, Ky., 667 S.W.2d 684 (1984), the taxpayers contended that the interim approach unconstitutionally failed to take into account a number of factors relevant to the assessment of the unmined coal. The Kentucky Court of Appeals agreed, rejecting KRC's arguments that the taxpayers had failed to demonstrate that their unmined coal properties were in fact overvalued; that the interim method provided a fair estimate of fair cash value; and that the taxpayers could establish the effect of any particular factor upon their properties' assessments or valuations by way of the protest and appeal procedure prescribed in KRS Chapter 131.

The Kentucky Supreme Court on Sep. 4, 1997, reversed the Court of Appeals. The court specifically held as follows:

> The level of accuracy which may be achieved by a private appraiser in a fee-type appraisal or a 'single property appraisal' of a parcel of real property simply cannot be attained by the tax assessor nor has it ever been required in the valuation of any property in Kentucky for taxation purposes. Accordingly, for taxation purposes, a tax assessor is allowed to use mass appraisal techniques.

The court further held that estimated property tax assessments are presumed valid, with the burden of proof resting upon each taxpayer to establish that an assessment is incorrect. Finally, the Supreme Court declared that taxpayers who believe that their assessments are in excess of fair cash value should protest those assessments in accordance with KRS 131.110 and appeal any adverse determination to the KBTA rather than bypassing the KBTA and filing a case directly in the circuit court as the taxpayers in this case did.

The taxpayers' petition for rehearing of the Supreme Court's decision was denied on Jan. 22, 1998.

Children's Psychiatric Hospital of Northern Kentucky, Inc. et al, Revenue Cabinet, et al, 96-SC-1123-T and _Yeoman, et al, v. Kentucky Health Policy Board, et al,_ 97-SC-0274-T, Kentucky Supreme Court

In these cases, the plaintiffs challenge the constitutionality of the health care provider tax enacted by the Kentucky General Assembly in 1993 (House Bill 1) and in 1994 (House Bill 250). The 1993 health care provider tax was previously sustained against constitutional attack by the Kentucky Supreme Court in ***Revenue Cabinet v. Smith***, Ky., 875 S.W.2d 873 (1994), *cert. denied sub nom.*, ***Yeoman v. Revenue Cabinet***, ___U.S.___, 115, S.Ct. 509, 130 L.Ed.2d 417 (1994).

The ***Yeoman*** plaintiffs, who previously challenged the 1993 tax, question the validity of the 1994 tax in this case. The ***Children's Psychiatric Hospital*** plaintiffs are 44 nonprofit hospitals who attack both the 1993 and 1994 tax on constitutional grounds similar to those relied upon by the ***Yeoman*** plaintiffs. The ***Children's Psychiatric Hospital*** plaintiffs also assert that they are exempt from the health care provider tax under the purely public charity exemption of Section 170 of the Kentucky Constitution.

Deciding in favor of KRC and the other defendants, the Franklin Circuit Court ruled that Section 170 afforded an exemption from property or ad valorem taxation only and did not apply to an excise tax such as the health care provider tax. The circuit court decision also rejected the other constitutional challenges to the 1993 and 1994 health care provider tax asserted by the plaintiffs based upon Sections 1, 2, 3, 51, and 59 of the Kentucky Constitution and the due process and equal protection clauses of the 14th Amendment to the U. S. Constitution. The court further held that the ***Yeoman*** plaintiffs were barred by the doctrine of *res judicata* from pressing constitutional claims that had been asserted and adjudicated in their previous challenge to the 1993 tax.

The plaintiffs have appealed the circuit court's decision. Their appeals have been transferred to the Kentucky Supreme Court. Briefing there has been completed and oral argument was held on November 13, 1997. KRC is now awaiting the court's decision.

Louisville Edible Oil Products, Inc. v. Revenue Cabinet, Ky. App., 957 S.W.2d 272 (1997)

In this case, the Kentucky Court of Appeals upheld KRC's sales tax assessment against Louisville Edible Oil Products (LEOP), a vegetable oil processor. KRC had assessed additional sales tax because LEOP had excluded its raw material costs—its cost of crude vegetable oil—from the cost of production calculation required under the sales and use tax energy exemption provided for in KRS 139.480(3).

The Court of Appeals held that the relevant administrative regulation, 103 KAR 30:140, held that "all costs, including raw material costs, must be included when computing the *cost of production*." The court further held that "*total cost* as used in the regulation does not mean some costs: it means all costs incurred to produce or to process a product—here, the edible oil."

The Court of Appeals rejected LEOP's arguments that the *plant facilities* language in KRS 139.480(3) and the Kentucky Supreme Court's ***James B. Beam*** decision limited the meaning of the term *cost of production*. The Court of Appeals similarly dismissed LEOP's claim of unconstitutional discrimination, holding that LEOP was "not similarly situated with an operator that processes materials owned by others or with a producer that processes its own materials."

Revenue Cabinet v. Wyatt, Ky. App., 963 S.W.2d 635 (1998)

In this case, the taxpayers sought refunds of individual income tax on the basis of the enterprise zone income tax exemption for gain from the sale of *qualified property*. The definition of *qualified property* included "[a]ny interest in a corporation."

One of the taxpayers was the sole shareholder of a corporation. This corporation sold its assets to another corporation. In that transaction, $1.5 million was for goodwill and $2 million was paid for the taxpayer's covenant not to compete.

KRC asserted that goodwill was an asset ***of*** a corporation but was not an interest ***in*** the corporation, such as a share of stock, that was qualified property under the exemption invoked. The covenant not to compete was also not an interest in the corporation, as it was an obligation of the individual taxpayer.

On Feb. 27, 1998, the Kentucky Court of Appeals rendered a decision upholding KRC on the covenant not to compete issue but not on the goodwill issue. The court further held that the McCracken Circuit Court, which ruled in the taxpayer's favor on all issues, had erroneously awarded the taxpayer's attorney fees pursuant to KRS 453.260. Noting that the issues presented were "of first impression in Kentucky" and that exemptions from taxation are to be strictly construed, the court held that KRC's position was reasonable and substantially justified.

Dean v. Commonwealth, Ky. App., 967 S.W.2d 594 (1998)

In this case, the taxpayers did not appeal their real property tax assessments to the local board of assessment appeals, but instead proceeded directly to circuit court with an action seeking declaratory and injunctive relief. The taxpayers asserted that KRS 132.010, 132.220, 132.450, and 132.690 were facially void, arbitrary, and unreasonable; took property without due process of law; and violated the separation of powers provision of the Kentucky Constitution. Their central contention was that the statutes contain no guidelines or *measuring stick* to determine the fair cash value of their property for property tax purposes.

The Mercer Circuit Court rejected the taxpayers' claims and granted summary judgment in favor of KRC, the Mercer County Property Valuation Administrator (PVA), and the Mercer County Board of Assessment Appeals. The taxpayers appealed the circuit court's decision to the Kentucky Court of Appeals.

The Court of Appeals affirmed the circuit court. The court reaffirmed prior court decisions holding that a PVA is not restricted to a particular method in making an assessment so long as the method is fair and equitable. The statutory provisions assailed by the taxpayers were constitutional, the court further ruled. If the taxpayers believed that their assessments were too high, the Court of Appeals held, then the taxpayers should have pursued the remedies provided by law—i.e., an appeal to the board of assessment appeals and beyond.

Cooksey Brothers Disposal Company, Inc. v. Boyd County, Kentucky, 97-CA-0400-MR, Kentucky Court of Appeals

This was a case in which the Division of Legal Services assisted the Boyd County Attorney in an action to collect unpaid public service corporation property taxes. The taxpayer contended that it could not be constitutionally taxed as a public service corporation. Specifically, it argued that the classification of municipal solid waste disposal facilities such as itself as a public service corporation under KRS 136.120(1) was an invalid classification under Kentucky Constitution §§ 1, 2, 3, and 171 and the U. S. Constitution's 14th Amendment. The taxpayer further argued that the statutory provision (i.e., KRS 136.120(1)) classifying it as a public service corporation violated the title requirement of Kentucky Constitution § 51 and that the imposition of both public service corporation property tax and the license fee imposed by KRS 61.878 constituted unlawful double taxation.

The Court of Appeals rejected the taxpayer's arguments in their entirety. The classification assailed by the taxpayers had a rational basis. The title requirement of Kentucky Constitution § 51 applied to legislative acts, not enacted statutes. Imposition of both a property tax and a license tax or fee did not constitute double taxation.

The Kentucky Supreme Court has denied the taxpayer's motion for discretionary review of the Court of Appeals' decision. The taxpayer has a petition for certiorari pending before the U.S. Supreme Court.

Hammond v. Revenue Cabinet,
96-CA-0649, Kentucky Court of Appeals

At issue in this case is whether KRC had sufficiently established grounds for dismissal of an employee. KRC had sought to prove the employee's excessive absenteeism, tardiness, and poor job performance through the employee's personnel records. As the legal basis for the admission into evidence of these records, KRC relied upon the business records exception to the hearsay rule.

The Personnel Board declined to find this evidence probative and ordered the employee reinstated. The Franklin Circuit Court reversed.

In its Oct. 10, 1997, opinion, the Kentucky Court of Appeals affirmed the circuit court and upheld the employee's dismissal. The court ruled that KRC's personnel records had sufficient probative value that the Personnel Board had no choice but to uphold KRC's dismissal of the employee.

The employee has a motion for discretionary review of the Court of Appeals' decision pending with the Kentucky Supreme Court.

Revenue Cabinet v. Humana, Inc.
Kentucky Court of Appeals

In this case, the taxpayers, for-profit hospitals, challenge the application of the sales and use tax exemptions provided for in KRS 139.472 for prescription medicine and prosthetic devices and physical aids. KRC determined that these exemptions did not apply to the purchases at issue in this case because the requirements prescribed in KRS 139.472(1)(a) and (2) were not met.

The KBTA granted the taxpayers' motion for summary judgment holding that the doctrine of contemporaneous construction precluded KRC from rectifying its previous interpretation of KRS 139.472, and because KRC's rescission of its previous policy violated KRS 13A.130.

The Franklin Circuit Court affirmed the KBTA's action. KRC appealed the circuit court's decision to the Kentucky Court of Appeals, where briefing has been completed and oral argument held on May 6, 1998.

Revenue Cabinet v. Gruner & Jahr Group, Inc. d/b/a/ Brown Printing Company
97-CI-00294, Franklin Circuit Court

In this case, the Franklin Circuit Court upheld a sales tax assessment of $5,242,480 for transactions in which tangible personal property sold by a Kentucky retailer to an out-of-state business was delivered in this state to a common carrier hired by the out-of-state customer. The court ruled that these sales were consummated in this state under KRS 139.200 and Regulation 103 KAR 30:190 § 2, as the common carriers received physical possession of the property in Kentucky as the purchasers' representatives.

USX v. Revenue Cabinet
Franklin Circuit Court

USX Corporation has filed an action in Franklin Circuit Court seeking a judicial determination that the corporation license tax statute KRS 136.071 is unconstitutional as a violation of the U.S. Constitution's commerce, due process, and equal protection clauses and also a violation of various provisions of the Kentucky Constitution. USX seeks an order enjoining KRC from implementing KRS 136.071's provisions allowing corporations with commercial domiciles inside Kentucky (but not those with commercial domiciles outside Kentucky) to exclude, under certain circumstances, their investments in other corporations from the computation of their taxable capital. This case is currently in the pretrial stage.

A Review of Tax Law Changes Enacted by the 1998 General Assembly

The 1998 Kentucky General Assembly created, amended, or repealed numerous statutes during the recently completed regular session. A total of 1,733 bills and resolutions was introduced. Of this total, 616 became law for an enactment rate of just above 40 percent.

The tax portion of each bill is described in this review. In addition, other bills and resolutions which have some impact on KRC are included. Effective dates are shown when specifically stated in the legislation. Otherwise, the changes are effective July 15, 1998.

In the following review, the enacted bills are grouped by tax type, with the bill number in parentheses. Where practical, bills referencing multiple taxes are listed under each of the referenced taxes with a description of the change affecting the tax type under which it is listed. Following the changes relating to specific taxes are bills which are general in nature, bills which are applicable to all taxes administered by KRC, and studies in which KRC will likely participate.

INCOME TAXES

Internal Revenue Code (IRC) Update—(Effective for tax years beginning after Dec. 31, 1996.) House Bill 170 amends KRS 141.010(3) to update the Kentucky income tax reference to the IRC. The IRC reference date was changed to Dec. 31, 1997, for tax years beginning on or after Jan. 1, 1997. This slightly unusual date makes Kentucky's tax laws correspond with federal tax laws for tax year 1997. Included in the update are the provisions within the Small Business Job Protection Act of 1996, the Health Insurance Portability and Accountability Act of 1996, and the Taxpayer Relief Act of 1997. *(HB 170)*

The following list contains the major changes to the IRC which are adopted for Kentucky income tax purposes:

- Married individuals may exclude up to $500,000 (Single–$250,000) of gain on the sale of a personal residence.

- A graduated increase in the Section 179 deduction for the expense of noncapitalized property acquired in 1997 through 2003 will be allowed. The increases are as follows:

1997	$18,000
1998	$18,500
1999	$19,000
2000	$20,000
2001 or 2002	$24,000
2003 or thereafter	$25,000

- More corporations will qualify to elect Subchapter S treatment.

- The 1996 Act created the Savings Incentive Match Plans for Employees (SIMPLE). SIMPLE is a retirement plan for small businesses where the employer is required to make payments and the employee may match. Employer contributions are deductible as a business expense.

- A graduated increase in the amount of deduction for the health insurance of self-employed individuals is allowed. The increases are as follows:

1997	40 percent
1998 and 1999	45 percent
2000 and 2001	50 percent
2002	60 percent
2003 through 2005	80 percent
2006	90 percent
2007 or thereafter	100 percent

- Qualified distributions from a Roth IRA are exempt from Kentucky tax and taxable distributions are eligible for the pension exclusion under KRS 141.010(10)(i). Income as a result of transferring a deductible IRA to a Roth IRA in 1998 is reported ratably over four years. This income is eligible for the pension exclusion under KRS 141.010(10)(i) in each of the four years.

- A deduction for amounts paid for long-term care insurance is allowed even if the individual is eligible for employer-subsidized health insurance.

- The computation of the net operating loss (NOL) carryback and carryforward periods is modified. An NOL will be carried back two years and then forward 20 years.

- Up to $1,000 of interest paid after Dec. 31, 1997, on qualified education loans is deductible.

- Multiple changes to IRAs including the Roth IRA, the Spousal IRA, the Educational IRA, and increased income limits for the phaseout of deductions are adopted.

Kentucky Educational Savings Plan Trust—Various sections within KRS 164A are amended to comply with Public Law 104-188 to allow the deferral of federal tax on earnings for participants. Earnings on contributions were already exempt for Kentucky income tax purposes; therefore, the amendment eliminates a federal-state difference in adjusted gross income. *(SB 5)*

Income Received by Precinct Workers—(Effective for tax years beginning after Dec. 31, 1997.) KRS 141.010(10) is amended to exempt income received for election training or work at election booths from Kentucky individual income tax. Various KRS Chapters are amended to exempt this income from local license fees and occupational taxes. *(HB 65)*

Income from Tobacco Settlement—KRS 141.010(10) is amended to exclude from individual income tax any amount received by a producer of tobacco or a tobacco quota owner from a national settlement agreement between the tobacco industry and the states' attorneys general or from any federal legislation related to the agreement. (*SB 247*)

Health Insurance Premiums—(Effective for tax years beginning after Dec. 31, 1998.) KRS 141.010(10) is amended to exclude 70 percent of the cost of health insurance for the taxpayer, the taxpayer's spouse, and their dependents. The deduction increases to 100 percent for tax years ending after June 30, 2000. This equalizes the tax treatment of employer-provided insurance (exempt from gross income), self-employed health insurance (for 1997—40 percent deductible from adjusted gross income), and privately purchased health insurance (deductible as an itemized deduction). *(HB 321 and HB 315)* ***Caution:*** *Amounts must be adjusted for self-employed insurance already excluded and may not be used as itemized deductions.*

Capital Gains Income—(Effective for tax years beginning after Dec. 31, 1997.) KRS 141.010(10) is amended to exclude for individual income tax purposes capital gains on property taken by eminent domain. *(SB 19)*

Long-term Care Insurance—(Effective for tax years beginning after Dec. 31, 1997.) KRS 141.010(10) is amended to exclude any amounts paid for long-term care insurance. The act provides an exclusion from gross income for amounts paid for long-term care insurance not previously excluded. The IRC allows limited long-term care premiums as a medical deduction and also allows, in 1998, self-employed individuals to deduct 45 percent of long-term care premiums. *(SB 19)*

Financial Institutions Electing Subchapter S Treatment—(Effective for tax years beginning after Dec. 31, 1996.) KRS 141.010(10) is amended to exclude from adjusted gross income the distributive share of an individual shareholder's net income from an S corporation subject to either the bank franchise tax imposed under KRS 136.505 or the capital stock tax imposed under KRS 136.300. The shareholder's basis of stock held in the S corporation subject to the bank franchise tax or the capital stock tax is the same as the basis for federal income tax purposes. *(HB 419)*

Kentucky Investment Fund Tax Credit—New sections of KRS 154.20 were created to establish the Kentucky Investment Fund Program and authorize the Kentucky Economic Development Finance Authority (KEDFA) to certify investment funds and investment fund managers on or after July 1, 1999. An investor who makes a cash contribution to an investment fund certified by KEDFA is allowed a nonrefundable credit against the Kentucky individual income tax, Kentucky corporation income tax, or Kentucky corporation license tax equal to 40 percent of the cash contribution. The credit may be claimed in any tax year after Dec. 31, 1998, during which the investment is made. The amount of credit that an investor may claim in any tax year is limited to 25 percent of the total amount of credit certified by the authority as available to the investor. The total amount of tax credits certified by KEDFA for all investors in all investment funds may not exceed $20,000,000. A new section of KRS Chapter 141 was created to establish procedures for determining the amount of credit an investor is entitled to take each year. KRS 154.20-300 through 154.20-390 regarding the Commonwealth Venture Fund was repealed, and KRS 141.0205 was amended to replace reference to the Commonwealth Venture Fund with reference to the Kentucky Investment Fund. (*HB 206)*

Skills Training Investment Tax Credit—New sections of KRS Chapter 154 were created to provide that the Bluegrass State Skills Corporation may approve a company's occupational or skills upgrade training program and may award a nonrefundable credit against the Kentucky individual or corporation income tax. The credit is equal to 50 percent of the approved cost incurred by the approved company in connection with its occupational or skills upgrade training program. The credit may not exceed $500 per employee and $100,000 per approved company for each biennium. If the amount of the approved credit exceeds the income tax liability of the approved company in the year approved, any excess may be carried forward for three successive taxable years. A new section of KRS Chapter 141 is created to establish procedures for determining the amount of credit an approved company is entitled to take each year, and KRS 141.0205 is amended to include the credit in the order of allowable credits. (*HB 280)*

Kentucky Rural Economic Development Act (KREDA)—KRS 154.22-040(1) is amended to include counties that have had an average rate of unemployment exceeding the statewide unemployment rate by 200 percent in the most recent 12 consecutive months as qualified counties under the KREDA economic incentive program. KRS 154.22-040(3) is also amended to reduce the minimum investment of a KREDA project to $100,000 from the current amount of $500,000. *(SB 224)*

Limited Liability Companies (LLC)—Various sections of KRS Chapter 275 are amended to make technical changes with the most significant being to provide that an LLC may be organized by a single member. Various other chapters of Kentucky Revised Statutes governing business entities in Kentucky are amended for technical changes. Also, KRS 141.208 is amended to provide that an LLC is to be treated in the same manner for Kentucky income tax purposes as it is treated for federal income tax purposes. *(HB 666)*

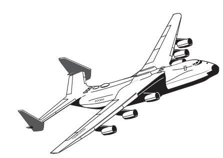
Real Estate Investment Trust (REIT)—KRS 141.010(14) is amended to define "taxable net income" of a corporation that is treated as a REIT under IRC Section 856 to mean "real estate investment trust taxable net income" as defined in IRC Section 857(b)(2). Thus, a REIT is now allowed the dividend paid deduction for Kentucky income tax purposes effective for tax years ending after July 15, 1998. *(HB 696)*

Refunds Resulting from Unitary Business Returns—The Executive Branch Budget Bill for the 1998-2000 biennium provides that notwithstanding KRS 134.580, no taxpayer shall be refunded or credited any overpayment of tax collected under KRS Chapter 141 if the overpayment is attributable to the filing of a consolidated, combined, or unitary business return for any taxable year ending before Dec. 31, 1995, and the refund claim or any amended refund claim is filed after Dec. 22, 1994. *(HB 321)*

PROPERTY TAXES

All property tax legislation will become effective Jan. 1, 1999, unless otherwise noted.

Airplanes—KRS 132.020 is amended to provide that aircraft, not used in the business of transporting persons or property for compensation or hire, be taxed at a state rate of 1.5 cents per $100 of value. KRS 132.200 is amended to allow counties, cities, schools, or other taxing districts to exempt this property from local taxation. (*HB 141*)



Documented Boats—KRS 132.020 is amended to provide that federally documented vessels that are not used in the business of transporting persons or property for compensation or hire, be taxed at a state rate of 1.5 cents per $100 of value. KRS 132.200 is amended to allow counties, cities, schools, or other taxing districts to exempt this property from taxation. (*HB 588*)

Floor Plan Equipment Inventory—KRS 132.020 is amended to provide that the 5 cent rate for goods held for sale in the regular course of business includes machinery and equipment held in inventory for sale or lease, if originating under a floor plan financing arrangement. (*HB 198*)

Manufacturing Machinery—KRS 131.020 is amended to delete the reference to "individuals and corporations," which extends the reduced rate of 15 cents per $100 of value to all manufacturing machinery, regardless of ownership. KRS 132.200 is amended to provide that manufacturing machinery and new boats and marine equipment held for sale under a floor plan financing arrangement are subject to state tax only. (*HB 199*)

Distribution Center Goods—KRS 132.095(1) is amended to provide that goods shipped into Kentucky and placed in a warehouse or distribution center pending further shipment out of state will receive a one-tenth of 1 cent state rate. KRS 132.095(2) is amended to permit all local districts to exempt the property from local taxation.

KRS 132.095(1) is also amended to remove the one-tenth of 1 cent rate for goods in transit which originate in state. Beginning in 1999, goods in transit must both originate and be destined for out of state. Therefore, goods in state pending shipment out of state will be subject to a state rate of 5 cents per $100 of value. All goods in transit will be subject to full local rates unless they are specifically exempted or given a reduced rate by a local taxing district. (*HB 65*)

Omitted Tangible Property—(Effective July 15, 1998.) KRS 132.320 is amended to provide that local taxing districts which have omitted tangible property revenues resulting from compliance efforts by KRC share in the costs of generating those revenues. (*HB 547*)

Protested Assessments—(Effective July 15, 1998.) KRS 132.486, 132.820, 136.180, and 136.1877 are amended to require the taxpayer who protests an assessment on personal property or real property assessed by KRC to pay taxes on the unprotested portion of the assessment (i.e., what the taxpayer asserts is the true fair cash value of the property in question). This allows local districts to receive some tax revenues while protested assessments are being resolved. (*HB 547*)

Unmined Minerals—KRS 131.190 is amended to permit KRC to provide an owner of unmined minerals or energy resources assessed under KRS 132.820(1), or owners of the surface land, factual information about the owner's property derived from returns filed by a third party and used to derive the owner's assessment. (*HB 387*)

Agricultural and Horticultural Land—KRS 132.450 is amended to provide that agricultural and horticultural land will not lose its agricultural and horticultural assessment if it fails to meet the minimum acreage requirement because a portion of the land has been acquired for public purposes. (*HB 317*)

Property Valuation Administrator (PVA) Exam—KRS 132.380 is amended to change the month of the PVA exam from October to November. (*HB 317*)

PVA Salary Incentives—KRS 132.385 is amended to delete the requirement that PVA salary increases, earned for obtaining a professional designation, be paid only if sufficient funds are available. (*HB 317*)

Collections—(Various effective dates.) Various sections of KRS Chapter 134 were amended to provide incentives to the sheriffs, county clerks, and county attorneys to collect unpaid property taxes. These incentives will result in a much more timely collection of property taxes and a much more reliable revenue stream for state and local taxing districts. KRS 134.480 was amended to allow the sheriff and the county clerk to accept payment by any commercial means, including credit cards. (*HB 568*)

Purchase of Development Rights—A new section of KRS Chapter 67A is created to allow a public referendum in urban government counties for the "Purchase of Development Rights" program in an effort to prevent development of rural properties. Purchases made under the program may be funded through an occupational license tax, an urban county property tax, or a transient room tax. The property tax, if approved by the voters, could be up to an additional 5 cents per $100 of value. (*HB 644*)

Funding of Public Parks—KRS 97.590 is amended to allow for a public referendum to permit all classes of cities and county governments to levy taxes not to exceed 5 cents per $100 of taxable property, within the corporate limits, for the purpose of purchasing and maintaining public parks. (*HB 48*)

Public Health Districts—KRS 212.755 is amended to increase the maximum tax rate levied by a public health district to 10 cents per $100 of value from the current rate of 4 cents per $100 of value. (*HB 279*)

Constitutional Amendment—The following question will be submitted to voters on the November Ballot: "Are you in favor of amending Section 170 of the Constitution of Kentucky to permit the General Assembly to exempt motor vehicles and any other class of personal property from the levy of all or any portion of the property tax and to extend the homestead property tax exemption to persons who are classified as totally disabled by any public or private retirement system?" (*HB 229*)

SALES AND USE TAX

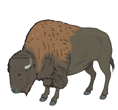
Expansion of the Tourism Development Act—(Effective April 1, 1998.) KRS Chapter 154 is amended to expand the Kentucky Tourism Development Act enacted during the 1996 Regular Session of the General Assembly. New types of tourism attractions that may qualify for tax inducements include Kentucky crafts and products centers, entertainment destination centers, and lodging facilities located on recreational property owned or leased by the commonwealth or federal government. The bill also changes the tax inducement from a sales tax credit to a sales tax refund. *(HB 397)*

Expansion of the Aviation Jet Fuel Tax Credit—(Effective July 1, 2000.) KRS Chapter 144 is amended to allow certificated air carriers a credit against Kentucky sales and use tax paid on aircraft fuel, including jet fuel, purchased after June 30, 2000. The air carrier must pay the first $1,000,000 applicable to the purchase of the fuel. The previous tax cap was $4,000,000 per year. *(HB 444)*

NEW SALES TAX EXEMPTIONS FOR FARMERS

Fuels Used for Agricultural Purposes—KRS 139.480(16) is amended to exempt gasoline, special fuels, liquefied petroleum gas, and natural gas used exclusively and directly to operate farm machinery, on-farm grain drying facilities, on-farm poultry, livestock, ratite, llama, alpaca, or dairy facilities. *(HB 675)*

Water—KRS 139.480 is amended to exempt 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. *(HB 433)*



Buffalo—(Effective Aug. 1, 1998.) KRS 139.480 is amended to exempt buffalo used as beasts of burden or in an agricultural pursuit, buffalo-raising facilities, and various items necessary to produce buffalo. *(HB 45)*

Aquaculture—(Effective Aug. 1, 1998.) KRS 139.480 is amended to exempt 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. *(HB 122)*

Baling Twine and Baling Wire—KRS 139.480 is amended to exempt twine and wire for the baling of hay and straw. *(HB 680)*

Repeal of Sunset Provisions—The July 31, 2000, sunset provisions for the livestock embryos/semen (KRS 139.480(25)) and the llama/alpaca (KRS 139.480(26)) exemptions have been repealed. Therefore, these exemptions will remain in effect. *(HB 675)*

OTHER SALES AND USE TAX EXEMPTIONS

Equine Water—KRS 139.470 is amended to exempt water used in the equine-raising business. *(HB 433)*

Nonprofit Educational Youth Programs—(Effective Aug. 1, 1998.) KRS 139.497 is amended to exempt sales made by nonprofit educational youth programs affiliated with a land grant university cooperative extension service (4-H) if the net proceeds from the sales are used solely for the benefit of the affiliated programs. *(HB 175)*

Coin-operated Bulk Vending Machines—(Effective Aug. 1, 1998.) KRS 139.470(6) is amended to exempt tangible personal property sold through coin-operated bulk vending machines if the sale amounts to 50 cents or less. Previously, the amount was limited to 25 cents or less. *(HB 253)*

Catalogs and Newspaper Inserts Shipped Outside Kentucky—(Retroactive to Jan. 1, 1988.) KRS 139.470 is amended to exempt printed 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. This exemption applies regardless of whether the carrier is selected by the buyer, seller, or an agent or representative of the buyer or seller, or whether the F.O.B. is seller's shipping point or buyer's destination. *(HB 675)*

MOTOR VEHICLE TAXES

Electronic Titles—KRS 186.045 through 186.190 and 186A.020 through 186A.530 are amended to eliminate the use of the vehicle transaction record for titling motor vehicles. It will be replaced by the title as the primary transfer document. This provision allows for the use of an electronic medium to transfer information and eliminate paper transactions when possible. An applicant for a motor vehicle title will not be required to provide his or her Social Security number as part of the application process. *(HB 311)*

MOTOR VEHICLE USAGE TAX

Change in Valuation Method for Motor Vehicle Usage Tax—(Effective Aug. 1, 1998.) KRS 138.450-138.460, 138.990, 186.190, 186.232, and KRS 190.990 are amended to change the valuation method for valuing motor vehicles for motor vehicle usage tax and provide penalties for abuse. New vehicles will be valued based on 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 manufacturers' suggested retail price will be used. Trade-in credit will not be given.

Most used vehicles will be valued based on the total consideration given. Trade-in credit will be allowed. Vehicles entering Kentucky which were previously registered in another state or country by the registrant and vehicles transferred as gifts will be taxed using average trade-in value from the reference manual. The total consideration will be attested to in a notarized affidavit signed by both buyer and seller. In the absence of such an affidavit, "retail price" will be established based on a reference manual prescribed by KRC. *(HB 74)*

Loaner Vehicles—The act creates a new section of KRS 138.455 to 138.470 and amends KRS 138.450-138.463 to provide that motor vehicle dealers in the business of servicing or repairing motor vehicles who loan vehicles for no consideration or monetary value will not be required to collect or remit U-Drive-It usage tax. *(HB 656)*

Limited Liability Companies (LLC)—KRS 138.470 is amended to extend the exemption from motor vehicle usage tax provided upon the incorporation or dissolution of a business to include vehicles to be transferred to or from an LLC and vehicles transferred between an LLC and its parent corporation. *(SB 102)*

MOTOR VEHICLE PROPERTY TAX

Valuation Method for Motor Vehicle Property Tax—(Retroactive to Jan. 1, 1998.) KRS 132.485 is amended to base taxable value for ad valorem property tax purposes on the average trade-in value listed in the standard manual prescribed by KRC, unless information is available that warrants any deviation from the standard value. *(HB 74)*

Salvage Vehicles—(Effective Jan. 1, 1999.) The act amends KRS 132.200 and 134.810 to provide that motor vehicles with a salvage title and held by an insurance company on Jan. 1 be subject to tax as goods held for sale in the regular course of business and taxed for state purposes only. The state tax rate will be reduced to 5 cents per $100 valuation from the current rate of 45 cents. This amendment allows salvage vehicles held by an insurance company to be treated for ad valorem property tax purposes in a manner similar to motor vehicle dealer inventories. *(HB 394)*

INSURANCE TAX

The following changes, effective Jan. 1, 2000, will make Kentucky's premium tax rate competitive with surrounding states, end the longtime controversy regarding the taxation of annuities, and equalize the tax treatment of domestic, foreign, and alien life insurers. *(HB 648)*

Capital and Reserves Tax on Domestic Life Insurers—KRS 136.320 is amended to reduce the tax rate by 20 percent per year for five years from the current rate of 70 cents per $100 to one-tenth of 1 cent per $100 in 2004 and thereafter.

State Premiums Tax on Domestic and Alien Life Insurers—KRS 136.330 is amended to phase in this tax over a five-year period to a rate of 1.5 percent in 2004 and thereafter. KRS 304.42-130 is amended to allow a credit to be given against the domestic life insurers premium tax liability for tax paid for capital and reserves (beginning in 2004). A new section of KRS Chapter 136 was created to allow domestic life insurers to make an irrevocable election prior to calendar year 2000, as to whether they will choose to pay local government premiums taxes or local capital and reserves taxes.

Annuities—KRS 136.330 is amended to exempt annuities from state insurance premiums tax.

State Premiums Tax—KRS 136.330 is amended to lower the premiums tax rate to 1.5 percent over a five-year period from the current 2 percent rate.

MISCELLANEOUS TAXES

SEVERANCE TAX—Inactive Crude Oil and Natural Gas Wells—A new section of KRS Chapter 143A is created to allow a severance tax credit of 4.5 percent for production from recovered inactive crude oil and natural gas wells. *(HB 765)*

MALT BEVERAGE TAX—Malt Beverage Educational Fund—A new section of KRS Chapter 211 is created to dedicate 1 percent of the malt beverage excise tax receipts and 1 percent of the malt beverage wholesale tax receipts to educational information and materials that deter or eliminate underage drinking. *(SB 207)*

HEALTH CARE PROVIDER TAX—Outpatient Prescription Drugs—KRS Chapter 142 was amended to phase out the provider tax on outpatient prescription drugs. The tax on outpatient prescription drugs will be reduced from 25 cents to 15 cents per prescription for the period July 1, 1999, through June 30, 2000. Effective July 1, 2000, the tax on outpatient prescription drugs will expire. *(HB 321 and HB 315)*

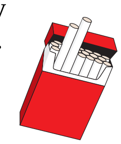
BANK FRANCHISE TAX—Kentucky Obligations—(Effective for tax years beginning after Dec. 31, 1997.) KRS 136.500 is amended to define the term "Kentucky obligations" to mean all obligations of the Commonwealth of Kentucky, its counties, municipalities, taxing districts, and school districts, exempt from taxation under the Kentucky Revised Statutes and the Constitution of Kentucky. The amendment allows as a deduction from capital an amount equal to the same percentage of total capital as the book value of Kentucky obligations bears to the book value of the total assets of the financial institution. Additionally, the quarterly averages of net capital and deductions for United States and Kentucky obligations will be divided by four, without regard to the actual existence of the financial institution. *(HB 419)*

PARI-MUTUEL TAX—Equine Drug Fund—KRS 230.378 is amended to dedicate revenue received for equine drug research programs to be deducted from the handle on simulcasting as well as live racing. *(HB 505)*

WINE EXCISE TAX—Farm Winery Reporting—KRS 241.010 is amended to allow Kentucky farm wineries to report and pay excise taxes on a quarterly rather than a monthly basis. *(SB 357)*

WASTE TIRE FEE—Disposal of Waste Tires—Several new sections of subchapter 50 of KRS Chapter 224 are created to simplify the waste tire law by reducing the number of exemptions. *(HB 636)*

CIGARETTE TAX—Agricultural Diversification—The Agricultural Diversification and Development Council is created. The purpose of the Council will be to provide assistance to farmers as they diversify from tobacco growers to alternative crop growers. Funds available from future increases in the cigarette tax, grants, gifts, appropriations, or money received as a result of the national settlement agreement between the tobacco industry and the states' attorneys general or from any federal legislation related to the agreement shall be distributed by the council to various diversification and health-related programs. *(SB 247)*



MOTOR FUELS TAX—Out-of-State Terminal Suppliers—KRS 131.130 is amended to provide that KRC may enter into agreements with out-of-state terminal suppliers for the collection and remittance of motor fuels tax and the petroleum environmental assurance fee. *(HB 328 and HB 675)*

TAX ADMINISTRATION

Electronic Funds Transfer (EFT)—KRS 131.155 is amended to establish new guidelines relating to EFT effective for remittances made on or after Aug. 1, 1998. This legislation does the following:

- Permits KRC to expand the requirement to remit taxes and fees via EFT to all taxes and fees administered by KRC. Administrative regulations are required for this purpose.
- Prohibits KRC from requiring EFT by anyone whose average payment per reporting period is less than $25,000 as of Aug. 1, 1998, $17,500 as of July 1, 1999, and $10,000 as of July 1, 2000.

- Permits KRC to waive the EFT requirement for taxpayers who are unable to comply.
- Allows taxpayers who pay by EFT to receive refunds by EFT after July 1, 2001.
- Imposes a penalty of one-half of 1 percent (0.5%) of the amount that should have been remitted by EFT, but provides an exception for reasonable cause. *(HB 328)*

Confidentiality of Taxpayer Records—KRS 131.020(3), 131.081, and 131.190 are amended to reverse legislation enacted in 1994 that permitted the Finance and Administration Cabinet's Office of Financial Management and Economic Analysis access to Internal Revenue Service tax return information received by KRC. The 1994 legislation was in violation of an exchange of information agreement between KRC and the IRS.

The bill also amends KRS 131.190(3) to limit the release of statistical information reported by all gasoline dealers to that of a group without revealing statistics of any particular dealer (licensee). *(HB 387)*

Reorganization of KRC—KRS 12.020 and 131.120 are amended to KRC's reorganization efforts as supported by Executive Order 97-715 with the exception that the new Department of Information Technology consists of two divisions instead of one. *(HB 503)*

Confidentiality of Taxpayer Information—KRS 197.120 is amended to prohibit the Department of Corrections from entering into a contract with KRC for the use of prison labor if the prisoners would have access to taxpayer information. The bill further creates a new section under KRS Chapter 131 to prohibit KRC from entering into a contract with the Department of Corrections, the United States government, any local government, or any private contractor for the use or employment of prisoners that allows the prisoners access to taxpayer information. *(HB 592)*

Electronic Signatures and Records—KRS Chapter 389 is enacted to provide standards for electronic signatures and records applicable to the executive branch of state government. This legislation makes these signatures and records legal and binding if all parties agree to the transaction, notwithstanding other statutes that provide for written signatures. Exceptions to these standards include wills, trusts, and the conveyance of any interest in real property. The Kentucky Information Resources Management Commission may promulgate administrative regulations to establish the electronic signature standards. *(HB 708)*

Liens—A statewide computerized Kentucky Lien Information System is created and will be administered by the Kentucky Secretary of State for the purpose of accumulating, indexing, and disseminating information relative to personal property liens and related filings. This legislation requires a secured party to file in the Secretary of State's Office a financing statement, or any amendment, assignment, continuation, release, or termination related thereto. Filings with the Secretary of State are for informational purposes only and are not intended to convey notice or constitute perfection of liens. *(HB 739)*

Administrative Regulations—Additional procedures are enacted within KRS Chapter 13A regarding the notice of intent of an administrative regulation, material incorporated within an administrative regulation, and the effect of an administrative regulation being found deficient. All state agencies are subject to these acts. *(HB 287 and HB 853)*

TOPICS SCHEDULED FOR STUDY

Study on Taxation of Public Utilities—A task force is established to study the taxation of public service companies which provide utility service. (*HJR 89*)

Study on Electric Deregulation—A task force is established to study the deregulation of the electric industry in Kentucky. (*HJR 95*)

Coal Severance Tax Study—A joint resolution creates a two-year study which will review incentives to mine economically marginal seams of coal and report the findings to the Interim Joint Committee on Agriculture and Natural Resources before the 2000 legislative session. *(SR 118)*

Solid Waste Study—A task force is created which will study the options for dealing with solid waste problems in Kentucky and make recommendations to the legislature by the 2000 session. *(HB 371)*

Governor Patton Approves KRC Reorganization

On June 11, 1997, Governor Paul E. Patton signed Executive Order 97-715, reorganizing KRC. The order was effective on July 1, 1997, along with a related administrative order issued by former KRC Secretary Margaret Handmaker on March 1, 1997.

The KRC organizational changes were:

- The Office of General Counsel became the Department of Law. The former position of general counsel became the position of commissioner of the Department of Law.

- The Division of Collections moved from the Department of Compliance and Taxpayer Assistance to the Department of Law.

- The Department of Compliance and Taxpayer Assistance became the Department of Tax Administration. The Division of Tax Administration became the Division of Compliance and Taxpayer Assistance.

- The Division of Revenue Operations moved from the Department of Administrative Services to the Department of Tax Administration.

- The Office of Financial and Administrative Services replaced the Division of Financial and Administrative Services. This office consists of the Budget, Training and Development, and Human Resources branches. It was removed from the Department of Administrative Services and now reports directly to the secretary. The PVA Administrative Support Section, also a part of the Office of Financial and Administrative Services, was elevated to branch level. The Public Information and Communication Services Branch was moved from the Office of Financial and Administrative Services to the Department of Law.

- The Disclosure Section was elevated to branch level and reports directly to the secretary.

- The Department of Property Taxation became the Department of Property Valuation.

- The Department of Administrative Services became the Department of Information Technology. The Division of Information Systems Resources within that department became the Division of Information Technology.

- The Division of Tax Policy and Research became two divisions, the Division of Tax Policy and the Division of Research. They replace the former Tax Policy and Research sections.

- The East, Central, and West branches in the Division of Field Operations became Region 1, Region 2, and Region 3 respectively. The Northern Kentucky Taxpayer Service Center (TSC) moved from the Central Branch to Region 1; the Bowling Green TSC moved from the West Branch to Region 2; the Corbin TSC moved from the East Branch to Region 2; and the Lexington TSC moved to Region 3.

- The Audit Support and Training Branch was established in the Division of Field Operations. This branch consists of the Audit Selection, Electronic Data Interchange Auditing, and Training sections.

- The Severance Tax Section and Cigarette Tax Unit in the Division of Compliance and Taxpayer Assistance were abolished and combined with other areas within the division.

- Several other minor organizational changes were made.

Governor Praises KRC Workforce During Cabinet-wide Meeting

Governor Paul E. Patton thanked and praised KRC employees for their efforts during KRC's first Cabinet-wide meeting in three years on Wednesday, May 20, 1998.

"I have a great deal of respect for the dedication and professionalism of state government employees," Patton told the crowd assembled at the Farnham Dudgeon Civic Center in Frankfort. "You are the ones who do the day-to-day work to make this government function."

Patton stressed the importance of KRC's role in his *EMPOWER Kentucky* initiative to make state government more efficient.

"You are the lead agency as far as *EMPOWER Kentucky* is concerned. You have received the biggest investment, and will provide the biggest return. You've shown you are willing to accommodate change, and we appreciate that," Patton said.

Patton said his administration is attempting to improve the business climate in Kentucky in part through changes in the state's tax laws, and KRC employees play a significant part in this effort. Improving the quality of the workforce by improving education is another goal of his administration.

Government's role is to provide services to the people, and Kentucky has a good government, Patton said.

"It's because of you people," the governor said, "it's not because of me. I'm here to thank you, on behalf of the people of Kentucky, for everything that you do every day."

The governor was accompanied by Andrew "Skipper" Martin, his chief of staff, and Crit Luallen, Secretary of the Executive Cabinet.

KRC employees and *EMPOWER* were also major topics for Secretary Sarah "Susie" Schaaf.

"Every day when I drive to Frankfort, I thank God for the employees of the Revenue Cabinet and their professionalism, competency, and understanding. I am grateful to you all," she said.

EMPOWER and the Integrated Tax System (ITS) are KRC's bridges to the next millennium, Schaaf said. "We invite you to travel with us into the next millennium."

Schaaf also said that tax collection is an important task because it funds all services provided by government.

"Tax collection does not have to be an unpleasant event, either for us or the taxpayers," she said.

Other topics discussed during the meeting were the results of a Cabinet-wide survey, and the status of the refund project made necessary because of the ***St. Ledger v. Revenue Cabinet*** court case.

The two-hour meeting was the first Cabinet-wide meeting held since 1995. More frequent meetings were promised as part of KRC's commitment to provide open and honest lines of two-way communication between management and employees.

KRC Administrative Expenditures

KRC administrative costs for Fiscal Year 1997-98 totaled $60,385,698, an increase of 2.94 percent from Fiscal Year 1996-97. KRC's administrative costs reflect the cost to continue the Cabinet's normal ongoing operations. Excluded from the administrative costs are *EMPOWER Kentucky* initiative costs for one-time projects, which are funded through accounts maintained by the Finance and Administration Cabinet. KRC administrative costs for personnel costs represented 67 percent of the total. Operating costs for rent, postage, costs for technology payable to the Department of Information Systems, travel, printing, and other miscellaneous expenses, rose at a modest rate of only 3 percent from the prior year.

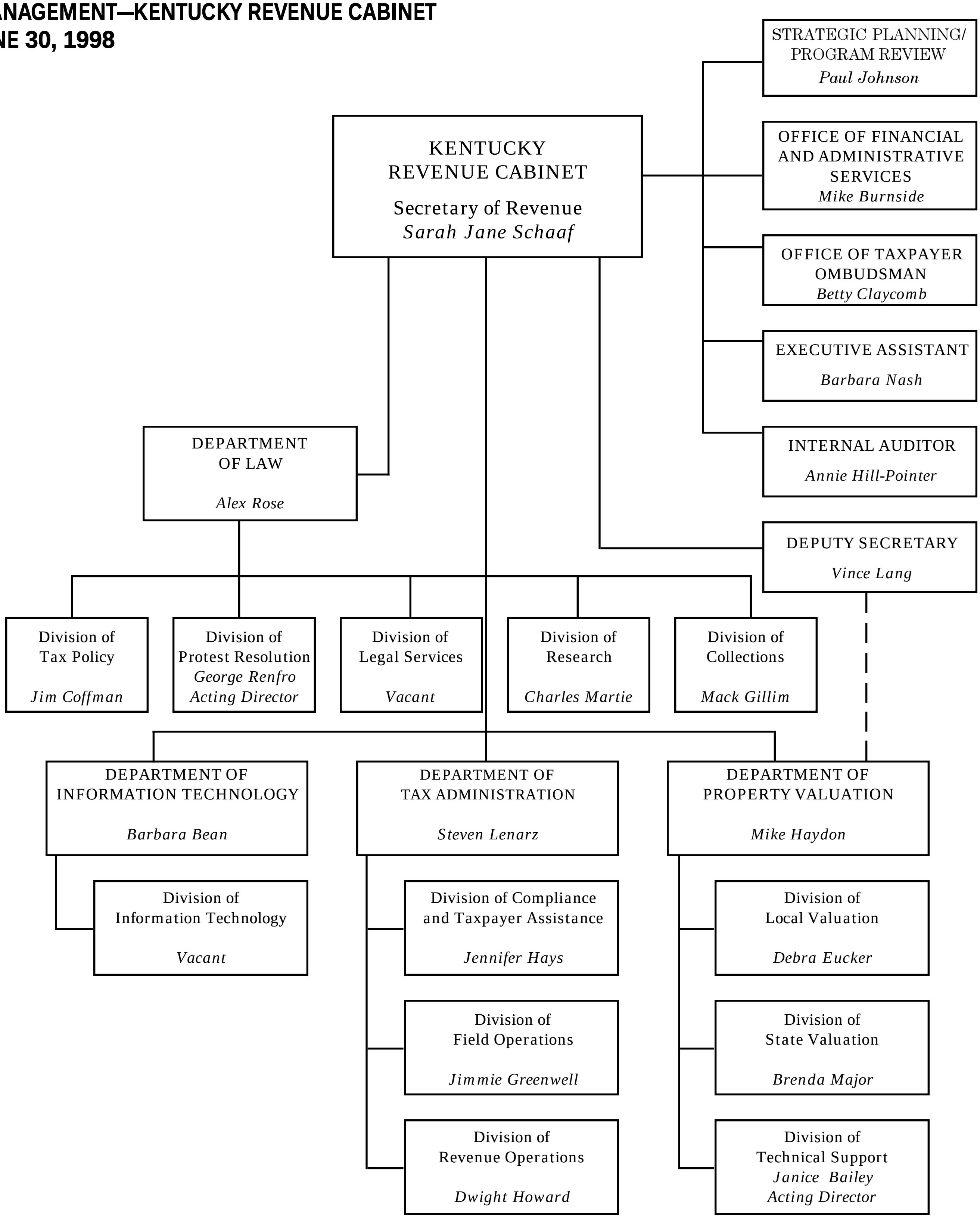
At the end of the fiscal year, KRC General Fund operating funds which lapsed to the state surplus pool totaled $253,641. The surplus amount was attributed to unused personnel vacancy credits remaining at the end of the year. Personnel vacancy credits provided funds for technology enhancements, phone system upgrades, and installation of network connections for four taxpayer service centers.

An average of approximately 985 full-time permanent employees worked for KRC during Fiscal Year 1997-98. KRC's full-time permanent personnel cap was 1,033 budgeted positions. In addition, approximately 180 seasonal employees worked to support ongoing operations. The majority of these seasonal employees worked during the individual income tax refund processing season, January through June.

ADMINISTRATIVE COSTS, FISCAL YEAR 1998
(Excludes PVA's)

	General Fund	Agency Fund	Road Fund	Total
Salaries full-time (inc. benefits)	$ 35,052,940	$ 1,091,200	$ 809,700	$ 36,953,840
Seasonal employees	1,471,174	0	0	1,471,174
Overtime/block 50s	460,176	0	0	460,176
Legal/audit services/ consultants	791,335	0	0	791,335
Janitorial services	230,380	0	0	230,380
Temporary services	143,851	0	0	143,851
Other personnel costs	444,949	0	0	444,949
Total Personnel	**$ 38,594,805**	**$ 1,091,200**	**$ 809,700**	**$ 40,495,705**
Utilities	$ 264,908	$ 5,000	$ 5,200	$ 275,108
Rent/rentals/carpool	2,617,833	18,000	65,200	2,701,033
Maintenance and repairs	796,650	0	13,200	809,850
Postage	2,689,079	83,884	306,100	3,079,063
Printing/other services	1,117,783	253,044	22,600	1,393,427
Telecommunications	403,353	6,318	11,200	420,871
D.I.S. costs	6,959,004	184,900	60,200	7,204,104
Computer equipment	839,557	113,731	15,453	968,741
Supplies	414,490	22,452	0	436,942
Commodities/furniture	192,129	1,922	0	194,051
Software/telephone equipment	334,617	17,264	2,895	354,776
Travel	1,185,939	39,548	20,236	1,245,723
Filing/lien/collection fees	32,396	137,704	0	170,100
Dues/subscription/other	474,377	39,018	11,487	524,882
Total Operating	**$ 18,322,115**	**$ 922,785**	**$ 533,771**	**$ 19,778,671**
Computer equipment	111,322	0	0	111,322
Total Capital Outlay	**$ 111,322**	**$ 0**	**$ 0**	**$ 111,322**
Total Administrative Costs	**$ 57,028,242**	**$2,013,985**	**$ 1,343,471**	**$ 60,385,698**

MANAGEMENT—KENTUCKY REVENUE CABINET
JUNE 30, 1998



J. Bailey

B. Bean

Secretary Sarah Jane Schaaf

M. Burnside

B. Claycomb

J. Coffman

D. Eucker

M. Gillim

J. Greenwell

M. Haydon

J. Hays

A. Hill-Pointer

D. Howard

P. Johnson

V. Lang

S. Lenarz

C. Martie

B. Major

B. Nash

G. Renfro

A. Rose

KRC Administration

Sarah Jane "Susie" Schaaf Appointed KRC Secretary

On Feb. 3, 1998, Sarah Jane "Susie" Schaaf was appointed KRC Secretary by Governor Paul Patton.

Secretary Schaaf brings to KRC 20 years of experience in finance and investment. Most recently, she was a certified financial planner and director of marketing for Cotton and Allen P.S.C, certified public accountants and consultants in Louisville. She has also been vice president of product development for financial information services in the retail marketing division of First National Bank of Louisville (now National City Bank). Prior to that she was vice president of new business development investment for Citizens Fidelity Bank and Trust Company (now PNC Bank). She also operated an art gallery in St. Matthews.

Secretary Schaaf is a graduate of Northwestern University and participated in the honors program at the University of Edinburgh, Scotland. She received her financial planning certification from the College of Financial Planning in Denver, Colo., and is a member of the International Board of Certified Financial Planners, the Association of Accounting Marketers, and the Louisville Employee Benefit Council.

Schaaf is a resident of Louisville, where she is very active in civic and community affairs. She is a current or former member of the boards of directors of the Jefferson County Chapter of the American Red Cross, Louisville's public television station (Channel 15), the Louisville Collegiate School, and Baptist East Hospital. She has also served as president of the Junior League of Louisville, the Bingham Child Guidance Clinic, and the Morton Center in Louisville. She is a graduate of the 1981 class of Leadership Louisville.

Schaaf has three children and two grandchildren.

KRC Management Appointments

On *July 1, 1997*, James Greenwell was appointed director of the Division of Field Operations.

Greenwell joined KRC in February 1976 as an auditor in the Bowling Green Taxpayer Service Center. He has held several supervisory positions and was a regional manager for the East Branch at the time of his appointment.

Greenwell holds a bachelor of science degree in accounting from the University of Kentucky.

On *July 1, 1997*, Dr. Charles Martie was appointed director of the Division of Research. He was previously supervisor of KRC's Research Section.

Martie was formerly chairman of the Department of Economics at Quinnipiac College in Hamden, Conn., and taught economics courses as an associate professor. He also served as staff economist for the Connecticut Bipartisan Committee on State Tax Revenue and Related Fiscal Policy, and worked with the Federal Trade Commission.

He holds a bachelor's degree and a doctoral degree in economics from the University of Connecticut.

On *July 16, 1997*, Dwight Howard was appointed director of the Division of Revenue Operations. He was previously director of the Division of Field Operations.

Howard is a 28-year KRC veteran who began his career as a field representative in the Owensboro TSC in 1969. He has also served as district manager of the Owensboro TSC and director of the Division of Collections.

On *Aug. 1, 1997*, Debra Eucker was appointed director of the Division of Local Valuation. She was previously an attorney manager with the Division of Legal Services.

Eucker began her KRC tenure in August 1991 as a staff attorney. Prior to joining KRC, she was a law clerk for former federal appeals court judge Pierce Lively, and a litigation attorney with the Lexington law firm of Brown, Todd and Heyburn.

She holds a bachelor of arts degree in political science and English from Miami University in Oxford, Ohio, and earned her law degree from the University of Cincinnati Law School.

On *Sept. 1, 1997,* Brenda Major was appointed director of the Division of State Valuation.

Major came to KRC from the Office of Financial Management and Economic Analysis (OFMEA) in the Finance and Administration Cabinet, where she spent five years as a tax consultant. She began her career with KRC in 1977 and, with the exception of her five years with OFMEA, has spent her entire career with KRC.

She holds a bachelor of science degree from the University of Kentucky.

On *Oct. 1, 1997,* Barbara Bean was appointed commissioner of the Department of Information Technology. She was the director of the Division of Information Technology at the time of her appointment.

Bean came to KRC from the Kentucky Department of Education, where she was involved in implementing the technology aspect of the Kentucky Education Reform Act. She had previously worked for the Department of Information Systems and the former Department of Revenue, as well as in the quality control field in the private sector.

She holds a bachelor of science degree in mathematics from Centre College, and a master's degree in public administration from Kentucky State University.

On *June 16, 1998,* Jennifer Hays was appointed director of the Division of Compliance and Taxpayer Assistance.

Hays was a tax consultant with KRC's Division of Tax Policy at the time of her appointment, and had also worked in the Division of Protest Resolution. She joined KRC in October 1984 and has also worked for the former Cabinet for Human Resources.

She holds a bachelor of science degree in accounting and a bachelor of business administration degree in financial management from the University of Kentucky.

KRC Departments and Their Duties

The Kentucky Revenue Cabinet consists of 12 divisions, headed by the Office of the Secretary. The divisions are organized into four departments—Information Technology, Law, Property Valuation, and Tax Administration.

Office of the Secretary

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

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

The **Financial and Administrative Services** office assists KRC in personnel and fiscal services, and training and development. It provides support for the new procurement card system for obtaining office supplies and equipment, educational, budget and fiscal, and personnel services for KRC.

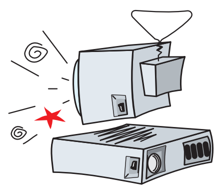
The **Internal Audit** office is responsible for auditing the accounting, control, and custodial activities of KRC to ensure compliance with applicable federal and state laws, administrative regulations, policies, and procedures. In addition, the Disclosure Branch, responsible for the disclosure of confidential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

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

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

Department of Information Technology

The Department of Information Technology consists of one division, the Division of Information Technology. It provides direction for development of information resource policies and offers overall technical support for information technologies used within KRC. The department also has responsibility for the efficient delivery of information services in support of the agency mission and objectives.



The **Division of Information Technology** is responsible for network services support, application development support services, production control, technology procurement, and computer operations.

Department of Law

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

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

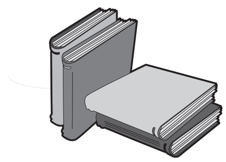
The **Division of Legal Services** represents KRC in administrative proceedings before the Kentucky Board of Tax Appeals and Personnel Board and in legal actions involving tax and a variety of other issues at every level of the state and federal court system. The division also performs a wide range of other services and functions which include rendering advice and written legal opinions to KRC personnel, other state government personnel, and taxpayers concerning the state's tax laws as well as other relevant areas of the law; reviewing and drafting proposed statutes and regulations; analyzing tax laws and assisting with their implementation and administration; assisting with the preparation of KRC informational publications; and providing assistance and advice in connection with audits, protest conferences, and other stages of the enforcement of the tax laws.

The **Division of Protest Resolution** reviews and bills tax audits performed by the audit staffs of KRC's 11 taxpayer service centers. The division is responsible for responding to and resolving taxpayers' protests of the field audit adjustments and resulting tax assessments. In resolving protests, the division conducts conferences and issues final rulings upon request or whenever deemed necessary. The division is also required to resolve protests of office audits conducted by other taxing sections within KRC.

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

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

The **Public Information and Communication Services Branch** is responsible for producing KRC publications; designing tax forms and administering related programs such as bulk forms, library forms, substitute forms, and software; implementing media/public relations initiatives such as preparing news releases, handling media inquiries, and managing KRC's Speakers' Bureau; coordinating KRC's printing requests; maintaining a historical display at KRC's main office; and administering KRC's Online Taxpayer Service Center Internet site.



Department of Tax Administration

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

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

The **Division of Field Operations** is responsible for providing quality taxpayer service from the 11 taxpayer service centers. The centers provide taxpayer assistance and education, prepare returns, distribute forms, collect delinquent taxes, and perform field audits. The division also provides instructors, develops training materials, and coordinates training for most in-house tax schools.

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

Department of Property Valuation

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

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

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

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

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Alcoholic Beverage Wholesale Sales Tax	KRS 243.884	9 percent of wholesale sales of distilled spirits, wine and malt beverages.	A wholesale sales tax on alcoholic beverage wholesalers/distributors to be reported monthly. There are statutory exemptions.
Bank Franchise Tax	KRS 136.500 et seq.	1.1 percent of net capital. Minimum tax is $300 per year.	Tax is imposed on every financial institution regularly engaged in business in Kentucky at any time during the calendar year. A financial institution is presumed to be regularly engaged in business in Kentucky if during any taxable year it obtains or solicits business with 20 or more persons within Kentucky, or if receipts attributable to sources in Kentucky equal or exceed $100,000. Tax is in lieu of all city, county and local taxes except for the real estate transfer taxes, real property and tangible personal property taxes upon user of utility services and the local deposit franchise tax.
Beer Consumer Tax	KRS 243.720 et seq.	$2.50 per barrel of 31 gallons.	An excise tax imposed on distributors or retailers of malt beverages who purchase malt beverages directly from a brewer. There are statutory exemptions and credits. There is a 50 percent discount for domestic brewers.
Breeders' Award Fund Allocation	KRS 230.380	34 percent of commission.	Simulcast facilities remit to the Revenue Cabinet no later than the fifth business day following the close of each week of racing.
Cigarette Enforcement and Administration Fee	KRS 365.390	.001 cent per pack (rate subject to change annually).	Fee paid by cigarette wholesalers and unclassified acquirers to provide for the expenses of the Revenue Cabinet in administering the Cigarette Tax Law.
Cigarette Licenses	KRS 138.195	Resident wholesaler .... $500 Nonresident wholesaler .... $500 Subjobber .... $500 Vending machine operator .... $ 25 Transporter .... $ 50 Unclassified acquirer .... $ 50	Annual license fee imposed upon various dealers and handlers of cigarettes. More than one license may be required by the Revenue Cabinet for any dealer or handler depending upon the diversity of his business and the number of established places of business.
Cigarette Tax	KRS 138.130 et seq.	3 cents per 20 cigarettes, proportioned for other quantities.	An excise tax on cigarettes paid by resident and nonresident wholesalers and unclassified acquirers. The tax is paid by purchasing stamps within 48 hours after cigarettes are received by a resident wholesaler. A nonresident wholesaler must affix the tax stamps prior to importing them into Kentucky.
Coal Tax	KRS 143.010. 143.020 et seq.	50 cents per ton minimum or 4.5 percent of gross value. (The minimum tax shall not apply to a taxpayer who only processes coal.)	Tax is based on the gross value of coal severed and/or processed in Kentucky.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Corporation Income Tax	KRS 141.010 et seq., 155.170	First $25,000 .... 4 percent Next $25,000 .... 5 percent Next $50,000 .... 6 percent Next $150,000 .... 7 percent All Over $250,000 .... 8.25 percent Business Development Corporations .... 4.5 percent	Annual tax on the entire net income of the corporation apportioned and allocated to Kentucky. Corporations whose estimated tax liability will exceed $5,000 must file a declaration of estimated tax due and pay the estimated tax in three installments. Financial institutions as defined in KRS 136.500, except bankers banks organized under KRS 287.135, insurance companies; savings and loan associations; corporations exempted by Internal Revenue Code (IRC) Section 501; and religious, educational, charitable and like corporations not conducted for profit are exempt from corporate income tax. An "electing small business corporation," (S Corporation) as defined in Section 1371(b) of the IRC, is recognized as being exempt from Kentucky corporation income tax except for tax on net capital gain of such corporation as provided in KRS 141.040(5). For taxable years ending on or after December 31, 1995, KRS 141.200 allows an affiliated group to elect to file a consolidated Kentucky income tax return with the election binding for 96 consecutive calendar months. KRS 141.120 prohibits affiliated groups from filing a combined Kentucky corporation income tax return using the unitary business concept.
Corporation License Tax	KRS 136.070 et seq.	$2.10 per each $1,000 of capital employed in the business. Kentucky tax is based on the amount of such capital apportioned to Kentucky. Minimum tax is $30.	Annual license tax levied against any corporation owning or leasing property or having an employee in Kentucky. Public service companies, certified alcohol production facilities, certified fluidized bed energy production facilities, and corporations exempt from income tax (except S corporations) are also exempt from license tax. A corporation with gross income of $500,000 or less is allowed a credit against the license tax of $1.40 on each $1,000 of the first $350,000 of capital employed.
Distilled Spirits Case Sales Tax	KRS 243.710	5 cents per case.	Excise tax on distilled spirits sold by wholesalers to retailers in Kentucky.
Distilled Spirits and Wine Consumer Taxes	KRS 243.720 et seq.	Distilled spirits containing over 6 percent alcohol by volume per gallon .... $ 1.92 per liter .... 0.5073 Distilled spirits containing 6 percent or less alcohol by volume per gallon .... $ 0.25 per liter .... 0.0661 Wine per gallon .... $ 0.50 per liter .... 0.1321 (Proportionate amount charged on smaller quantities, but not less than 4 cents on any retail container of wine.)	Excise tax imposed upon the use, sale or distribution by sale or gift of distilled spirits and wine. There are statutory exemptions.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Health Care Provider Tax	KRS 142.301 to 142.359	2.5 percent of gross receipts for hospital services. 2.0 percent of gross receipts for nursing facility services, licensed home health agency services, HMO services (excluding premium receipts) and ICF/MR services. **1997-98:** 1.0 percent of gross receipts for physician services. 25 cents per outpatient prescription.	Effective July 1, 1993, a provider tax is imposed on providers of taxable medical services. Registration is required prior to the beginning of operations.
Individual Income Tax	KRS 141.010 et seq.	First $3,000 .... 2 percent Next $1,000 .... 3 percent Next $1,000 .... 4 percent Next $3,000 .... 5 percent In excess of $8,000 .... 6 percent	Graduated tax upon an individual's net income. Residents must pay on their entire taxable income. Nonresidents must pay on that portion of their income attributable to Kentucky sources. Fiduciaries must pay on that portion of income of an estate or trusts not distributed or distributable to beneficiaries.
Inheritance and Estate Taxes	KRS 140.010 et seq.	Inheritance tax .... 2–16 percent Estate tax .... an amount by which the state death tax credit allowable under the federal tax law exceeds the inheritance tax.	The inheritance tax is a tax upon the right to receive property upon the death of another person. The rate of tax and the exemptions allowed vary according to the legal relationship of the beneficiary to the decedent. The total inheritable interest of a surviving spouse is fully exempted. Also, if the date of death was after June 30, 1995, the tax is being totally phased out for certain other beneficiaries over a four-year period. The Kentucky estate tax is the amount by which the allowable federal state death tax credit exceeds the Kentucky inheritance tax.
Insurance Premium Surcharge	KRS 136.392	1.5 percent of premiums.	An insurance premium surcharge on insured Kentucky risks. There are statutory exemptions.
Insurance Premium Taxes	KRS 136.330 to 136.390, 299.530, 304.3-270, 304.4-030	All insurance except domestic life..... 2 percent Fire insurance* .... 0.75 percent *Represents additional tax on applicable premiums.	Annual tax imposed on insurance companies and risk retention groups based upon premium receipts on business done. There are statutory exemptions.
Legal Process Taxes	KRS 142.010 et seq.	Conveyances of real property (deeds) ..... $3.00 Mortgages, financial statements and security agreements .... $3.00 Marriage licenses* .... $3.50 Powers of attorney to convey real or personal property .... $3.00 Lien or conveyance of coal, oil, gas or other mineral right or privilege $3.00	Taxes imposed on the filing of an instrument subject to tax or the issuance of a marriage license. Collected by county clerk. *A $10 Spouse Abuse Shelter Fund fee levied on marriage licenses by KRS 209.160 is, by agreement between the Revenue Cabinet and the Cabinet for Human Resources, also reported and paid to the Revenue Cabinet by county clerks as part of the monthly report of legal process taxes due.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Marijuana and Controlled Substance Tax	KRS 138.870	$3.50 per gram on marijuana, loose. $1,000 per marijuana plant. $200 per gram controlled substance by weight. $2,000 per 50 dosage units of controlled substance.	Growers, sellers, dealers, buyers and manufacturers must obtain a tax stamp to affix to the product. Law enforcement agencies must notify the Revenue Cabinet of seizure of product not bearing tax stamp.
Motor Fuels Tax—Gasoline	KRS 138.210 et seq.	9 percent of average wholesale price of gasoline, but not less than 10 cents per gallon. Rate determined quarterly. A 5 cent per gallon "Supplemental Highway User Motor Fuel Tax" also applies.	An excise tax paid by licensed dealers on all gasoline received in this state. There are statutory provisions for partial or full tax refunds for designated users.
Motor Fuels Tax— Liquefied Petroleum Gas	KRS 234.310 to 234.440	Variable rate same as gasoline. The 5 cent per gallon supplemental tax also applies to liquefied petroleum gas.	An excise tax paid by licensed dealers on all liquefied petroleum motor fuel withdrawn to propel motor vehicles on the public highways, unless the carburetion system has been approved by the Natural Resources and Environmental Protection Cabinet.
Motor Fuels Tax—Petroleum Storage Tank Environmental Assurance Fee	KRS 224.60-145	1.4 cents per gallon.	A petroleum storage tank environmental assurance fee is levied on all taxable gasoline and special fuel reported in this state by licensed dealers. There are provisions for exemptions or refunds for qualifying gasoline or special fuels not to be used on the public highways.
Motor Fuels Tax—Special Fuels	KRS 138.210 et seq.	Variable rate same as gasoline. A 2 cent per gallon "Supplemental Highway User Motor Fuel Tax" also applies.	An excise tax is levied on all special fuels received in this state by licensed dealers. There are statutory provisions for tax credits and partial or full tax refunds for designated users.
Motor Vehicle Usage Tax	KRS 138.450 et seq.	6 percent of the retail price as defined in KRS 138.450. Optional tax payment method available for U-Drive-It operators based on 6 percent of the gross rental or lease charges.	Tax imposed on new and used motor vehicles when registered for the first time in this state and when ownership is transferred. There are statutory exemptions and credits. Regular usage tax payments are made to the county clerk and forwarded to the Revenue Cabinet. U-Drive-It usage tax payments are made directly to the Transportation Cabinet on a monthly basis.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Natural Resources Severance and Processing Taxes (Minerals, Natural Gas and Natural Gas Liquids)	KRS 143A.010, 143A.020 et seq.	4.5 percent of gross value. 12 cents per ton (clay production).	Tax of 4.5 percent of the gross value is imposed on every taxpayer engaged in the business of severing and/or processing minerals (including natural gas and natural gas liquids) in Kentucky with the exception of clay. Clay production is taxed at 12 cents per ton. A credit equal to the tax of 12 cents per ton is granted to those taxpayers who sever or process clay sold to and used as a component of landfill construction by an approved waste disposal facility within this state. Also, no tax is imposed on the processing of ball clay. This tax does not apply to fluorspar, lead, zinc, tar sands and barite severed for any purposes; or to rock, limestone, or gravel used for privately maintained but publicly dedicated roads; or limestone when sold or used by the taxpayer for agricultural purposes so as to qualify for exemption from sales and use tax. A credit equal to the tax is allowed on the gross value of limestone which is severed or processed within this state and sold to a purchaser outside this state. This credit is extended only to taxpayers who sever or process limestone through the rip-rap construction aggregate of agricultural limestone stages, and who sell in interstate commerce not less than 60 percent of such stone. The credit shall not be allowed to a taxpayer who processes the limestone beyond the agricultural limestone stages.
Oil Production Tax	KRS 137.120 et seq.	4.5 percent of market value of crude petroleum produced in Kentucky.	Tax on the production of crude petroleum is attached when the crude petroleum is first transported from the tanks or other receptacle located at the place of production. Transporter of crude petroleum, as agent, pays tax for all persons owning any interest in such oil.
Property Taxes:			
Agricultural Products			
In hands of producer or agent	KRS 132.020(1), 132.200(6)	1.5 cents (per $100 of assessment).	State rate only.
Tobacco not at manufacturer's plant (Storage)	KRS 132.020(1), 132.200(6)	1.5 cents (per $100 of assessment).	Also subject to county and city rates.
Other agricultural products not at manufacturer's plant (Storage)	KRS 132.020 (1),132.200(6)	1.5 cents (per $100 of assessment).	Also subject to county and city rates.
Annuities or Rights to Receive Income	KRS 132.215(2)	0.1 cent (per $100 of assessment).	State rate only.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Bank Deposits			
Domestic and Out-of-State	KRS 132.030(1)	0.1 cent (per $100 of assessment).	Tax is based on deposits as of January 1 and is paid by the institution on behalf of the depositors. State rate only.
Brokers' Accounts Receivable (Also see **Margin Accounts**)	KRS 132.050	10 cents (per $100 of assessment).	State rate only.
Car Lines (Private)	KRS 136.120(4), 136.180(3)	Subject to annual adjustment.	Subject to annual adjustment. Local tax collected and distributed by the Revenue Cabinet effective January 1, 1994.
Distilled Spirits	KRS 132.020(10)	5 cents (per $100 of assessment).	Subject to full local rates.
Farm Machinery Used in Farming	KRS 132.020(1), 132.200(1)	0.1 cent (per $100 of assessment).	State rate only.
Goods Held for Sale in the Regular Course of Business	KRS 132.020(10)	5 cents (per $100 of assessment).	Subject to local rates.
Intangibles			
Money in hand, notes, bonds, accounts and other credits, except those arising from out-of-state business, and other not specified elsewhere.	KRS 132.020(1), 136.120(1)	25 cents (per $100 of assessment).	State rate only.
Accounts receivable, notes, bonds, credits, nondomestic bank deposits and other intangibles arising from out-of-state business, patents and copyrights, and tobacco base allotments.	KRS 132.020(2), 132.120(2)	1.5 cents (per $100 of assessment).	State rate only.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Leasehold Interest (Owned by tax-exempt governmental unit)	KRS 132.020(1)	1.5 cents (per $100 of assessment).	State rate only.
Life Insurance Companies			
(Domestic)	KRS 136.320		
Capital		70 cents (per $100 of assessment).	Also subject to county and city rates.
Reserves		0.1 cent (per $100 of assessment).	State rate only.
Policy Proceeds on Deposit (Individual)	KRS 132.216	25 cents (per $100 of assessment).	State rate only.
Livestock and Poultry	KRS 132.020(1)	0.1 cent (per $100 of assessment).	State rate only.
Manufacturing Machinery	KRS 132.020(1), 132.200(4)	15 cents (per $100 of assessment).	State rate only.
Margin Accounts (See **Brokers' Accounts Receivable**)	KRS 132.060	25 cents (per $100 of assessment).	State rate only.
Mobile Homes (Real Property)	KRS 132.751	Subject to annual adjustment. Taxed at real estate rate.	Subject to full local rates.
Motor Vehicles	KRS 132.487	45 cents (per $100 of assessment).	Full local rates. Collected upon registration.
Pollution Control Facilities	KRS 132.020(1), 132.200(9)	15 cents (per $100 of assessment).	State rate only.
Public Warehouses			
Goods held for sale except goods in transit	KRS 132.020(10)	5 cents (per $100 of assessment).	Full local rates.
Goods in transit	KRS 132.095	0.1 cent (per $100 of assessment).	State rate only.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Radio, Television and Telephonic Equipment	KRS 132.020(1), 132.200(5)	15 cents (per $100 of assessment).	Full local rates.
Railroads (Intrastate)	KRS 132.020(11)	10 cents (per $100 of assessment both real and tangible).	Multiplier applied to local rates. Multiplier subject to annual adjustment.
Raw Materials and Products in Course of Manufacture	KRS 132.020(10), 132.200(4)	5 cents (per $100 of assessment).	State rate only.
Real Estate not Elsewhere Specified	KRS 132.020(1)	Adjusted annually (by July 1) per KRS 132.020(8); the state real estate rate for 1993 was 18.0 cents, for 1994 was 17.2 cents, for 1995 was 16.7 cents, for 1996 was 16.3 cents, and for 1997 was 15.7 cents.	Full local rates.
Recreational Vehicles	KRS 132.750, OAG 82-504	Classification depends on permanency of location. 45 cents (per $100 of assessment).	Subject to full local rates.
Recycling Machinery	KRS 132.020(1), 132.200(16)	45 cents (per $100 of assessment).	State rate only.
Retirement Plan or Profit-Sharing Plan Tax	KRS 132.043	0.1 cent (per $100 of assessment).	State rate only. Taxable to individual participant.
Savings and Loan Associations (Domestic) (Foreign included effective January 1, 1990)	KRS 136.300(1)	10 cents (per $100 of assessment).	State rate only.
Tangible Property not Elsewhere Specified	KRS 132.020(1)	45 cents (per $100 of assessment).	Full local rates.
Trucks, Tractors, Trailers, Semi-Trailers and Buses (Interstate)	KRS 136.183	Subject to annual adjustment.	Local tax collected and distributed by the Revenue Cabinet effective January 1, 1993.

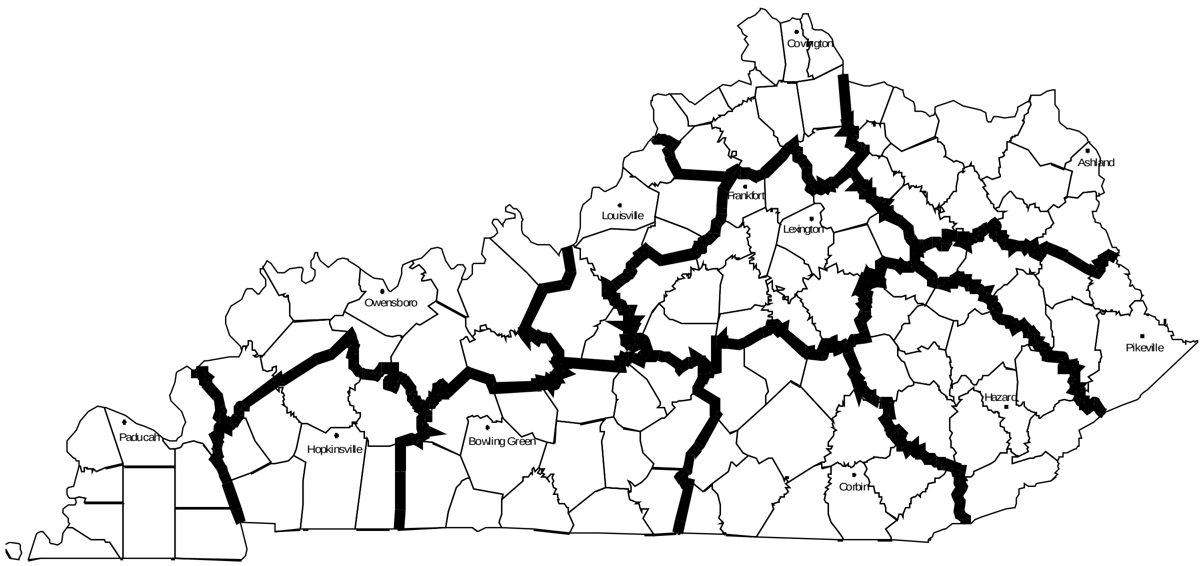
TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Unmined Coal	KRS 132.020(5)	Real estate rate: 18.0 cents for 1993, 17.2 cents for 1994, 16.7 cents for 1995, 16.3 cents for 1996, and 15.7 cents for 1997.	Full local rates.
Watercraft Commercial	KRS 136.181	45 cents (per $100 of assessment).	Full local rates.
Individual	KRS 132.020(1)	45 cents (per $100 of assessment).	Full local rates.
Public Service Commission Assessment	KRS 278.130 et seq.	Maximum assessment .... 2.0 mills Minimum assessment $50	Assessment imposed annually on utility companies under the jurisdiction of the Public Service Commission based on proportionate share of gross intrastate revenues by each company.
Public Service Company Property Taxes	KRS 136.115 et seq.	Property of public service corporations taxed at the same rate as property owned by any individual or corporation (see rates under **Property Taxes**).	Property of public service corporations taxed at the same rate as property owned by any individual or corporation (see rates under **Property Taxes**).
Racing Taxes: **(1) License Tax**	(1) KRS 137.170 et seq.	(1) Per day of races. **Average Daily Mutuel Handle (for preceding year)** — **Tax Rate Per Day** $ 0 — $ 25,000 — $ 0 25,001 — 250,000 — 175 250,001 — 450,000 — 500 450,001 — 700,000 — 1,000 700,001 — 800,000 — 1,500 800,001 — 900,000 — 2,000 900,001 and above — 2,500	(1) License tax imposed upon the operation of a track at which horse races are run under the jurisdiction of the Kentucky Racing Commission. Reported and paid within 30 days of end of each race meeting. An annual recapitulation report is due on or before December 31 each year for the race year ended November 30.
(2) Admission Tax	(2) KRS 138.480 et seq., 139.100(2)(c)	(2) Tracks under jurisdiction of the Kentucky Racing Commission .... 15 cents/person	(2) Excise tax on each paid admission to race track. There are statutory exemptions. Reported and paid within 30 days of end of each race meeting.

TAXES ADMINISTERED BY THE REVENUE CABINET (In Effect as of June 30, 1998)

TAX	LEGAL REFERENCE	STATE RATE	DESCRIPTION
Racing Taxes: (continued) **(3) Pari-Mutuel Tax**	(3) KRS 138.510 et seq.	(3) 3.5 percent of total wagered at all thoroughbred tracks under Kentucky Racing Commission jurisdiction with average daily handle of $1.2 million or more; 1.5 percent if average daily handle is less than $1.2 million. 3.75 percent of total wagered at all standardbred tracks under Kentucky Racing Commission jurisdiction with average daily handle of $1.2 million or more; 1.75 percent if average daily handle is less than $1.2 million. 3 percent of telephone account wagering and the total wagered at "receiving" tracks.	(3) Excise tax is imposed on every person, corporation or association which operates a horse race track at which betting is conducted. Excise tax is also imposed on receiving tracks participating in intertrack wagering on simulcast races. Average daily handle is computed from the amount wagered at the **host** track, excluding money wagered at receiving tracks and all **telephone account** wagering. A portion of the pari-mutuel tax is allocated to the following: • Equine Drug Research • Equine Industry Program • Higher Education Equine Trust and Revolving Fund • Thoroughbred Development Fund • Standardbred, Quarterhorse, Appaloosa and Arabian Development Fund Reported and paid weekly.
Rural Cooperative Annual Tax	KRS 279.200, 279.530	$10.	Annual payment by corporations (RECCs and RTCCs) formed under KRS Chapter 279 in lieu of certain taxes.
Sales and Use Taxes	KRS 139.010 et seq.	Sales tax .... 6 percent Use tax .... 6 percent	Sales tax is imposed on the retailer for the privilege of making retail sales of tangible personal property or taxable services within Kentucky. Use tax is imposed on the use, storage or other consumption in the state of tangible personal property purchased for use, storage or other consumption in this state. There are statutory exemptions.
Waste Tire Fee	KRS 224.2613	$1 per tire sold at retail.	Applies to the retail sale of new motor vehicle tires sold in Kentucky. Does not apply to new cars brought into the state for sale or use. Sales of recapped tires are exempt from the fee. Retailers may apply to the Natural Resources and Environmental Protection Cabinet for exemption. All retailers must report volume of waste tires disposed even if exempt from fee.
Withholding (Individual Income Tax)	KRS 141.010 et seq.	Deduction from salaries or wages based upon formula or tax tables.	Employers are required to withhold individual income tax from payment of wages or salaries each pay period. Withholding tables and formulas are provided for common pay periods.

KENTUCKY TAXPAYER SERVICE CENTERS



• **Taxpayer Service Center**

District Boundary

Ashland, 41105-0687
P.O. Box 687
134 Sixteenth Street
Telephone: (606) 920-2037
Fax: (606) 920-2039

Bowling Green, 42102-2040
P.O. Box 2040
1502 Westen Street
Telephone: (502) 746-7470
Fax: (502) 746-7847

Corbin, 40702-3298
P.O. Box 1298
Falls Road Plaza, Suite 5
1707 18th Street
Telephone: (606) 528-3322
Fax: (606) 523-1972

Frankfort, 40620
200 Fair Oaks Lane, Second Floor
Individual Income Tax Branch
Telephone: (502) 564-4581
Fax: (502) 564-3685

Hazard, 41702-4194
P.O. Box 419
233 Birch Street
Telephone: (606) 435-6017
Fax: (606) 435-6018

Hopkinsville, 42241-0695
P.O. Box 695
105 Hammond Plaza
4011 Ft. Campbell Blvd.
Telephone: (502) 889-6521
Fax: (502) 889-6563

Lexington, 40507-1556
301 East Main Street
Suite 500
Telephone: (606) 246-2165
Fax: (606) 246-2164

Louisville, 40202-2446
620 South Third Street
Suite 102
Telephone: (502) 595-4512
Fax: (502) 595-4205

Northern Kentucky, 41042-1385
Turfway Ridge Office Park
7310 Turfway Rd., Suite 190
Florence
Telephone: (606) 371-9049
Fax: (606) 371-9154

Owensboro, 42302-0128
P.O. Box 128
401 Frederica Street
Building C, Suite 201
Telephone: (502) 687-7301
Fax: (502) 687-7244

Paducah, 42002-2336
P.O. Box 2336
555 Jefferson Street, Suites 302/306
Telephone: (502) 575-7148
Fax: (502) 575-7027

Pikeville, 41501-2913
5333 North Mayo Trail
Telephone: (606) 433-7675
Fax: (606) 433-7679