COST FALL 2014
Kentucky State and Local Tax Developments

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I. INCOME/FRANCHISE TAXES

A. Legislative Developments

The Kentucky General Assembly adjourned its Regular Session *sine die* April 15, 2014. As a result, there have been no developments since the Spring Update.

B. Judicial Developments

1. *Department of Revenue v. AT&T Corporation*, Kentucky Court of Appeals, No. 2008-CA-001888-MR (July 3, 2014) (not to be published), *motion for discretionary review filed*, Kentucky Supreme Court, No. 2014-SC-430-D (August 1, 2014) (Pending).

In this case, the Kentucky Court of Appeals affirmed the judgment of the trial court holding the Department of Revenue's ("DOR" or "Department") denial of the taxpayer's refund claim was not supported by statute. While the decision will have limited applicability due to the changes in Kentucky's statutes since the periods in question, it is still good to see a taxpayer victory when a refund claim was at issue.

Today's version of KRS § 141.200, Kentucky's consolidated filing statute, requires a corporation have *nexus* with Kentucky before the corporation may be included in a consolidated group. The version of KRS § 141.200 at issue was for tax years 1995, 1996 and 1997 required corporations electing to file a consolidated return to use their federal consolidated affiliated group. This meant a corporation did *not* have to have nexus with Kentucky to be included in the consolidated group.

Initially, AT&T filed its corporation income tax returns using the federal consolidated group. Later, the corporation amended its returns to include only those corporations with nexus in Kentucky. The court refers to the non-nexus companies as the "non-Kentucky subsidiaries". The amended returns reflected an overpayment by AT&T of approximately $5.7M.

The version of KRS § 141.200 in effect during the tax periods at issue stated, in pertinent part:

> (1) As used in this section, unless the context requires otherwise:
>
> (a) "Affiliated group" means affiliated group as defined in Section 1504(a)[1] of the Internal Revenue Code and related regulations;
>
> (b) "Consolidated return" means a Kentucky corporation income tax return filed by members of an affiliated group in accordance with this section. The determinations and computations required by this chapter shall be made in accordance with the provisions of Section 1502 of the Internal Revenue Code and related regulations, except as required by differences between this chapter and the Internal Revenue Code, Corporations exempt from taxation under KRS § 141.040 shall not be included in the return;
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> (2) Every corporation doing business in this state, except those exempt from taxation under KRS § 141.040, shall, for each taxable year, file a separate return unless the corporation was, for any part of the taxable year, a member of an affiliated group electing to file a consolidated return in accordance with subsection (3) of this section.
>
> (3)(a) An affiliated group, whether or not filing a federal consolidated return, may elect to file a consolidated return which includes all members of the affiliated group.
>
> (b) An affiliated group electing to file a consolidated return under paragraph (a) of this subsection shall be treated for all purposes as a single corporation under the provisions of this chapter. All transactions between corporations included in the consolidated return shall be eliminated in computing net income in accordance with KRS § 141.010(13), and in determining the property, payroll, and sales factors in accordance with Section 1 of this Act.
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> (e) For each taxable year for which an affiliated group has made an election in accordance with paragraph (a) of this subsection, the consolidated return shall include all corporations which are members of the affiliated group.

Subsections (1)(b), (2) and (3)(e) each reference KRS § 141.040. Subsection (1) of KRS § 141.040 was Kentucky's corporation income tax nexus statute during the periods at issue. In relevant part, the statute provided:

> (1) Every corporation organized under the laws of this state, every corporation having its commercial domicile . . . in this state, and every foreign

> corporation owning or leasing property located in this state or having one (1) or more individuals receiving compensation . . . in this state, except those corporations listed in paragraphs (a) to (i) of this subsection, shall pay for each taxable year a tax to be computed by the taxpayer on taxable net income at the rates specified in subsections (2), (3), and (4) of this section: ….

As KRS § 141.040(1) provides, Kentucky's nexus standard at the time was "physical presence".

The Court avoided the obvious constitutional question by solely relying on rules of statutory construction, specifically on the rule, "Taxing laws should be plain and precise, for they impose a burden on the people." The Court found KRS § 141.200 ambiguous because Sections (3)(a)(b) and (e) stated *all* members of the affiliated group had to be included in the return, but KRS § 141.040(1) stated corporations had to own or lease property or pay compensation in the state before being subject to income tax.

AT&T's non-Kentucky subsidiaries did not own or lease property in Kentucky or pay compensation here. The Court concluded, "Therefore, [the non-Kentucky subsidiaries] cannot be taxed. … We are required to resolve ambiguities in taxing statutes in favor of the taxpayer. By doing so in this case, we find persuasive AT&Ts argument that only the Kentucky subsidiaries are to be included on the consolidated return …."

The Department filed a motion for discretionary review at the Kentucky Supreme Court. The Department's motion is pending.

2. *World Acceptance Corporation, et al. v. Commonwealth of Kentucky, Finance & Administration Cabinet, Department of Revenue*, Kentucky Board of Tax Appeals, File No. K13-R-18, Order No. K-24682 (August 29, 2014), appealed to Franklin Circuit Court, Civil Action No. 2014-CI-1193 (September 29, 2014) (Pending).

World Acceptance Corporation ("WAC") and its wholly-owned subsidiary, World Finance Corporation of Kentucky ("WFCKY") (collectively "Taxpayers") appealed the Department's denial of its income tax refund claims for tax years 2007 through 2010. The issue presented to the Board was whether WAC and WFCKY are required by Kentucky law to file consolidated Kentucky corporation income tax returns for the relevant periods. Kentucky requires a "common parent corporation doing business in this state" to file a consolidated tax return if the parent owns more than 80% in stock and value of the subsidiary. KRS § 141.200(10).

The Department acknowledged the parent company met the 80% requirement and had nexus in Kentucky. WAC had an employee working in the Commonwealth 30-60 days per year and WFCKY paid a management fee to WAC. The controversy emanates from the fact that the Department provided a letter ruling stating the Taxpayers should file consolidated returns, but after the returns were filed reflecting significant refund claims, the Department changed its position.

The Department claims the parent, WAC, must, but does not, meet the definition of "includible corporation" because WAC was a corporation realizing a net operating loss whose property, payroll and sales factors were de minimis. KRS § 141.200(9)(e)(7). Such corporations are excluded from the definition of "includible corporation" and therefore, cannot file a consolidated return. The Taxpayers argue the definition of "includible corporation" applicable to a "common parent corporation" is set forth at KRS § 141.200(9)(b), and, even if the Department was correct that KRS § 141.200((9)(e)(7) is applicable, WAC's apportionment factors were not *de minimis* (per the Department's own letter ruling).

The Kentucky Board of Tax Appeals ("KBTA" or "Board") rejected the arguments of the Taxpayers and affirmed the conclusions of the Department that whether WAC was an includible corporation was controlled by KRS § 141.200(9)(e) and not (9)(b) and that WAC was not an includible corporation because its apportionment factors were de minimis.

Perhaps more importantly, however, the Board found that the Department was not bound by the letter ruling provided to WAC. The Board stated that WAC's letter ruling request did not provide information that WAC's management services were provided out-of-state and that WAC's Kentucky employee also worked in other states. The Board found that those facts were material and changed the sourcing of the payroll and sales factors, and had the Department known those facts it would have reached a different conclusion.

Therefore, the Board upheld the final ruling of the Department and denied the inclusion of WAC in the consolidated return. The Taxpayers have appealed to the Franklin Circuit Court. A briefing schedule will be entered into shortly.

C. Administrative Developments

1. Occupational License Taxes: Opinion of the Attorney General, No. 14-002 (June 13, 2014).

The La Grange City Council passed an ordinance which required any attorney or law firm engaged in the practice of law within the city limits of La Grange to make an application for a business license. The ordinance was being enforced against attorneys from areas outside the city who had little or no contact with the city. The Kentucky Bar Association requested an opinion as to whether the license fee is generally appropriate and to what extent it may be enforced against attorneys with only limited contacts with the city of La Grange.

Citing *Elliot v. City of Louisville*, 40 S.W. 690 (Ky. 1897) and *Baker v. City of Lexington*, 53 S.W. 16 (Ky. 1899), the Attorney General opined that the city may require a license to practice law. However, citing *Evers v. City of Mayfield*, 85 S.W. 697, (Ky. 1905); *Yantis v. City of Lexington*, 94 S.W. 653 (Ky. 1906); *Dreidel v. City of Louisville*, 105 S.W.2d 807 (Ky. 1937); and *Newlin v. Stuart*, 117 S.W.2d 608 (Ky. 1938), the Attorney General stated such a license fee may only be imposed against "resident" attorneys. The license fee may not be imposed on people who come to the city under specific employment to attend to a special matter.

The Attorney General next considered the amount of business that would warrant imposition of the license fee. The opinion states that "isolated or infrequent business in a community is not a sufficient basis to impose a license fee" but "continuous and regular business likely would be subject to a license fee."

2. New Markets Development Program Regulations.

The General Assembly in 2014 H.B. 445 amended the New Markets Development Program ("NMDP") for taxable years beginning on or after January 1, 2014. DOR has issued an emergency rule, 103 KAR 15:180E, in order to conform to the amendments and to provide community development entities with the forms and procedures necessary to apply for and administer the NMDP tax credits. Very few changes were made to the existing regulation 103 KAR 15:180, with the majority being non-substantive.

The regulation now specifies that in applying for the NMDP, an applicant must also pay a refundable performance fee. The performance fee is equal to one-half of one percent (0.5%) of the amount of the equity investment or long-term debt security requested to be certified as a qualified equity investment. The performance fee may not exceed five hundred thousand dollars ($500,000).

The regulation further incorporates by reference updated forms for the application and administration of the NMDP. The following Revenue Forms have been updated by the Department effective May 2014:

- Revenue Form 41A720-S80, Application for Certification of Qualified Equity Investments Eligible for Kentucky New Markets Development Program Tax Credit

- Revenue Form 41A720-S81, Notice of Kentucky New Markets Development Program Tax Credit and Certification

- Revenue Form 41A720-S82, Notice of Kentucky New Markets Development Program Tax Credit Recapture

The emergency regulation became effective June 5, 2014. A permanent regulation is pending.

II. TRANSACTIONAL/GROSS RECEIPTS TAXES

A. Legislative Developments

The Kentucky General Assembly adjourned its Regular Session *sine die* April 15, 2014. As a result, there have been no developments since the Spring Update.

B. Judicial Developments

1. *Warren Rural Electric Cooperative Corporation v. Finance and Administration Cabinet, Department of Revenue*, KBTA File No. K13-R-34 (Pending).

At issue in this case is whether Warren Rural Electric Cooperative's ("Warren RECC") purchases of computer software and optional computer service and maintenance charges are excluded from Kentucky sales and use tax because they constitute "custom" software, or are subject to tax because they are "prewritten" software within the meaning of Kentucky law.

Under Kentucky law, sales tax is imposed on gross receipts derived from retail sales of tangible personal property, regardless of the method of delivery, and certain enumerated services, which specifically does not include custom software. Tangible personal property is defined under Kentucky law as including prewritten software. Further, under KRS § 139.010(22), computer software "designed and developed by the author or other creator to the specifications of a specific purchaser" is not subject to sales tax, and modifications or enhancements to prewritten software will not be subject to sales tax where there is a separately stated charge for the modification or enhancement.

Warren RECC, a non-profit rural electric cooperative, purchased financial and accounting computer software uniquely designed for and individualized to the company. The Department originally agreed in writing that Warren RECC's software and maintenance charges were not subject to sales and use tax and would be removed from the audit based on the Department's determinations in a protest filed by Cumberland Valley Electric, Inc. However, the Department reversed its position, and determined that Warren RECC's software and related charges were taxable.

On appeal to the Board, Warren RECC is arguing that the computer software is custom software not subject to sales and use tax since it was designed specifically for Warren RECC. Additionally, Warren RECC is also arguing that modifications or enhancements to the software are not taxable because the charges were separately stated on the invoices. Warren RECC is also arguing that because the case involves a question of whether the software and charges are subject to tax, and does not involve a question of exemption from tax, any doubts or ambiguities as to the meaning of the applicable statutes must be resolved in the taxpayer's favor. Further, Warren RECC argues that the Department has had a longstanding administrative position of not subjecting custom software to sales tax, so the assessment violates the doctrine of contemporaneous construction. Finally, Warren RECC is contending the optional computer service and maintenance agreements are not subject to sales and use tax based on published guidance issued by the Department.

The Department argues that the software is not custom software because it is marketed to many rural electric cooperatives, and is not sold exclusively to Warren RECC. It also argues that the service and maintenance fees are included within the definition of prewritten software and constitute a "bundled transaction" under KRS § 139.215(3), which provides: "Bundled transaction means the retail sale of two (2) or more products, except real property and services to

real property where: 1. The products are otherwise distinct and identifiable; and 2. The products are sold for one (1) nonitemized price."

The parties are currently in discovery and the case has been scheduled for an evidentiary hearing before the Board on May 26, 2015.

The authors' firm represents Warren RECC in this case.

2. *Sprint Communications Company v. Department of Revenue*, KBTA File No. K13-R-03 (May 22, 2014) (Final).

In this action, the Board found the sale for resale of switch access services in 2005 subject to sales and use tax. In general, "switch access" is the provision of telecommunications service by a local exchange carrier to a third party for resale. Telecommunication carriers maintained that the sale of switch access service should be excluded from sales tax as a sale for resale. In 2005, Sprint Communications Co., LP ("Sprint") sold switch access services to third parties for resale to their customers and accepted completed resale certificates.

Kentucky has a long history of sales taxation of telecommunications services. In the mid- to late-1990's a dispute arose as to the authority of the Department to assess sales and use tax on the sale of switch access services. During the time of the dispute, the Department did not require payment of sales tax on the sales. But, in 2000, effective January 1, 2001, the General Assembly amended Kentucky's sales tax statutes to broaden the types of communications services subject to tax. Accordingly, the Department promulgated an emergency regulation that later became 103 KAR § 28:140. The regulation stated that beginning January 1, 2001, switch access services would be subject to tax; that is, the sales would not be exempt as being for resale. Pursuant to the regulation, the Department assessed Sprint sales tax for its sale of switch access services for 2005.

In 2005, the General Assembly again amended Kentucky's sales tax statutes, but this time the legislature expressly exempted sale for resale of switch access services from sales tax. The amendment was effective January 1, 2006. In protesting the Department's assessment Sprint claimed the 2005 legislation merely clarified existing law and, therefore, the intervening regulation should be disregarded because it was a change in the Department's pre-2001 position. Sprint maintained that prior to amendment, the statutes were ambiguous and the Department should be bound by its pre-2001 construction of the statutes. Sprint argued that the doctrine of contemporaneous construction should bind the Department to its prior interpretation of the statutes.

The Board ruled that Sprint's sales of switch access services were subject to tax because the Department's regulation was in effect at that time and clearly and unambiguously stated that access services were taxable. The Board held that even assuming that the Department did change its position when it promulgated the regulation, the doctrine of contemporaneous construction would not prohibit such a change going forward. Relying on *Revenue Cabinet v. Lazarus, Inc.*, 49 S.W.3d 172 (Ky. 2001), the Board stated that contemporaneous construction cannot be founded upon an administrative agency's failure to correctly apply the law; an agency

is always free to correct a misapplication of the law. Therefore, the Board stated that such a change was permissible so long as the regulation was in conformity with the statutes.

Sprint did not argue that the statutes in 2005 did not support Department's position set forth in the regulation. The Board stated that without evidence that that the Department improperly added to or detracted from the statutes, the Board was bound by the clear and plain meaning of the regulation. Consequently, the Board found the regulation was controlling and the taxpayer's access services sold in 2005 were subject to sales tax.

Sprint argued that, even if the sales were subject to tax, Sprint accepted resale certificates in good faith and therefore should not be liable for the tax. The Board held that no taxpayer could accept a resale certificate in good faith after the issuance of the unambiguous regulation. Therefore, the acceptance of the resale certificates did not shield Sprint from sales tax liability. The Department's assessment and final ruling was upheld. Subsequently, this case was settled.

3. *Sam's East, Inc. v. Department of Revenue*, KBTA Case No. K13-R-21 and *Wal-Mart East v. Department of Revenue*, KBTA Case No. K13-R-20, Order No. K-24665 (June 27, 2014), appealed to Franklin Circuit Court, Civil Action No. 14-CI-00870 (Pending).

In these cases, the Board addressed the constitutionality of budget bill provisions relating to taxation. Prior to attempts to amend the statute, KRS § 139.570 provided a vendor who collects sales tax for Kentucky may retain 1.5% of the first $1,000 collected and 1% of the amount in excess of $1,000 per month. The Legislature in the 2003, 2005 and 2006 Budget Bills attempted to impose a limit of $1,500 per month on the amount of vendor compensation notwithstanding KRS § 139.570. In 2009, the Legislature repealed and reenacted KRS § 139.570 to include the $1,500 compensation limit and stated the limit was retroactive to July 1, 2003. For the periods of July 1, 2003 – June 30, 2004 and July 1, 2005 – June 30, 2008, Wal-Mart and Sam's remitted the sales tax collected and withheld $1,500 as vendor compensation.

In September 2008, Wal-Mart and Sam's submitted refund claims to the Department for vendor compensation owed to them over the $1,500 limit. The taxpayers argued that the inclusion of the compensation limit in the budget bills violated § 51 of the Kentucky Constitution for three reasons. First, the taxpayers argued that the inclusion of the limit violated the "single subject" requirement of § 51 because with the inclusion, the bill addressed both appropriation and taxation. Second, the taxpayers argued § 51 was violated because the subjects of the budget bills failed to reflect the inclusion of tax items. Third, the taxpayers argued that § 51 was violated because KRS § 139.570 was not reenacted in its entirety when amended. Alternatively, the taxpayers argued the vendor compensation limits expired along with the budget bills and the the limits are no longer in effect.

The Department denied the refund request ruling the refund claims were barred by the two year statute of limitations in KRS § 134.590. The taxpayers appealed to the Board.

In their appeal, the taxpayers reasserted their arguments relating to Ky. Const. § 51 and also asserted the 2009 amendment to KRS § 139.570 was unconstitutional. Specifically, the

taxpayers argued that the 2009 amendment unconstitutionally repurposed sales tax proceeds in contravention of Ky. Const. § 180. The taxpayers asserted the funds had been collected with the purpose of paying vendor compensation but the 2009 amendment repurposed those funds for the General Fund.

Additionally, the taxpayers argued the Department improperly applied the two year statute of limitations in KRS § 134.590 rather than the four year period in KRS § 134.580. The taxpayer maintains KRS § 134.590 was applicable only if the refund sought for taxes paid under a validly enacted statute subsequently is determined to be unconstitutional. The taxpayers did not assert KRS § 139.570 was unconstitutional but that the budget bills and the attempted amendment of the statute were unconstitutional. Because the taxpayers did not claim KRS § 139.570 was unconstitutional, the taxpayers argued the four year limitation period of KRS § 134.580 applied.

These cases were consolidated and the Board issued an Order on June 27, 2014. In its Order the Board ruled that the challenge to the amendments to KRS § 139.570 and the question of which refund statute to apply were facial challenges over which the Board did not have jurisdiction. As a result, the Board denied the taxpayers' motion for summary disposition and upheld the final rulings of the Department denying the taxpayers' refund claims.

The taxpayers appealed the Board's Order to the Franklin Circuit Court. Briefing is in progress.

4. *Ohio Valley Aluminum Company, LLC v. Department of Revenue*, Kentucky Court of Appeals, 2013-CA-000507 (September 12, 2014).

This case addresses the doctrine of substance over form and the use of "tolling agreements" for purposes of the partial exemption from sales tax of energy and energy-producing fuels used in manufacturing.

Kentucky's sales and use taxes are levied at 6% of gross receipts derived from furnishing utility services (communications services, electric power, water, and natural, artificial, and mixed gas). Kentucky's school districts are authorized to levy up to a 3% utility gross receipts license tax ("UGRLT") on the gross receipts from the provision of the same services. Most rural Kentucky school districts levy this tax at the full 3% rate.

Kentucky's statutory scheme provides for an exemption from sales and use taxes and the UGRLT on energy or energy-producing fuels used in the course of manufacturing, processing, mining, or refining to the extent that the cost of energy or energy-producing fuels exceeds three percent of the cost of production. Taxpayers are required to submit an application for an energy direct pay authorization ("EDPA") to the Department. If granted, taxpayers then pay an estimated tax each month directly to the DOR, rather than to their energy provider. In the application, the taxpayer provides its costs of production and costs related to energy and energy-producing fuels based upon costs incurred in the last completed fiscal or calendar year. *See* 103 KAR 30:140.

The DOR denied the application of Ohio Valley Aluminum Company, LLC ("Ohio Valley") for an EDPA, and denied the company's related refund claims for overpayments of UGRLT and sales and use taxes. The DOR based its denial on Ohio Valley's failure to include in its cost of production the cost of raw or scrap aluminum.

Ohio Valley argued it was not required to include the cost of the raw aluminum in its cost of production because those materials were owned by its wholly-owned subsidiary, OVACO, and Ohio Valley was merely acting as a "tolling facility" pursuant to a tolling agreement with OVACO. Ohio Valley argued further that the DOR's auditor training manuals recognized such "tolling agreements". The toller is not required to include the cost of raw materials in its cost of production calculations.

The evidence indicated that Ohio Valley and OVACO had entered into a tolling agreement where OVACO owned the raw aluminum and Ohio Valley processed the aluminum into billets for a fee. The DOR argued that the relationship in operations between Ohio Valley and OVACO were not "separate and distinct" as required by the applicable case law in order for the cost of the aluminum to be separated from the rest of Ohio Valley's cost and allocated to OVACO.

The Board affirmed the decision of the Department agreeing that Ohio Valley's aluminum casting operation was not "separate and distinct" from OVACO, which existed on paper only and had no employees. The Board determined that Ohio Valley was engaged in only one operation at its plant (where it melted raw and scrap aluminum and cast it into billets), and that it was dependent on OVACO for the raw and scrap aluminum which it used. Consequently, the Board determined that Ohio Valley had only one plant facility under applicable law and that all costs associated with the production of the aluminum billets should be included in "cost of production" for purposes of the energy exemptions from both the sales and use taxes and UGRLT.[1]

The Board's decision was appealed to Shelby Circuit Court, Civil Action No. 12-CI-00368. On February 21, 2013, the circuit court affirmed the decision of the Board. The court held the Board's decision was supported by substantial evidence and applicable law. The Court of Appeals affirmed the circuit court's decision agreeing that Ohio Valley's aluminum casting operation was not "separate and distinct" from OVACO, which existed on paper only and had no employees.

The Court determined that Ohio Valley was engaged in only one operation at its plant (where it melted raw and scrap aluminum and cast it into billets), and that it was dependent on OVACO for the raw and scrap aluminum which it used. Consequently, the Court determined that Ohio Valley had only one plant facility under applicable law and that all costs associated with the production of the aluminum billets should be included in "cost of production" for purposes of the energy exemptions from both the sales and use taxes and UGRLT.

The Court further applied the "substance over form" doctrine to the case. The Court found the doctrine was applicable in the case of the sales tax and UGRLT. The Court found that

[1] File Nos. K-10-R-35 and K-10-R-36, Order No. K-22086 (May 22, 2012).

the substance of the relationship between OVACO and Ohio Valley evidenced a single entity, rather than two distinct entities. The Court specifically noted that the entities shared a single bank account and employees and that Ohio Valley was the sole member of OVACO.

A motion for discretionary review to the Kentucky Supreme Court is anticipated.

5. *Interstate Gas Supply, Inc. for use and benefit of Tri-State Healthcare Laundry, Inc. v. Department of Revenue, Finance and Administration Cabinet*, Franklin Circuit Court, Civil Action No. 12-CI-00947 (September 13, 2013), appealed to Kentucky Court of Appeals, Case No. 2013-CA-001766 (Pending).

The Franklin Circuit Court's holding in this case, as with the decision of the Board, further limits the tax exemptions granted by the Kentucky Constitution. Interstate Gas Supply, Inc. ("IGS"), an Ohio natural gas marketer, sought refunds of use tax collected and paid on sales of natural gas by IGS to Tri-State Healthcare Laundry, Inc. ("Tri-State"). Tri-State is a joint-cooperative laundry association owned by several non-profit charitable hospitals in Northern Kentucky. Tri-State provides centralized laundry services to those hospitals, and Tri-State purchases natural gas from IGS for use in its laundry services. IGS collected use tax on its natural gas sales to Tri-State and remitted the tax to Kentucky.

On October 20, 2009, IGS—on behalf of Tri-State—claimed a refund for all use tax paid on Tri-State's natural gas purchases. IGS claimed that Tri-State is exempt from use tax pursuant to § 170 of the Kentucky Constitution. Section 170 exempts from taxation institutions of purely public charity and states, in relevant part:

> There shall be exempt from taxation public property used for public purposes; places of burial not held for private or corporate profit; real property owned and occupied by, and personal property both tangible and intangible owned by, institutions of religion; institutions of purely public charity . . .

Ky. Const. § 170.

Tri-State has previously been determined by the Department to be an institution of "purely public charity." Nevertheless, the DOR denied IGS's refund request, claiming that § 170 only extends to property taxes and that the use tax is not a property tax. The DOR relied heavily upon *Children's Psychiatric Hospital of Northern Kentucky v. Revenue Cabinet*, 989 S.W.2d 583 (Ky. 1999) ("*Children's Psych.*"), as the basis for its decision. In *Children's Psych.*, the Supreme Court of Kentucky held that the § 170 exemption does not extend to the Kentucky healthcare provider tax. The DOR claimed that the court's ruling in *Children's Psych.* limited all exemptions in § 170 to property taxes.

IGS appealed the DOR's ruling to the Board. IGS argued that the § 170 exemption for purely public charities is *not* limited to *ad valorem* property taxes and instead extends to all revenue raising taxes. IGS relied upon a long line of cases dating back to 1896 holding that, unlike the other exemptions in § 170, the charitable exemption exempts the institution as a whole

from taxation and is not limited to property taxes. Three cases cited by IGS specifically recognized an exemption from sales and use taxes for purely public charities. IGS further argued that *Children's Psych.* was limited to the healthcare provider tax. Finally, IGS claimed that even if § 170 were limited to property taxes, the incidence of the use tax was so similar to a property tax that it was encompassed within the exemption language.

The Board found that *Children's Psych.* was not limited to the provider tax and instead applied to all Kentucky taxes, implicitly overruling any precedent to the contrary. The Board specifically found that because the use tax is not levied on a percentage or rate of the value of the property on a regular basis, the use tax is not an *ad valorem* property tax and thus is not within the § 170 charitable exemption. Thus, the Board found that IGS was not entitled to a refund on behalf of Tri-State.

IGS appealed the decision of the Board to the Franklin Circuit Court. The court affirmed, concluding that § 170 of the Kentucky Constitution only exempts institutions of purely public charity from the payment of property taxes. The court relied upon *Children's Psych.* as the basis for its decision, finding it to be the most recent case interpreting the § 170 charitable exemption. The court found that *Children's Psych.* "specifically held that the exemption only extended to property or ad valorem taxes," and since the use tax is not a property tax, the exemption did not apply. Therefore, the court found that Tri-State was not entitled to a refund on the use tax paid on its purchases of natural gas from IGS.

IGS appealed to the Court of Appeals, case number 2013-CA-001766 where oral argument will be held on October 13, 2014.

The authors' firm represents IGS/TSHL in the action.

6. *Progress Metal Reclamation Company v. Commonwealth of Kentucky, Finance & Administration Cabinet, Department of Revenue*, Franklin Circuit Court, Civil Action No. 12-CI-00637 (September 23, 2013), Kentucky Court of Appeals, Case Nos. 2013-CA-1765 and 2013-CA-1776 (consolidated) (Pending).

This case addresses the tension in Kentucky law between the allowance of a sales and use tax manufacturing exemption for "industrial tools" and the exclusion of "repair, replacement, or spare parts" from the scope of the exemption. The tension arises from the language of the applicable statutes. During the period at issue, KRS § 139.470(11)(a)2.c. allowed an exemption for industrial tools provided they are "directly used in manufacturing or industrial processing" and have a "useful life of less than one (1) year." The statute offers the following description of items that qualify for the exemption:

> This group is limited to hand tools such as jigs, dies, drills, cutters, rolls, reamers, chucks, saws, spray guns, etc., and to tools attached to a machine such as molds, grinding balls, grinding wheels, dies, bits, cutting blades, etc. Normally, for industrial tools to be

> considered directly used in manufacturing, they shall come into direct contact with the product being manufactured.

The application of the exemption is complicated by the fact that KRS § 139.470(11)(b) excludes repair, replacement, or spare parts from the scope of the exemption. The term "repair, replacement, or spare parts" is defined by KRS § 139.010(26) (previously KRS § 139.170(4)) to mean "any tangible personal property used to maintain, restore, mend, or repair machinery or equipment." Controversies frequently arise as a result of the exclusion of repair, replacement, or spare parts and the requirement in the exemption that industrial tools have a useful life of less than one year.

Progress Metal Reclamation Company ("Progress Metal") claims hammer pins used in its business of recycling and manufacturing scrap metal for steel mills are exempt as industrial tools and claims liquid oxygen it uses in its cutting torch is exempt as an industrial supply. The Department issued a final ruling holding the hammer pins were not industrial tools and thus, were subject to sales and use tax. The Department also determined liquid oxygen used by Progress Metal in its cutting torches was an energy producing fuel and not exempt as an industrial supply.

Progress Metal appealed the Department's determinations to the Board wherein the testimony established the hammer pins hold hammers in place on rotors that break up metal. Progress Metal argued the hammer pins qualify for the exemption from tax because they function as chucks or tool holders since they hold hammers in place and give them the force necessary to shred metal. Further, Progress Metal argued the hammer pins have a useful life of less than one year. The Department took the contrary position that the hammer pins did not qualify for the exemption because they were repair, replacement or spare parts. The Board agreed with the Department regarding the hammer pins and held they were not industrial tools but repair, replacement or spare parts that wear out within a few weeks.

Progress Metal also argued liquid oxygen used in an oxy-fuel torch cutting process to cut large pieces of metal into smaller pieces was exempt from tax as an industrial supply. KRS § 139.470(11)(a)2.b. defines this exemption to include "supplies such as lubricating and compounding oils, grease, machine waste, abrasives, chemicals, solvents, fluxes, anodes, filtering materials, fire brick, catalysts, dyes, refrigerants, explosives, etc." The company also argued the Department had previously exempted liquid oxygen from 1965 to 2004 but changed its position in 2004, despite no change in the law, thus violating the doctrine of contemporaneous construction. The Board noted the Department failed to address Progress Metal's argument regarding the doctrine of contemporaneous construction and the Department did not argue liquid oxygen was not an industrial supply. It therefore reversed the Department's final ruling as to the liquid oxygen and both parties appealed to the Franklin Circuit Court.

The court reviewed the administrative record, and indicated the Board's decision was based on substantial evidence of record and a reasonable interpretation of the law. The court first addressed the industrial supply exemption, and indicated in 1994 KRS § 139.470(11) was amended and the meaning of repair, replacement or spare parts as set forth in KRS § 139.170 (now KRS § 139.010(26)) was adopted. The court agreed with the Department that in amending

the statute, the legislature "intended to clearly distinguish between those materials and supplies intended to be used up in a manufacturing process and those parts which simply wear out." The court noted that since the testimony of record before the Board was that the hammer pins were part of the rotor assembly that held hammers in place, and they were replaced every two to four weeks, it was apparent the pins simply wore out. Further, the court noted KRS § 139.470(11)(a)2. provides as a general rule: "for hand tools to be considered directly used in manufacturing, they shall come into direct contact with the product being manufactured." The court then upheld the Board's determination that the evidence proved that although the hammer pins came into contact with metal on an incidental basis, the hammers actually broke up the metal.

The court also upheld the Board's determination that liquid oxygen qualified as an exempt industrial supply pursuant to KRS § 139.470(11)(a)2.b. The court noted the Board held the doctrine of contemporaneous construction applied so the liquid oxygen was an industrial supply as the Department had previously classified it for nearly 40 years. The court relied upon *Revenue Cabinet v. Lazarus, Inc.,* 49 S.W.3d 172, 174 (2001), which held:

> The doctrine of contemporaneous construction means that where an administrative agency has the responsibility of interpreting a statute that is in some manner ambiguous, the agency is restricted to any long-standing construction of the provisions of the statute it has made previously. Practical construction of an ambiguous law by administrative officers continued without interruption for a very long period is entitled to controlling weight.

The court agreed with the Board's reasoning, and concluded that under the doctrine of contemporaneous construction, the Department was restricted to its longstanding treatment of liquid oxygen as exempt from sales tax. Both the Department and Taxpayer filed appeals, which have been consolidated in the Court of Appeals. Briefing was completed mid-September, 2014.

7. *City of Florence v. Flanery*, Franklin Circuit Court, Civil Action Number 11-CI-1418 (June 5, 2013), appealed to Kentucky Court of Appeals, Case No. 2013-CA-001112 (Pending).

This case arises from the enactment in 2005 of certain taxes on providers or communications services and multichannel video programming ("MVP", *i.e.*, cable and satellite television) services. KRS § 136.600 et seq. provides for a 3% tax on the retail purchase of MVP services, a 2.4% tax on all revenues received by providers of such services and a 1.3% tax on all revenues received by providers of communications services (collectively, the "Telecommunications Tax"). With the enactment of the Telecommunications Tax, KRS § 136.660 prohibits local governments from collecting franchise fees such providers.

A number of Kentucky cities and the Kentucky League of Cities challenged the constitutionality of Kentucky's Telecommunications Tax in a declaratory judgment action styled *City of Florence, et al. v. Flanery, et al.*, Franklin Circuit Court, Civil Action Number 11-CI-1418. The cities claim that the Telecommunications Tax impairs their right to levy franchise

fees against providers of communications and MVP services in violation of Sections 163 and 164 of the Kentucky Constitution.

The Telecommunications Tax is set forth in KRS §§ 136.600-136.660. The tax is imposed on gross revenues derived from the furnishing of both communications and MVP services. The term "multichannel video programming" is defined by statute to include cable services, satellite broadcast and wireless cable services, and Internet protocol television. A non-exhaustive list of the services that fall within the definition of "communications service" includes local and long-distance telephone services, telegraph and teletypewriter services, prepaid and postpaid calling services, data transport services, ring tones, voice mail, and Voice over Internet Protocol.

The enactment of the Telecommunications Tax fundamentally altered the manner in which the services at issue are taxed at the state and local levels. Previously, political subdivisions like the cities that brought this challenge collected franchise fees directly from certain providers and received a portion of the public service company property taxes imposed by the State. The pre-existing law resulted in inequities and unfairness among providers and consumers however, because direct broadcast satellite providers did not pay state or local fees on their MVP services (*see* 47 U.S.C. §152). In addition, AT&T Kentucky, Inc. claimed it was not required to obtain local franchises or pay local franchise fees by virtue of being the successor to an entity granted a state-wide franchise in the late 1800s. The Telecommunications Tax allows local governments to require franchises but prohibits the collection of franchise fees. Instead, a portion of the funds generated through the Telecommunications Tax are disbursed by the State to the political subdivisions in lieu of locally collected franchise fees as "hold harmless" distributions. KRS § 136.660 also provides that any local government that nevertheless seeks to collect franchise fees is prohibited from receiving any distributions of Telecommunications Tax revenue and any provider paying such a fee is entitled to a credit against the Tax.

The cities are claiming these funds do not fully compensate them for their lost tax and franchise fee revenues and that political subdivisions have lost $41 million in revenues since the Telecommunications Tax became effective on January 1, 2006. The cities maintain that the Telecommunications Tax is unconstitutional because it deprives them of a right to levy franchise fees against the providers granted by Sections 163 and 164 of the Kentucky Constitution. Section 163 prohibits utilities from erecting infrastructure within a city or town "without the consent of the proper legislative bodies or boards of such city or town being first obtained." Section 164 prohibits municipalities from issuing franchises for periods longer than twenty years and requires franchises to be awarded to the highest and best bidder following a public solicitation. The cities and the Kentucky League of Cities filed their complaint on September 23, 2011. The defendants are Lori Flanery, in her official capacity as Secretary of the Finance and Administration Cabinet, and Thomas Miller, in his official capacity as Commissioner of the DOR. The Kentucky CATV Association, Inc., a trade association representing cable television providers, subsequently intervened as an additional defendant in the action.

The Franklin Circuit Court issued its opinion on June 5, 2013, granting the defendants judgment on the pleadings. The court found that the Telecommunications Tax "was enacted based on a promise that local governments would not be penalized for giving up the franchise

fees on cable television, but that legislative promise has not been fulfilled" because "[p]olitical subdivisions in fact only receive approximately 83% of the amount collected historically from franchise fees and ad valorem tax on franchise portions of telecommunications companies' operating property." The court held that despite this shortfall, the Telecommunications Tax and its prohibition on local franchise fees is a constitutionally permissible exercise of legislative authority.

The court held that Sections 163 and 164 of the Kentucky Constitution do not prohibit the General Assembly from exercising control over the levy and collection of franchise fees. The court rejected the plaintiffs' claim that these constitutional provisions grant exclusive franchising authority to cities, finding that the General Assembly retained significant power over franchising in municipalities including the right to exercise police power and the right to implement the control of rates and services of utilities. The court construed Sections 163 and 164 as vesting a municipality only with the "rights and power to control the *original occupation* of its rights-of-way." The court found that the Telecommunications Tax preserves the right of cities to require telecommunications companies to obtain a franchise and, in any event, the plaintiffs had already authorized the use of public property for telecommunications services. Further, the Telecommunications Tax was consistent with the remuneration requirements of Sections 163 and 164 because cities are compensated for the use of their rights-of-way through the tax's monthly "hold harmless" distributions.

The court found the General Assembly's enactment of the Telecommunications Tax to be a valid exercise of legislative authority under Section 181 of the Kentucky Constitution. The constitutional provision authorizes the legislature to delegate to local government the power to "provide for the payment of license fees on franchises." The court concluded that "license fees" as used in this provision "includes fees for the privileges associated with franchises." The court analogized the Legislature's enactment of the Telecommunications Tax to its control of utility rates through the Kentucky Public Service Commission, finding that the tax "which prescribes set rates, to be no different." The court concluded that the Telecommunications Tax was constitutional because it does interfere with a city's ability to grant a franchise "but only with [its] ability to directly impose a fee on the franchise." Noting that cities had not truly been "held harmless" by the enactment of the Telecommunications Tax, the court said that was a matter of budgetary policy and the appropriate remedy was through the legislative process and not the judicial process.

The plaintiffs have appealed the decision to the Kentucky Court of Appeals, and the case has been submitted for decision. A decision is expected at any time.

The authors' firm represents the Kentucky CATV Association, Inc. in this action.

8. *Netflix, Inc. v. Commonwealth of Kentucky, Finance & Administration Cabinet, Department of Revenue*, KBTA File Nos. K13-R-31 and K13-R-32 (Pending).

Netflix has filed two petitions of appeal at the Board. The first (K13-R-31) challenges the Department's denial of Netflix's refund claim of the gross revenues tax on multichannel

video programming and communications services, imposed pursuant to Kentucky Revised Statutes section 136.616 ("Gross Revenues Tax") and the excise tax on multichannel video programming services, imposed pursuant to section 136.604 ("Excise Tax") (collectively "Taxes"). The second (K13-R-32) challenges the Department's denial of Netflix's refund claim for utility gross receipts license tax ("UGRLT" or "school tax"). The disputes only apply to the streaming services of Netflix and not its DVD rental business. The issue in each case is whether the streaming service is subject to the gross revenues, excise or school tax.

Kentucky is attempting to impose three separate Taxes on the provision of "multichannel video programming service." First, Kentucky imposes, on the provider of the service, the Gross Revenues Tax at the rate of 2.4% of gross revenues. KRS § 136.616(2)(a). Second, it imposes, on the consumer of the service, the Excise Tax at the rate of 3% of the retail price. KRS § 136.604(1). Third, Kentucky imposes the UGRLT on the provider, which the provider may pass-through to the end user. KRS § 160.614. Netflix's maintains its streaming service is not a multichannel video programming service.

"Multichannel video programming service[s]" are defined by Kentucky's statute as "*programming provided by or generally considered comparable to programming provided by a television broadcast station* and shall include but not be limited to: (a) Cable service; (b) Satellite broadcast and wireless cable service; and (c) Internet protocol television provided through wireline facilities without regard to delivery technology . . . ." KRS § 136.602(8) (emphasis added). Federal statutes define "video programming" in the same terms, namely as "*programming provided by, or generally considered comparable to programming provided by, a television broadcast station*." 47 U.S.C. § 522(20) (emphasis added). The federal definition is used for the purposes of identifying entities subject to regulation by the Federal Communications Commission ("FCC"). 47 U.S.C. § 521.

Netflix maintains it meets neither the Kentucky nor federal definition related to video programming. The Department argues Netflix's streaming service is a digital product delivered electronically and thus, subject to the Taxes.

A hearing before the Board is scheduled for October 21, 2014.

The authors' firm is co-counsel for Netflix.

9. V*irgin Mobile USA, L.P. v. Commonwealth of Kentucky ex rel. Commercial Mobile Radio Service Emergency Telecommunications Board*, Kentucky Supreme Court, Case Nos. 2012-SC-621-D and 2012-SC-626-D (August 21, 2014), *pet. for rehearing filed* (September 10, 2014).

In this case, the Kentucky Court of Appeals held that Virgin Mobile USA, LP ("Virgin Mobile") was subject to the Commercial Mobile Radio Service ("CMRS") "service charge" imposed under KRS § 65.7629 prior to amendments in July 2006 specifically imposing the charge on prepaid wireless connections. The Court began by examining the background and history of KRS §§ 65.7621-65.7643, the CMRS Act, which was enacted in 1998 in response to a

mandate from the Federal Communications Commission requiring all emergency 911 systems to service wireless callers. Virgin Mobile was a reseller of wireless services over the Sprint Network during the periods at issue, 2002 through 2005. Its customers prepaid for their service and did not receive phone bills.

Virgin Mobile remitted the CMRS service charge to the Commercial Mobile Radio Service Emergency Telecommunications Board ("CMRS Board") from 2002 through 2005. However, rather than collecting the tax from its customers, Virgin Mobile remitted the tax from its general revenues. Virgin Mobile stopped remitting the tax in June 2005 and requested refunds of all prior payments after learning that several national tax reporting agencies had determined the service charge did not apply to prepaid wireless services. The CMRS Board refused to issue the refunds.

After the statutes were amended in July 2006 to clearly apply to prepaid wireless connections, Virgin Mobile began crediting its prior payments against the services charges. Virgin Mobile began remitting tax in November 2008 after exhausting its credit.

The CMRS Board filed suit against Virgin Mobile in Jefferson Circuit Court, which held for the CMRS Board, awarding it the service charges, as well as additional amounts, that Virgin Mobile did not remit between 2005 and 2007. The circuit court also awarded the CMRS Board post-judgment interest, but denied its request for prejudgment interest. The CMRS Board filed a motion requesting prejudgment interest and attorney's fees. The circuit court again denied the CMRS Board's request for prejudgment interest, but granted its request for attorney's fees.

The Court of Appeals first noted that the issues before it were disputed questions of law, so that it was not bound by the circuit court's decision, but would review the decision de novo. The Court indicated that Virgin Mobile raised three issues on appeal: (1) the lower court erred in holding that the CMRS service charge applied to it prior to the July 2006 amendments; (2) Virgin Mobile was entitled to a refund of amounts mistakenly paid or a credit for such amounts against post-July 2006 charges; and (3) the circuit court erred in requiring Virgin Mobile to pay the CMRS Board's attorney's fees. In response, the CMRS Board argued: (1) the circuit court correctly held that the statutes in effect prior to 2006 applied to prepaid wireless customers and providers; (2) Virgin Mobile was not entitled to a refund or credit for the taxes it had remitted; and (3) the circuit court correctly awarded the CMRS Board its attorney's fees pursuant to KRS § 65.7635(5).

Further, in its cross-appeal, the CMRS Board argued that it was entitled to prejudgment interest. The Court held that a plain reading of KRS § 65.7629 left no question but that the tax applied to CMRS providers, defined in the statute as "a person or entity who provides CMRS to an end user, including resellers." The Court determined that Virgin Mobile was a CMRS provider because it clearly provided mobile phone services to its customers, whether those services were purchased directly from Virgin Mobile or through a third-party retailer and subsequently activated by Virgin Mobile. The Court determined that the 2006 amendments changed only the permissible methods of collection and not the duty to collect.

The Court next held that because it affirmed the circuit court in finding that the pre-2006 statute applied to Virgin Mobile and it was required to collect the charges in question, the issue of whether it was entitled to a refund or credit was moot and it declined to address the issue further.

The Court noted that KRS § 65.7635(5) authorizes an award of attorney's fees to the prevailing party in litigation. The Court determined that the statute was "somewhat unclear" and recognized that national tax services had opined that prepaid wireless providers were not subject to the taxes. Accordingly, the Court held that Virgin Mobile disputed the payment of the charges in good faith and held that the circuit court exceeded its discretion in ordering Virgin Mobile to pay the CMRS Board's attorney's fees. It therefore reversed the circuit court's award of attorney's fees.

The Court next addressed the CMRS Board's cross-appeal, where it argued that it was entitled to prejudgment interest because: (1) the CMRS service charge was not a tax; (2) if the CMRS service charge were a tax, KRS § 131.183 allows prejudgment interest; and (3) the CMRS Board was entitled to prejudgment interest on a liquidated sum. The Court indicated that Virgin Mobile argued in response: (1) the fee was indeed a tax; (2) interest on taxes is not authorized unless specifically provided by statute; (3) KRS § 131.183 does not provide for prejudgment interest; and (4) Kentucky law is clear that prejudgment interest shall not be awarded where there is a good faith dispute as to whether the amount was actually due and owing.

The Court first opined that a trial court's decision to deny prejudgment interest must be reviewed under an abuse of discretion standard. The Court reviewed the language of KRS § 131.183, and held that because it only authorized interest on taxes administered by the Department and did not extend to taxes administered by the CMRS Board, it excluded other taxes, including those administered by the CMRS Board. The Court also held that Virgin Mobile disputed the CMRS tax in good faith in reliance upon national tax and business law information services as well as its own accountants and tax advisors. It therefore affirmed the circuit court's decision holding that prejudgment interest was improper.

The Kentucky Supreme Court granted motions for discretionary reviewed filed by Virgin Mobile and the CMRS Board and noted that the issues before it were disputed questions of law; thus, its review would be de novo. The Court next stated that it would be guided by the rule of statutory construction that the intention of the General Assembly must be ascertained and given effect.

The Court first addressed Virgin Mobile's argument that the lower court erred in holding that the CMRS service charge applied to it prior to the July 2006 amendments. The Court found that Virgin Mobile was entitled to summary judgment holding that it was not required to collect from its prepaid customers a CMRS service charge prior to July 2006. In reaching this conclusion, the Court analyzed the language of the pre-2006 statute, finding that Virgin Mobile did not provide monthly billing and therefore could not be a "billing provider" under the pre-2006 statute's mandatory collection procedure. The Court noted that it could "reasonably find" an intent by the General Assembly in the pre-2006 statute that all wireless customers pay the

CMRS charge. But, the Court abided by the plain language of the statute, concluding that the plain language showed no intention to require all CMRS providers to collect the service charge, but rather, only "billing providers" that sent monthly bills to their customers.

The Court next addressed whether Virgin Mobile was entitled to a refund of amounts mistakenly paid or a credit for such amounts against post-July 2006 charges. The Court summarily rejected Virgin Mobile's refund claim, stating that because Virgin Mobile repaid itself by setoff, the issue of refund was not properly before the Court. The Court found that because Virgin Mobile used a credit, it had the money in hand and was not due a refund.

The Court proceeded to discuss Virgin Mobile's credit/recoupment claim. The Court rejected Virgin Mobile's claim that KRS § 134.580 authorized a refund or credit on the basis that CMRS charges are paid into the CMRS Fund and not "into the State Treasury" as required by the statute. Noting the merits of Virgin's common law refund claim, the Court nevertheless rejected it on the basis that such claims involved the right to refund which the Court already had found not to be at issue. The Court noted that had Virgin mobile remitted the amounts when due, and timely filed an action for a refund, the common law right to a refund would have been proper. The Court concluded that Virgin Mobile's erroneous payment of pre-2006 CMRS charges did not justify its failure to make the required payments after July 2006. The Court found no authority for Virgin Mobile's recoupment by credit.

Ultimately, the Court affirmed the Court of Appeals insofar as it affirmed the trial court's judgment that Virgin Mobile was liable for the underpayment of post-July 2006 CMRS fees totaling $286,807.20. As a result, the CMRS Board will have an award against Virgin Mobile for this amount based on failure to remit post-2006 CMRS fees, despite the Court's finding that Virgin Mobile was not required to originally pay that amount under the pre-2006 statute and that Virgin Mobile could have initiated an action to recover the erroneously paid CMRS charges. The Court reversed the Court of Appeals on the issue of attorney's fees, concluding that the resolution of the case was mixed with Virgin Mobile winning on the pre-2006 issue and the CMRS Board winning on the post-2006 issue. The Court found the attorney's fee issue must be reassessed by the trial court, taking into account the extent of each party's success in determining whether to award attorney's fees.

Virgin Mobile filed a petition for rehearing with the Court on September 10, 2014. Virgin Mobile has asked that the Court reconsider the denial of the refund claim. In its petition, Virgin Mobile asserts the Court made certain factual errors. Specifically, Virgin Mobile claims the Court denied its refund claims under the mistaken belief that the refund claim was a claim for setoff or recoupment against later payment obligations and under the mistaken belief that Virgin Mobile collected the tax from its customers. Because Virgin Mobile is not entitled to offset its pre-2006 payments against later liabilities, Virgin Mobile claims the denial of the refund of the pre-2006 payments deprives it of its full remedy.

The authors' firm represents Virgin Mobile in this action.

C. Administrative Developments

1. Sales and Use Tax "Taxability Matrix"

Effective August 1, 2014, the Department published an updated "Kentucky State Taxability Matrix" on July 29, 2014. The Department made several citation changes to conform to statutory revisions. Citing KRS § 139.195(1) and § 139.200, the Department also stated that "Ancillary Services" for telecommunications and related products are taxable (previously the Department did not mark such services as taxable or non-taxable).

On September 22, 2014, the Department issued a revised Matrix effective August 1, 2014. Changes include technical revisions to the citations pertaining to computer-related products and vouchers. Taxability Matrix, Kentucky Department of Revenue, September 22, 2014 (available at http://www.streamlinedsalestax.org/otm/index.php?id=published).

2. Taxability of Bitcoin

In the June edition of the Kentucky Sales Tax Facts, the Department addressed the imposition of sales tax on purchases using Bitcoin. Bitcoin is a form of Internet virtual currency gaining popularity as an accepted form of payment by many online retailers. For Kentucky sales and use tax purposes, Bitcoins are the "consideration" provided by the purchaser in the transaction. Any business that accepts Bitcoins as a form of payment must convert the Bitcoin into U.S. dollars, and charge 6 percent Kentucky sales and use tax on any taxable transaction for which Bitcoin represents the financial instrument of consideration. Documentation must be maintained to verify the value of Bitcoin at the time of the transaction.

3. Interactive Voice Response Sales and Use Tax Return Filings

Beginning July 1, 2014, the Department no longer offers the IVR (Interactive Voice Response) sales and use tax zero return filings via the telephone. Returns for June 2014 and later periods must be filed by paper or online via Kentucky E-Tax. Kentucky Tax Alert, Vol. 33, No. 4 (June 2014).

III. PROPERTY TAXES

A. Legislative Developments

The Kentucky General Assembly adjourned its Regular Session *sine die* April 15, 2014. As a result, there have been no developments since the Spring Update.

B. Judicial Developments

1. *Wilson Equipment Co., LLC v. Commonwealth of Kentucky, Finance and Administration Cabinet, Department of Revenue*, KBTA File No. K13-R-13 (May 22, 2014), appealed to Franklin Circuit Court, No. 14-CI-00736 (Pending).

In this case the Board concluded that the tangible property tax exemption for equipment held under a floor plan financing arrangement is not limited to farm machinery and equipment and other types of "non-farm" equipment are also subject to the exemption.

The Board determined that Wilson Equipment Company, LLC ("Wilson") is a rental agency in the business of selling, retailing, leasing, renting and repairing machinery and equipment. Wilson reported certain property as exempt from local taxation on its 2004-2011 Kentucky tangible personal property tax returns pursuant to KRS § 132.200(16). KRS § 132.200(16) exempts from local taxation: "new farm machinery and other equipment held in the retailer's inventory for sale under a floor plan financing arrangement by a retailer as defined in KRS § 365.800."

The Board found that under the clear wording of the statute, there are two categories of property exempt under KRS § 132.200(16): (1) new farm machinery and (2) other equipment. To be exempt, both the new farm machinery and the other equipment must be held in the retailer's inventory for sale under a floor plan financing arrangement. In addition, the taxpayer must also be a "retailer" under KRS § 365.800, which includes retailers engaged in the business of selling and retailing farm implements, tractors, farm machinery, utility and industrial equipment, and lawn and garden equipment.

There was no dispute between the parties whether the property at issue was held under floor plan financing or whether Wilson was a retailer within the statutory definition of KRS § 365.800. However, the issue for decision by the Board was whether the Department properly denied Wilson's claim of exemption because not all of the property at issue was farm equipment. In the Department's view, the word "farm" in the statutory exemption applied to both "machinery" and "equipment," so that for property to be exempt under KRS § 132.200(16) it must be either farm machinery or farm equipment. Wilson's position was that the plain meaning of the statutory language exempted both farm machinery and any type of other equipment - - whether farm or non-farm.

The Board agreed with Wilson's position, and held that according to the plain meaning of the statute, the words "other equipment" in KRS § 132.200(16) include not only farm equipment, but also any other type of equipment, whether or not such equipment is farm equipment. The Board therefore held that as long as equipment falls within a category set forth in KRS § 365.800 and is held in a retailer's inventory for sale under a floor plan financing arrangement, it will be exempt from local taxation under KRS § 132.200(16). The Board concluded that the equipment at issue met this test and was therefore exempt from local taxation.

The Department has appealed the Board's ruling to the Franklin Circuit Court.

The authors' law firm represents Wilson Equipment in this case.

2. *Rent A Center East v. Finance and Administration Cabinet, Department of Revenue,* KBTA File No. K13-R-04, Order No. K-24567 (February 13, 2014), appealed to Jefferson Circuit Court, Civil Action No. 14-CI-001476 (Pending).

In this case, the issue is the valuation of tangible personal property owned by Rent A Center ("RAC"), which is in the business of renting household items such as computers, TVs, electronics, etc. Despite the relatively straight-forward nature of the issue, the Board made four decisions more far-reaching than how to value a taxpayer's tangible personal property. First, the Board granted a "directed verdict" for the Department on the basis that the Board was "unpersuaded by the case presented by the taxpayer", and provided an indication of what type of valuation evidence might be acceptable. Second, the Board excluded the taxpayer's potential expert witness of the basis that the witness had not been disclosed to the Department in a timely manner. Third, the Board held the Department was not required to set forth its method for valuing tangible personal property in a regulation. Finally, the Board upheld the Department's imposition of penalties based on the *omitted* property tax statute.

a. Directed Verdict for the Department and Acceptable Valuation Evidence

The Board granted a "directed verdict" based on the decision in *Koo v. Kentucky Department for Adult and Technical Education*, 919 S.W.2d 531 (Ky. App. 1995). In *Koo*, the Kentucky Court of Appeals upheld a directed verdict issued by a state hearing officer when the hearing officer found the appellant had failed to meet his burden of proof.

In its order, the Board notes the taxpayer did not present an appraiser as a witness and the corporate representative of the taxpayer admitted he was not presenting any valuation evidence. Instead, the witness "merely testified in general that he believed the property was overvalued" because rent-to-own property has a shorter useful life than the useful life required by the Department on its tax returns. Furthermore, no witness was called from the accounting firm that had prepared the tangible personal property tax returns at issue. The support for the values used by the accounting firm was described by the Board as "documents merely set[ting] forth conclusory information about the claimed overvaluation of the rental household items, but [] never any back-up, supporting information presented which specifically showed why the valuation was too high."

Before leaving the subject matter of valuation, the Board acknowledged the difficulty of valuing tangible personal property and provided taxpayers with a hint of what might be acceptable evidence. The Board stated,

> The Board understands it would be a daunting task to appraise each individual item of property, when there are thousands of items. In a future case, though, an appraiser could simply present a sampling of the items in question along with the supporting

> information necessary to demonstrate the existence of any additional physical, functional and economic obsolescence.

b. Exclusion of Taxpayer's Expert Witness

The Board upheld a motion in limine filed by the Department excluding the testimony of the taxpayer's proposed expert witness. The Department objected to the expert witness based on the taxpayer's failure to name an expert prior to the deadline for the close of discovery. Based on the Board's prehearing order all discovery must be completed within 60 days prior to the date on which the hearing is set. In this case, the discovery deadline was September 20, 2013. On October 7, 2013, counsel for RAC filed Supplemental Answers to the Department's interrogatories and disclosed the name of its intended expert witness. Citing its own administrative regulation, 802 KAR1:010 Section 4(3), which provides for the exclusion of documents or testimony at a hearing if a party fails to obey a discovery order, the Board did not take any testimony from the expert as to his qualifications or otherwise. However, a proffer of proof outlining the qualifications of the intended witness and his testimony was taken by the Board's hearing officer outside the hearing of the Board.

c. No Regulation Required, But Propriety of Department's Methodology Not Decided

Administrative guidance for Kentucky's tax law, especially property tax, is woefully lacking. Unfortunately, the Board rejected the taxpayer's argument that the Department's methodology for valuing tangible personal property should be set forth in a regulation. Instead, the Board held that because the method of assessment is set forth on the tax return and in the instructions to the return this was sufficient. In support of this decision the Board cited 103 KAR 3:010, which incorporates by reference all tax returns, forms and instructions of the Department. The Board also cited *Dan v. Revenue Cabinet*, 976 S.W.2d 594 (Ky. App. 1998) for the proposition, "the statutes are not unconstitutional because they do not provide a "measuring stick" for assessments." Nevertheless, the Board did note it was *not* making an "adjudication" as to the validity of the Department's method of assessment.

d. Imposition of *Omitted Property* Penalties

The taxpayer filed its tangible personal property tax returns using a methodology agreed to with the Department in a settlement agreement for prior years. The Board held the prior agreement did not cover the tax years before the Board, and the taxpayer did not seek the permission of the Department to use this approach in advance of filing the returns. Advance permission is necessary when an alternative valuation methodology is employed by a taxpayer.

In upholding the penalties based on the omitted property statute, KRS § 132.360, the Board found the taxpayer's returns constituted an initial "assessment" that could be "reopened" by the Department. Pursuant to KRS § 132.360(2), an assessment based on this "reopening" is to be "handled and collected as an omitted tax bill, and the additional tax shall be subject to the same penalties and interest as the tax on omitted property voluntarily listed."

Furthermore, the Board determined there was no basis for a waiver of the penalties. The taxpayer asserted it relied upon its accountant and "erroneous advice by tax advisor" is a basis for waiver. In finding this penalty exception inapplicable, the Board ruled: "[T]hat taxpayer did not exercise reasonable care and prudence when it failed to seek a determination for future years' application of its alternative method of valuation with the Department. Without such a determination, its tangible assessment was subject to being reopened, as it was, and the omitted penalty became applicable."

3. *Taylor v. Cumberland County PVA*, KBTA File No. K13-S-215, Order No. K-24651 (May 22, 2014) (Final).

The Board recently upheld an assessment for a four acre tract of unimproved land located at 317 Keen Street in Burkesville, Kentucky. The Cumberland County Property Valuation Administrator ("PVA") assessed the property at $80,000 for the 2013 tax year. The taxpayer valued the property at $50,000 in his petition of appeal. The Cumberland County Board of Assessment Appeals valued the property at $80,000, and the taxpayer appealed to the Board.

As the party seeking to set aside the assessment of the Cumberland County Board of Assessment Appeals, the taxpayer bore the burden of proving a lower value on appeal to the Board. The property at issue was zoned for commercial purposes. The taxpayer argued the value of the property was decreased because of water drainage issues. In support of his valuation, the taxpayer presented three residential land sales and a church land sale, ranging from $4,100 to $11,057 an acre.

The PVA relied upon two additional sales for approximately $20,000 an acre. One sale relied upon by the PVA occurred in 2011 for $20,000 an acre. There was only one building between the subject property and this sale. The taxpayer claimed he did not use this sale because it was too small. The other sale relied upon by the PVA was a 2012 sale of 2.59 acres of noncommercial river property that sold for $50,000. The taxpayer argued this sale was too far from Burkesville.

The Board noted that under Section 172 of the Kentucky Constitution, all property must be assessed for taxation at its fair cash value, which is estimated at the price it would bring at a fair and voluntary sale. The Board concluded the taxpayer did not meet his burden of showing the property was overvalued by the PVA for the year 2013. The Board noted that the noncommercial sales presented by the taxpayer were not comparable to the subject commercial property, located in the most expensive commercial area in Burkesville. The Board also found the PVA's comparable sale of a property close to the subject property supported the PVA's assessment. Therefore, the Board upheld the final ruling of the Cumberland County Board of Assessment Appeals valuing the property at $80,000 for tax year 2013.

4. *Stearns Coal Company v. McCreary County Property Valuation Administrator*, KBTA Case No. K12-S-58 Order No. K-24471 (January 13, 2014), appealed to McCreary Circuit Court, Civil Action No. 14-CI-00026 (Pending).

Stearns Coal Company ("Stearns") owned property located in McCreary County consisting of approximately 400 acres and improvements. Between 1992 and 2010, the property was valued at $1 million for property tax purposes. In 2011, a new property valuation administrator ("PVA") assessed the property at $10 million. Stearns appealed the PVA's value and the circuit court entered a value of $1 million for the 2011 year.

In 2012, the PVA again reassessed the property and valued it at $14 million. Stearns appealed to the local board of assessment appeals, which reduced the valuation to $12 million. Stearns then appealed to the Board.

Stearns presented separate appraisals of the land and improvements. Using comparable sales, Stearns' appraiser valued the land at $360,000. A second appraiser valued the improvements at $500,000. However, the appraisal for the improvements considered only the coal, preparation plant, and handling facilities; it did not value other improvements such as the mineshaft, elevator, shop building or office building. The PVA failed to offer any information to rebut Stearns' appraisals.

The Board held Stearns carried its burden of proof as it related to the land. The use of comparable sales by Stearns and the lack of evidence presented by the PVA were sufficient for the Board to rule for Stearns on the land value. The Board rejected, however, Stearns' valuation of the improvements because the valuation failed to account for all improvements on the property. The Board also found there was insufficient evidence to support the PVA's claimed value of $12 million. In setting its value, the Board used the 2011 agreed upon value of $1 million, subtracted the $360,000 value of the land and determined the improvements had a value of $640,000. The PVA has appealed the Board's decision to the McCreary Circuit Court.

5. *Walter L. and Shirley H. Wilkening et al. v. Board of Education of Oldham County, Kentucky, et al.,* Kentucky Court of Appeals, No. 2010-CA-002020, *motion for discretionary review denied*, Kentucky Supreme Court, Case No. 2013-SC-492, *pet. for cert. filed*, United States Supreme Court, Docket No. 14-309 (September 9, 2014) (Pending).

This case is a class action by real property taxpayers in Oldham County, Kentucky and involves the proper calculation of the school district's real property tax rates for the 2003 through 2008 tax years. The taxpayers claim the Board of Education of Oldham County ("BOE") improperly increased its real property tax rate by 19% in 2003 and continued to levy excessive real property tax rates for each of the 2006 through 2008 tax years. The taxpayers are seeking class statutory and common law refunds of the excess taxes.

Kentucky law imposes annual limits on local government real property tax rates. Local governments may impose a tax rate that, when applied to the current year's assessment of property that was in existence in the prior year, will produce the same amount of revenue as

produced in the prior year (the so-called "Compensating Tax Rate"). Local governments may impose a rate that will generate up to 4% additional revenue than that produced by the Compensating Tax Rate provided they give public notice and hold a public hearing (the "4% Increase Tax Rate"). *See* KRS § 132.023 and § 132.027. Any portion of a real property tax rate that will generate more than a 4% increase above the Compensating Tax Rate is subject to voter recall.

School districts are subject to an additional limitation. School districts may not impose a real property tax rate in excess of the maximum rate they could have levied in the prior year (the "Subsection 1 Rate") without first holding a referendum and obtaining voter approval. KRS § 160.470(1)(a) and § 157.440(2).

The BOE in 2003 levied a tax rate that exceeded the Subsection 1 rate by 10.7¢ without obtaining prior voter approval. The BOE then used that new rate as the basis to calculate its Compensating Tax Rate for subsequent years.

The class representatives filed suit claiming that the portion of the rate in excess of the Subsection 1 Rate in 2003 and the portion of subsequent years' rates that exceed the lawful 4% Increase Tax Rate was unlawful and must be refunded. The BOE has claimed that language in various Executive Branch budget bills authorizing the funding of certain "nickel rates" to be used for school construction "impliedly suspended" the Subsection 1 Rate limitation. The BOE also has claimed that legislation enacted in 2008 retroactively authorized the BOE's prior real property tax rates by removing the voting requirement. *See* H.B. 734, 2008 Ky. Acts 80; H.B. 704, 2008 Ky. Acts 132.

The taxpayers have argued in response that there is no basis to imply a suspension of the Subsection 1 Rate limitation because the limitation does not prevent school districts from raising funds from other sources to fund the nickels authorized in the budgets. Also, KRS § 48.316, the statute that governs implied suspensions in budget legislation, does not allow an implied suspension of the Subsection 1 Rate limitation. As to including a local tax measure in a general appropriations bill, the taxpayers have argued such inclusion violates Section 51 of the Kentucky Constitution which requires that legislation relate to single subject which must be expressed in its title. Taxpayers have further argued that the 2008 legislation is not retroactive but if it retroactively repeals taxpayers' right to approve rate increases by referendum and remove the issue already pending before the courts from judicial review, then it unlawfully impairs taxpayers' fundamental right to vote and violates separation of powers guarantees.

The Franklin Circuit Court issued its opinion on October 6, 2010, granting the BOE summary judgment. The lower court characterized the Subsection 1 Rate limitation as a "fiscal straight jacket for local school finance" that hinders the ability of the state legislature to provide an efficient system of common schools as mandated by Section 183 of the Kentucky Constitution. Without analysis, the court concluded the language in the budget bills "must be construed, consistent with that constitutional mandate, to exempt the [Nickel rates]" from the Subsection 1 Rate limitation. The court also concluded that the 2008 legislation was an affirmation of prior legislatures' intent.

The taxpayers appealed and moved to transfer of their appeal directly to the Kentucky Supreme Court. The Kentucky Supreme Court denied that motion on May 19, 2011.

A unanimous panel of the Kentucky Court of Appeals then affirmed the circuit court on other grounds on June 28, 2013. The Court held that "at the time the [BOE] levied its taxes for the 2003-2008 years under the statutes in effect during this period, a prior vote was required." However, the Court also held that H.B. 704 retroactively exempted from voter approval the two additional nickel taxes it authorized. Though H.B. 704 contains no express statement that its retraction of the right to vote was retroactive, the Court nevertheless found it was "apparent" that H.B. 704 was meant to operate retroactively.

The Court rejected Taxpayers' claim that a retroactive repeal of a preexisting right to vote unconstitutionally impaired taxpayers' fundamental right to vote and violated due process and equal protection guarantees. The Court held that the right to vote is not a fundamental right "because such a right has been delegated by the legislature and can also be taken away by the legislature." The Court also gave short shrift to the constitutional due process guarantees afforded Kentucky voters and taxpayers. Citing *Miller v. Johnson Controls, Inc.*, 296 S.W.3d 392 (Ky. 2009), the Court applied a rational basis standard rather than the more-exacting strict scrutiny standard applicable to fundamental rights, and justified the retroactive deprivation of voting rights by declaring a "rational relationship" between the loss of those rights and the legitimate public purpose of adequately funding schools.

Next, citing *King v. Campbell County*, 217 S.W.3d 862 (Ky. App. 2005), the Court held that retroactively amending the statutes to validate years of unlawful tax rates did not violate the Separation of Powers Doctrine because the case had not become final when the legislation was enacted.

The Taxpayers' motion for discretionary review with the Kentucky Supreme Court was denied on June 11, 2014. The Taxpayers filed a petition for certiorari with the U.S. Supreme Court on September 9, 2014. In their petition, the Taxpayers presented two questions to the Court: (1) whether the retroactive repeal of a preexisting right to vote unconstitutionally impaired Taxpayers' fundamental right to vote, and (2) whether the state's interest in preventing tax refunds gives the state an unfettered right to retroactively repeal a right to vote in a compulsory referendum on prior tax rates. The Taxpayers argued the Court should grant the petition for two reasons: (1) to resolve the conflict between the opinion of the lower court and opinions of numerous U.S. Courts of Appeals and other state courts, and (2) to extend the Court's previous rulings that the right to vote is fundamental to compulsory referenda cases and that any substantial burden on that right should reviewed under due process strict scrutiny analysis.

The authors' firm represents the taxpayer class in this action.

6. *Coleman et al. v. Campbell Co. Public Library Bd. of Trustees*, Kentucky Court of Appeals, Case No. 2013-CA-000883-MR and *Kuhnhein et al. v. Kenton Co. Public Library Bd. of Trustees*, Kentucky Court of Appeals, Case Nos. 2013-CA-000874-MR and No. 2013-CA-001010 (Pending).

The Kentucky Court of Appeals recently granted motions for intermediate relief filed by both the Kenton and Campbell County library districts in these two companion cases. Both cases were initially filed as refund class actions challenging the method by which the library districts calculated their real property tax rates.

Under Kentucky law, library districts can be formed under a variety of different methods. Prior to July 13, 1984, and in accordance with KRS § 173.790, library districts could be formed by filing a petition signed by 51% or more of the voters who voted in the last general election with the County Fiscal Court. The petition had to specify the property tax rate to be levied to fund the district. The statute also provides that the property tax rate for a library district created by the petition method prior to July 13, 1984, cannot be increased or decreased without prior approval of the voters.

Taxpayers in Kenton and Campbell counties brought suit against the library districts, asserting that the districts increased their tax rates despite the fact that no petitions had been filed in accordance with KRS § 173.790. The library districts argue that this requirement has been impliedly repealed by subsequent enactments of the General Assembly. Specifically, the library districts point to KRS § 132.010(6), which was enacted in 1979 and sets forth a formula for calculating ad valorem property tax rates. From 1979 until the present, the library districts have utilized KRS § 132.010(6) to calculate their tax rates. In their complaints, the Taxpayers assert the petition requirement in the library district statutes, as a more specific limitation only on library districts, controls over the more general limitations subsequently enacted by the legislature, including KRS § 132.010(6).

In orders granting partial summary judgment in favor of the Taxpayers, both the Campbell and Kenton Circuit Courts ruled the petition procedures outlined in KRS § 173.790 had to be followed and that KRS § 132.010(6) did not repeal the petition procedures. Thus, both courts held the increases in the property tax rates in the districts were improper. In the *Kuhnhein* case in Kenton Circuit Court, the judge ruled no refunds were due pursuant to the action because the plaintiffs had not met the requirements of KRS § 134.590, Kentucky's statute governing property tax refunds.

Both library districts appealed. In *Kuhnhein*, the Taxpayers cross-appealed with regard to their refund claims. The library districts also filed motions for intermediate relief under Civil Rule 76.33(1), which allows a party to an appeal to move the appellate court for intermediate relief "upon a satisfactory showing that otherwise he will suffer immediate and irreparable injury before a hearing may be had on the motion." The library districts claimed they would suffer immediate and irreparable injury if they were required to reset their tax rates and utilize reserve funds to operate the libraries pending appeal.

In two separate but nearly identical orders, the Court of Appeals granted the library districts' motions for intermediate relief. Quoting *Maupin v. Stansbury*, 575 S.W.2d 695, 698 (Ky. App. 1978), the Court noted, "the clearest example of immediate and irreparable injury is where it appears that the final judgment would be rendered completely meaningless should the probable harm alleged occur prior to trial." The Court also cited *Com. ex rel. Conway v. Thompson*, 300 S.W.3d 152, 170-71 (Ky. 2009), noting that "an erroneous interpretation of a statute resulting in the improper expenditure of scarce public funds constitutes an irreparable injury." Thus, finding the library districts had demonstrated the potential for immediate and irreparable injury, the Court granted their motions for intermediate relief and stayed the orders of the Kenton and Campbell Circuit Courts pending appeal. Both parties now await the ruling of the Court of Appeals on the underlying claims in the actions.

The authors' law firm is co-counsel for the Taxpayers in both cases.

7. *Chegg, Inc. v. Department of Revenue*, Franklin Circuit Court, Civil Action No. 14-CI-170 (January 13, 2014) (Pending).

In this case, the Board considered the scope of Kentucky's exemption from the tangible personal property tax for "goods stored in a warehouse". The Board held for the Department limiting the exemption to goods shipped out of state within six months never to return to Kentucky.

Beginning operations in 2007, Chegg, Inc. ("Chegg") operates an online network of textbook rentals for students. A significant portion of Chegg's textbook inventory is rented out at the start of January and August each year. At the end of each school semester, the students return the rented books to Chegg. In 2010, Chegg constructed a distribution center in Bullitt County, Kentucky, from which it ships and receives its inventory.

Chegg entered into a Voluntary Disclosure Agreement with the Department for its tangible personal property tax for tax years 2009 and 2010. In the voluntary disclosure, Chegg classified a portion of its Kentucky inventory of textbooks as "personal property held for shipment out-of-state". This "in-transit" classification exempts inventory from state and local tangible personal property taxation pursuant to KRS § 132.097 and § 132.099, respectively. The Department disagreed with the classification and issued notices of tax due, reclassifying the textbooks as taxable inventory. Chegg sought review at the Board.

At issue in the case was the exemption contained in KRS § 132.097 (and similarly in KRS § 132.099), which states:

> There shall be exempt from ad valorem tax for state purposes, personal property placed in a warehouse or distribution center for the purpose of subsequent shipment to an out-of-state destination. Personal property shall be deemed to be held for shipment to an out-of-state destination if the owner can reasonably demonstrate that the personal property will be shipped out of state within the next six (6) months.

Chegg argued that the textbooks qualified for the statutory exemption because they were rented by students and shipped out-of-state within six months of arriving at the facility. The Department argued that the statutory exemption is limited to items shipped out-of-state within six months that *never return to the state*. Because Chegg's textbooks were returned to the state at the end of each semester, the Department argued the exemption was inapplicable.

The Board noted that to have a taxable situs and be subject to the tangible personal property tax, the textbooks must have a permanent location. The Board stated that the textbooks had a "more or less permanent location" in Bullitt County, Kentucky, and further found that the statutory exemption must be construed narrowly. Thus, in the absence of language extending the exemption to property temporarily shipped out of the state, the Board found the exemption did

not extend to Chegg's textbooks. The Board concluded that the "plain and ordinary meaning" of the phrases 'shipped out-of-state' and 'out-of-state destination' is that the item must be delivered out-of-state and not returned to Kentucky. Therefore, the Board upheld the Department's assessment of tangible personal property tax against Chegg for the 2009 and 2010 tax years.

The Board went on to consider whether the imposition of the KRS § 132.290(3) 10% omitted property penalty was appropriate. The statute permits the imposition of the penalty for omitted property which is voluntary listed (versus 20% if the omitted property is *in*voluntarily listed). Although the Department typically waives such penalties as part of voluntary disclosure, no waiver occurred because Chegg did not pay the tax during voluntary disclosure. Chegg sought waiver of the penalties pursuant to the "reasonable cause" standard set forth in 103 KAR 1:040. Specifically, Chegg argued that it had sought and relied upon advice from its tax advisors regarding the filing of the tax return. As the Board explained, to obtain a waiver of penalties due to reliance on a tax advisor, the regulation requires the taxpayer demonstrate three requirements:

1. Taxpayer was unfamiliar with the tax law and actually relied upon the advice of the tax advisor;

2. Supporting documentation showing full disclosure of all relevant facts to the tax advisor and the advice received; and

3. Exercise of reasonable care and prudence in determining whether to secure advice of a tax advisor.

The Board determined Chegg failed to satisfy these requirements. The Board noted that the only evidence provided by Chegg was the names of the advisors providing the advice to them. The Board stated that Chegg, in light of the substantial investment made, should have sought further advice and a ruling from the Department on the matter. Due to Chegg's failure to satisfy the requirements of the regulation, the Board upheld the imposition of the 10% penalty.

Chegg then appealed to the Franklin Circuit Court. Before briefing the merits of the case, however, the parties asked the court to set the amount of a supersedeas bond or alternative security to stay the enforcement of the Board's order. The Honorable Judge Thomas D. Wingate issued Order No. 14-CI-00170, declining to require a bond or alternative security on appeals from the Board to the circuit court.

The requirement for posting of a supersedeas bond is set forth in KRS § 131.370(2). In relevant part, KRS § 131.370 provides:

> (1) Any party aggrieved by any final order of the Kentucky Board of Tax Appeals … may appeal to the Franklin Circuit Court ….
>
> (2) If the appeal is from an order sustaining a tax assessment, collection of the tax may be stayed by filing of a supersedeas bond in the manner directed by the Rules of Civil Procedure ….

The court held the statute only permitted a supersedeas bond for appeals taken to the Kentucky Court of Appeals, not administrative appeals taken to the circuit court. Therefore, given the case's procedural posture, the court determined it could not require a bond. The court affirmed this holding following a motion to reconsider on May 9, 2014.

The Department then filed an original action with the Kentucky Court of Appeals, Case No. 2014-CA-000855, seeking a writ of mandamus to compel the trial court to require the posting of a supersedeas bond. On August 14, 2014, the Court issued an order holding KRS Chapter 13B does not require the posting of the bond in an appeal from a final order of an administrative agency. Furthermore, the Court stated that KRS § 131.370(2) only requires the bond be posted to obtain a stay of the collection of the tax. Because the trial court order of March 26, 2014 did not stay the collection of the tax, the Court found no supersedeas bond was required. Therefore, the Court denied the petition for the writ of mandamus.

The case is now pending on the merits.

8. *College Heights Corporation v. Knox County Property Valuation Administrator*, KBTA Case No. K08-S-342 (March 26, 2014) (Final).

This case concerns a 2008 property tax appraisal of low cost housing for the elderly. College Heights Corporation was the lessor of 96 low income apartments for the elderly located in Knox County. In 2008, the Knox County Property Valuation Administrator ("PVA") assessed the property for $2,135,000. The taxpayer asserted a value of $940,000. Based upon an appraisal presented by the PVA, the Board ruled that the property had a value of $1,440,000. The case was appealed to the Knox Circuit Court and the Kentucky Court of Appeals. The Court of Appeals held that, given errors found in the appraisal, there was not substantial evidence to support the Board's valuation. Therefore, the Court of Appeal's remanded the case to the Board to determine the value of the property based on the remaining evidence in the record, excluding the appraisal presented by the PVA.

The Board examined the evidence remaining in the record and held without the appraisal the only evidence remaining for the PVA's valuation was the testimony of the PVA himself. The PVA testified he used a sales comparison approach by examining three other low income properties in other counties. However, the PVA had no knowledge of the other properties beyond their sales prices.

The Board then turned to the evidence submitted by the taxpayer. The taxpayer submitted an appraisal performed by an appraiser with an MAI designation and experience with low cost housing. The taxpayer's appraiser had physically examined the property, the 2007 audit report, the property contract rents, and analyzed three years of historic operating expenses. The appraisal used an income capitalization approach. The taxpayer's appraiser concluded the property's value was $940,000.

The Board held the taxpayer carried its burden of proof and the PVA's appraisal was excessive. The Board found persuasive the appraisal by the taxpayer's "well-qualified

appraiser." Therefore, the Board held the property was properly valued at $940,000. This decision was not appealed.

C. Administrative Developments

1. Property Tax Rates

On June 30, 2014, the Department announced that the state property tax rate for 2014 remains unchanged at 12.2¢ per $100 of assessed value.

IV. OTHER TAXES/EXACTIONS

A. Legislative Developments

The Kentucky General Assembly adjourned its Regular Session *sine die* April 15, 2014. As a result, there have been no developments since the Spring Update.

B. Judicial Developments

1. *Ohio Valley Wholesale Distributors, Inc. v. Commonwealth of Kentucky et al.*, Boyd Circuit Court, Civil Action No. 13-CI-00209 (Pending); and *OVWD, Inc. (Ohio Valley Wholesale Distributors, Inc.) v. Finance and Administration Cabinet, Department of Revenue*, KBTA File No. K13-R-15 (Pending).

In these actions, OVWD (fka Ohio Valley Wholesale Distributors, Inc.) is challenging the Department's assessment of cigarette and other tobacco products ("OTP") tax on OVWD's sales of untaxed cigarettes and OTP to out-of-state distributors. OVWD is a wholesale tobacco and convenience store merchandise distributor located in Ashland, Kentucky. The Department audited and assessed OVWD $11.5 million, including cigarette and OTP tax of $8.4 million plus interest, penalties and fees. The Department determined that the cigarettes and OTP in question were not actually sold to out-of-state distributors but to Superior Wholesale LLC, a licensed resident wholesaler located in Lexington, Kentucky. The Department's Final Ruling states as follows:

> Although cover documents show the product being shipped to [an Illinois or Indiana wholesaler] from OVWD's facility in Kentucky, documents from the common carrier transporting the product from OVWD show the product being diverted according to instructions from Superior [a Kentucky licensed wholesaler] to the state of New York. These products were never delivered to Illinois and Indiana. A representative from Superior Wholesale LLC ordered the products in question and physically supervised the loading of the product at OVWD's warehouse. Payment for product [sic] was made by Superior Wholesale LLC to OVWD.

The Department claims these transactions violated KRS § 138.195 which provides that "[n]o person licensed under this section except nonresident wholesalers shall either sell to or

purchase from any other such licensee untax-paid cigarettes." The Department further claims OVWD was required to stamp these cigarettes pursuant to KRS § 138.146 prior to selling them to Superior Wholesale LLC and that OTP tax was similarly due on sales of OTP to resident licensed wholesalers pursuant to KRS § 138.140(4).

The Department issued its final ruling in April 2013, and OVWD appealed to the Board. In its petition of appeal, OVWD alleges the cigarettes and OTP were sold to out-of-state distributors and, though admitting Superior Wholesale, LLC paid for the product, disputes the Department's determination that Superior was the actual purchaser and the product required to be stamped. OVWD alleges further defects in the Department's assessment. OVWD claims the Department has no authority to directly assess cigarette tax against a cigarette licensee and that the Department's exclusive statutory enforcement mechanism is the seizure and sale of untax-paid cigarettes. OVWD further claims the Department's imposition of tax on cigarettes and OTP sold to out-of-state customers violates Section 2 of the Kentucky Constitution because it impedes the free flow of commerce and violates the Commerce Clause of the U.S. Constitution because it subjects such cigarettes to an undue risk of multiple taxation. Finally, OVWD claims that any tax owed is obligation of OVWD's customers or Superior, not OVWD.

OVWD also challenges the Department's assessment of penalties one year after issuing its assessments of tax as an arbitrary exercise of power in violation of Ky. Const. § 2.

In addition to the proceeding at the Board, the dispute has taken on a life of its own in the courts. Prior to the issuance of the Department's Final Ruling, on March 4, 2013, OVWD filed a declaratory judgment action in Boyd Circuit Court (Civil Action No. 13-CI-00209) seeking a declaration that that the tax assessment violated the Kentucky and U.S. Constitutions because it was outside statutory authority and interfered with and discriminated against interstate commerce. The Department responded with an answer *and* by filing a petition with the Kentucky Court of Appeals seeking a writ of prohibition to prevent the exercise of jurisdiction by the circuit court over the underlying action. The Court of Appeals denied the Department's petition for a writ of prohibition on August 9, 2013, and the Department appealed to the Kentucky Supreme Court (Case No. 2013-SC-000624). The Kentucky Supreme Court upheld the Court of Appeals on September 18, 2014 (not to be published). It's unclear whether the parties will now attempt to resolve their dispute at the Board or in the circuit court.

2. *Saint Joseph Health System, Inc. v. Department of Revenue*, KBTA Case No. K12-R-18 (Pending).

At issue before the Board in *Saint Joseph* is the application of the Kentucky provider tax on hospitals. After being denied refunds by the Department, Saint Joseph Health System, Inc. ("Saint Joseph") raised two issues on appeal, one of statutory construction and one of federal preemption. Saint Joseph filed a motion for partial summary judgment on the statutory construction issue. However, the Board denied Saint Joseph's motion.

In 2006, the General Assembly, to ensure base collections of $180,000,000 of hospital provider taxes, enacted H.B. 380. H.B. 380 limited the hospital provider tax liability for tax year 2006-07 to the amount a hospital paid in fiscal year 2005-06 with provision for a "true-up"

should collections fall below the $180,000,000 threshold. Saint Joseph overpaid the provider tax in the 2005-06 tax year by improperly including receipts exempt from tax pursuant to federal and state law. The Department granted refunds for the 2005-06 tax year, but denied Saint Joseph refunds for taxes paid for the 2006-07 tax year. The refunds sought for the 2006-07 tax year represented the amounts erroneously overpaid with regard to the 2005-06 tax year.

Saint Joseph argued that pursuant to H.B. 380, its 2006-07 liability should be limited to the amount paid *after refunds* for the 2005-06 tax year. Specifically, Saint Joseph argued the statutory language limiting the liability to the amount "paid in" did not mean the amount literally paid in cash between July 1 and June 30, but meant the amount paid "with respect to" or "for" the prior fiscal year.

The Department argued H.B. 380 mandated payments for the 2006-07 tax year equal the pre-refund payments for 2005-06. The Department argued that should the refunds affect the subsequent year, collections could be less than $180,000,000 in contravention of H.B. 380. Furthermore, the Department claimed whether or not overpayments were made in the 2005-06 tax year such payments served as the base for 2006-07 tax year without any further adjustment.

In holding for the Department, the Board ignored the normal payment scheme for the provider tax and found the language of H.B. 380 was clear in setting the base at the amounts paid in, and not with respect to, the 2005-06 year. The Board held H.B. 380 mandated the Department set the 2006-07 liability equal to the original payments made for the 2005-06 year without adjustment for subsequent refunds awarded by the Department. The Board acknowledged taxpayers making overpayments in 2005-06 would continue to make overpayments. However, the Board stated the baseline set by H.B. 380 was not meant to reflect later adjustments. In the absence of language addressing taxpayer-specific variables in the calculation, the Board found the base liability could not be adjusted. Accordingly, the Board denied Saint Joseph's motion for partial summary judgment.

The Department also filed a motion to dismiss Counts 4 through 7 of Saint Joseph's petition of appeal for failure to state a claim upon which relief could be granted. In Counts 4, 6, and 7, Saint Joseph claimed the Department engaged in selective enforcement in the denial of Saint Joseph's refund claims in violation of the United States and Kentucky Constitutions. Specifically, Saint Joseph claimed the Department denied Saint Joseph's refund claims while the refund claims of similarly situated taxpayers were granted. In Count 5, Saint Joseph asserted the Department's arbitrary denial of its refund claim deprived Saint Joseph of its refund without just compensation in violation of the Takings Clause. In its motion to dismiss, the Department argued Saint Joseph's petition set forth only conclusory allegations and failed to state plausible claims for relief.

Saint Joseph's response to the Department's motion to dismiss was two-fold. First, Saint Joseph noted the Department's motion was based upon the Kentucky and Federal Civil Rules of Procedure, which are inapplicable in proceedings before an administrative agency such as the Board. Second, Saint Joseph argued that, assuming the Civil Rules do apply, the Department incorrectly relied upon federal pleading standards, which are more stringent than Kentucky's

pleading standard. In Kentucky, a pleading is sufficient to survive a motion to dismiss if it contains any set of facts which, if proven, would entitle the claimant to relief.

The Board's brief order granting the Department's motion to dismiss failed to address the applicability of the Civil Rules. Instead, the Board found Saint Joseph failed to allege a specific set of facts in support of its claims for selective enforcement and never attempted to amend its petition to present such facts. Saint Joseph has filed a motion for reconsideration of the Board's order. In its motion, Saint Joseph also seeks an order compelling the Department to respond to certain discovery requests seeking evidence the Department has engaged in unequal treatment with respect to taxpayers' refund claims. Saint Joseph argues the Board's order granting the Department's motion to dismiss erroneously imposes an undue burden on Saint Joseph in presenting its petition of appeal, as evidence necessary to support Saint Joseph's claims is solely in the control of the Department and must be obtained through discovery.

The Board also directed the parties to brief whether the issue of federal preemption constitutes an "as applied" or a facial challenge to the provider tax statute. The Board has authority to decide "as applied" challenges but lacks the authority to determine whether a statute is facially unconstitutional. The Department claimed Saint Joseph's petition presents a facial challenge to the statute, which the Board cannot decide. Saint Joseph countered that its petition clearly alleges the Department's application of the provider tax statute to Saint Joseph's preempted receipts violates federal law and the United States Constitution. The Board agreed with Saint Joseph, finding Saint Joseph's petition raises an "as applied" challenge the Board has the authority to decide.

The Board must address the remaining issue of federal preemption. Saint Joseph's brief is due October 29, 2014.

The authors' firm represents Saint Joseph.

3. Severance Tax - *Roanoke Cement Company, LLC v. Finance and Administration Cabinet, Department of Revenue*, Kentucky Court of Appeals, 2013 CA-000471 (February 21, 2014), *motion for disc. rev. filed*, Kentucky Supreme Court, Case No. 2014-SC-149-D. (Pending).

In an opinion rendered February 21, 2014, the Kentucky Court of Appeals found the availability of the limestone tax credit contained in KRS § 143A.035 is determined by the residency of the purchaser and not the place of consummation of the sale.

From March 31, 2007 through January 31, 2009, Roanoke Cement Company, LLC ("Roanoke") owned and operated a limestone quarry in Salem, Kentucky. Roanoke sold approximately 99% of the limestone it severed to out-of-state customers. In those sales, the customer arranged transportation of the limestone from the Roanoke quarry. Pursuant to KRS § 143A.020, Roanoke paid the mineral severance tax on the limestone severed from the quarry. Roanoke subsequently claimed a refund of tax paid by claiming a credit under KRS § 143A.035. The credit is permitted against the mineral severance tax where at least 60% of the limestone is

sold in interstate commerce and sold to a purchaser outside of Kentucky. The relevant portion of the statute reads:

> (1) A credit is hereby allowed… on the gross value of limestone which is severed or processed within this state and sold to a purchaser outside of this state.
>
> …
>
> (3) The credit allowed in this section shall extend only to a taxpayer … who sells in interstate commerce not less than sixty percent (60%) of such stone….

KRS § 143A.035. Roanoke believed it was entitled to the credit because it sold 99% of its limestone to out-of-state purchasers and shipment was made on interstate rivers (i.e. the Cumberland River).

The Department denied Roanoke's refund claim asserting Roanoke did not satisfy the credit statute because less than 60% of the limestone was sold in interstate commerce. The Department alleged that to qualify for the credit, the sales must be consummated outside the state and that Roanoke consummated is sales and delivered the product within Kentucky. Roanoke appealed the denial to the Board.

On appeal, Board found Roanoke was entitled to the credit, and that the place of consummation of the sale was not controlling. The Department appealed to the Franklin Circuit Court. The court affirmed the order of the Board and found that the phrase "out-of-state", as used in the credit statute, modified the word "purchaser" and was not used to describe the location of the sale. Therefore, as the majority of the sales were in interstate commerce, Roanoke was entitled to the credit. The Department appealed to the Kentucky Court of Appeals.

The Court affirmed the opinions of the Board and the circuit court and held Roanoke was entitled to the tax credit. The appellate court noted that although the credit provision should be interpreted narrowly in favor of the state, the primary objective is to uphold the legislative intent of the credit. The Department argued the phrase "in interstate commerce" as used in the statute meant only those sales triggering Commerce Clause protections. Because Roanoke's sales were completed entirely within Kentucky, the Department maintained the sales were not in interstate commerce. In support of its contention, the Department cited to sales and use tax regulation 103 KAR 30:190.

The Court rejected the application of sales and use tax concepts in the interpretation of the credit. The Court held because Roanoke's sales were to out-of-state purchasers the sales affected the price and supply of limestone nationwide and therefore, were necessarily in interstate commerce. Thus, Roanoke was entitled to the credit.

The Department next argued that, even if Roanoke were entitled to the credit, the credit should exclude sales consummated in Kentucky and sold along the Cumberland River because such sales were not "to a purchaser outside the state" as required by the statute. In essence, the

Department argued the phrase "outside the state" modified the word "sold". The Court disagreed and found the phrase properly modified the word "purchaser" and not the word "sold". Furthermore, the Court held the method of delivery was irrelevant to the underlying policy of the credit. Therefore, sales with delivery made within Kentucky to out-of-state purchasers qualified for the credit.

C. Administrative Developments

1. Motor vehicle usage tax–trade-in allowance

The Department has posted a reminder on its website that, effective for sales on or after July 1, 2014, the retail price of new motor vehicles for purposes of the motor vehicle usage tax is determined by reducing the amount of total consideration given by the trade-in allowance of any motor vehicle traded in by the buyer. New vehicles purchased prior to July 1, but titled/registered after July 1, are not eligible for the trade-in allowance.

2. Gasoline and Special Fuels Tax

The Department has finalized regulation 103 KAR 43:330, which prescribes the method of measurement of compressed natural gas and liquefied natural gas in gallons as a special fuel. For purposes of reporting the number of gallons subject to the tax imposed by Gasoline and Special Fuels Tax (KRS § 138.220), every special fuels dealer must convert compressed natural gas or liquefied natural gas into gallons. The new rule provides that the conversion rate for compressed natural gas is 5.66 lbs. or 126.67 cubic feet of compressed natural gas to one gallon of special fuels and the conversion rate for liquefied natural gas is 6.06 lbs. of liquefied natural gas to one gallon of special fuels. The regulation took effect August 1, 2014.

V. OTHER NOTES OF INTEREST

A. Legislative Developments

The Kentucky General Assembly's Regular Session adjourned *sine die* April 15, 2014. As a result, there have been no developments since the Spring Update.

B. Judicial Developments

1. 911 Funding – *Greater Cincinnati/Northern Kentucky Apartment Ass'n, Inc. v. Campbell County Fiscal Court,* Campbell Circuit Court, Case No. 13-CI-00956 (June 6, 2014), motion to transfer to the Kentucky Supreme Court, Case No. 2014-SC-000383 granted September 18, 2014 (Pending).

Last summer, Campbell County in Northern Kentucky joined the ranks of other Kentucky counties seeking to fund 911 services by non-traditional means. Historically, 911 services in Campbell County have been funded by a $3.00 per month subscriber charge imposed upon landline telephones. Like other counties, Campbell County has experienced a decrease in funding due to the replacement of landlines with wireless telephones and other new technology. The

Campbell County Fiscal Court concluded the $3.00 subscriber charge is no longer sufficient to provide reliable emergency communication services.

As a result, on August 7, 2013, the Campbell County Fiscal Court adopted Ordinance O04-13, which replaces the subscriber charge with an annual fee of $45.00 imposed upon each occupied individual residential and commercial unit located on real property in Campbell County. The ordinance has sparked considerable criticism, and on September 12, 2013, a civil action was commenced in Campbell Circuit Court challenging the legality of the ordinance. The lawsuit was filed by the Greater Cincinnati/Northern Kentucky Apartment Association, in conjunction with multiple owners of individual commercial and residential units located in Campbell County.

The lawsuit sought to have the ordinance declared void *ab initio* because it levies an unauthorized and unconstitutional fee or tax. The plaintiffs asserted there are four legally prescribed methods by which a political subdivision in Kentucky, such as Campbell County, may collect funds from its residents: (1) special assessments; (2) regulatory fees and taxes; (3) user fees; and (4) revenue-raising fees and taxes, and the imposition of a flat fee (of $45.00 on owners of real property), does not satisfy the criteria of any of the four methods. The lawsuit sought to have the 911 fee declared unconstitutional and to enjoin Campbell County from collecting the fee.

The County defended the lawsuit by arguing the 911 service charge is a valid user fee. The County argued all real property owners are "users" of 911 service because the service is available to everyone in the county and confers a benefit upon society at large. The plaintiffs countered that a valid user fee must be based upon actual use of the service, and owners of real property may never dial 911 and thus may never use the service for which they pay a fee.

The circuit court adopted the County's broad definition of "use" and found the plaintiffs are "users" of 911 service because the service is *available* to them should they need it. The court declined to define "use" as "actual use", finding real property owners are "users" of 911 service even if they never dial 911. The Court concluded that, although a user fee can be based upon actual use, a valid user fee also may be based upon the availability of a service, or a conferred benefit. The plaintiffs appealed the circuit court's ruling to the Court of Appeals. The County then filed a motion to transfer at the Kentucky Supreme Court. The Kentucky Supreme Court granted the Appellees' motion to transfer on September 18, 2014. The first brief to the Court is due in November.

The author's law firm represents the plaintiffs in this litigation.

2. 911 Funding – *City of Lancaster v. Garrard County*, Kentucky Court of Appeals, Case No. 2013-CA000716-MR (July 3, 2014), *pet. for rehearing filed* July 15, 2014 (Pending).

The Kentucky Court of Appeals has reversed and remanded a decision of the Garrard Circuit Court upholding Garrard County's 911 fee as a valid user fee.

The facts leading to this lawsuit began nearly two years ago. On August 13, 2012, the Garrard County Fiscal Court adopted Ordinance O-08-12-1, which replaces the subscriber charge on landline telephones used to help fund 911 emergency telephone service with a fee of $0.25 imposed upon each and every water meter in Garrard County. The ordinance also requires every water company, water association in Garrard County to collect and remit the fees. On November 9, 2012, a civil action was commenced in Garrard Circuit Court challenging the legality of the ordinance. The lawsuit was filed against Garrard County, Kentucky, and the Garrard County Fiscal Court, alleging the ordinance is unconstitutional and collection of the fee is an unconstitutional taking of property.

While the circuit court upheld the validity of the ordinance, the Court of Appeals held the fee is not a valid user fee but instead an invalid tax. Appellants claimed the circuit court erred in granting summary judgment upholding the validity of the fee. The Court of Appeals agreed. The court noted that, under Kentucky case law, a valid user fee exists where there is a reasonable relationship between the fee charged and the benefit received. Generally, the court stated, a user fee is imposed upon the recipient of a benefit received from the government or for a particular government service. The court gave as examples of valid user fees tolls paid by drivers for the use of a particular highway or fees paid by individuals with landline phones for the benefit of 911 service. The court found the fee of $0.25 upon each water meter imposed by Garrard County's ordinance is not directly related to the benefit of 911 telephone service.

Although the Court found the circuit court erred by granting summary judgment upholding the ordinance as imposing a valid user fee, the Court of Appeals did not reach the questions of whether the fee constitutes a license or a tax. The Court directed the circuit court to consider these questions on remand. However, the Court noted that if the circuit court finds the ordinance imposes a tax, both parties have conceded at oral argument that the tax would be unconstitutional and thus in violation of Kentucky law.

The Fiscal Court filed a petition for rehearing on July 15, 2014 with the Court. The Fiscal Court asserts the Court erred in interpreting the lower court's holding that the 911 fee was a valid user fee pursuant to the user fee statute; rather, the Fiscal Court contends the lower court found it was a lawful fee pursuant to the 911 statute. The Fiscal Court argues that the validity of the 911 fee should be determined pursuant solely to the 911 fee statute (KRS § 65.760) without resort to other laws. Further, the Fiscal Court argues the Court erred in determining the previously imposed landline 911 fees are classic user fees and instead are fees pursuant to the authority of the 911 fee statute. Therefore, the Fiscal court argues the Court misapplied state law and argues the 911 fee should be upheld.

The author's law firm represents amicus curiae in this litigation.

3. Occupational License Tax - *City of Corbin and Joe White v. Knox County*, Kentucky Court of Appeals, 2013-CA-000984 and 2013-CA-001090 (May 23, 2014) *motion for disc. rev. filed*, Kentucky Supreme Court, Case No. 2014-SC-330 (June 20, 2014).

The Kentucky Court of Appeals affirmed a ruling of the Knox Circuit Court upholding the constitutionality of KRS § 68.197(8), which prescribes the applicability of providing for a credit against the county occupational license tax for a city occupational license tax from March 14, 2012 through July 15, 2014. The provision provides that any credit of city license fees against county license fees existing between a city and county as of March 15, 2012, shall remain in effect as it is on March 15, 2012. This provision also states that the provisions of subsection (7) providing for a credit against the county occupational license tax for a city occupational license tax shall not apply to a city and county unless both the city and county have levied and are collecting license fees on March 15, 2012.

In 1999, the Knox County Fiscal Court established and began collecting an occupational license tax on trades and professions within Knox County. In 2005, the City of Corbin, a city partially situated within Knox County, established a similar license tax. However, the City of Corbin never has attempted to collect its occupational license tax. Therefore, under KRS § 68.197(8), the statutory credit would be unavailable to the City's citizens through July 15, 2014.

The City of Corbin and Joe White, a business owner and resident of Corbin and Knox County, sought a declaration that KRS § 68.197(8) is unconstitutional. The City and White claimed the provision is unconstitutional because: (1) it was enacted in violation of the title or notice requirement of Section 51 of the Kentucky Constitution; (2) it violates the constitutional prohibition against special legislation set forth in Sections 59 and 60 of the Kentucky Constitution; and (3) it is arbitrary, unreasonable, and discriminatory in violation of Sections 2 and 3 of the Kentucky Constitution.

The Court of Appeals disagreed, finding KRS § 68.197(8) is constitutional in all respects. The Court noted that the title or notice requirement requires the title of an act to provide at least "a clue" as to the act's contents in order to prevent surprise or fraud upon the legislature. The Court found this requirement is satisfied with respect to KRS § 68.197(8). The Court noted that the bill providing for KRS § 68.197(8) was entitled, "AN ACT relating to fiscal matters and declaring an emergency." The Court found credits of city occupational license taxes against county occupational license taxes are logically included within the broad category of "fiscal matters," as "fiscal" generally is understood as relating to public revenue. Therefore, the Court found the title of the act gives fair notice of its provisions and does not violate Section 51 of the Kentucky Constitution.

The Court also found KRS § 68.197(8) is not special legislation. The City and White argued the provision constitutes special legislation because it distinguishes between cities that levied and collected occupational license taxes as of March 15, 2012 and those that did not. The Court noted, however, that a legislative classification distinguishing between some cities and counties is constitutional so long as it is based upon some reasonable and natural distinction. The Court found KRS § 68.197(8) places a moratorium on new mandatory occupational license

tax credits in order to preserve the existing division of occupational license taxes and avoid new and potentially disruptive divisions of revenue during a twenty-eight month period. The Court found that maintaining the status quo during this period of "fiscal turbulence" serves a legitimate legislative purpose.

Finally, the Court found KRS § 68.197(8) is not arbitrary because it does not single out a particular entity for special taxation or require a particular entity to bear a heavier burden than other entities. The Court concluded KRS § 68.197(8) is rationally related to legitimate state objectives and fully constitutional.

The City of Corbin and Joe White filed a motion for discretionary review at the Kentucky Supreme Court on June 20, 2014. The motion is pending.

4. Pollution Control Certificate - *Eco Power Solutions (USA) Corp. v. Commonwealth of Kentucky Finance and Administration Cabinet et al.*, Franklin Circuit Court, Civil Action No. 2013-CI-000942 (August 26, 2014) (Final).

In *Eco Power*, the Board considered whether a taxpayer's demonstration facility, built to showcase its pollution control equipment, qualifies as a "pollution control facility," entitling the taxpayer to a pollution control certificate for purposes of the sales and use tax.

The taxpayer, Eco Power Solutions (USA) Corp. ("Eco Power"), offers customers pollution control solutions designed to recapture energy and reduce emissions. Eco Power's primary customers are large coal and natural gas users. In order to showcase its pollution control equipment, Eco Power built a demonstration facility in Louisville. The facility contains two fossil fuel burning emission units that create pollution. Eco Power's on-site pollution control equipment, called "COMPLY 2000 units", significantly reduce the air pollution produced by the emission units.

Eco Power applied for a pollution control certificate, which would enable Eco Power to purchase materials and equipment for its demonstration facility without paying sales or use tax. Pursuant to KRS § 139.480(12), property designated as a "pollution control facility" is exempt from sales and use tax. A "pollution control facility" is defined by KRS § 224.1-300(1) as "[a]ny property designed, constructed, or installed as a component part of any commercial or industrial premises for the primary purpose of decreasing air pollution". The DOR denied Eco Power's request for a pollution control certificate on the basis that the primary purpose of the COMPLY 2000 units was to market and demonstrate Eco Power's product, not to reduce air pollution.

The Board concluded otherwise and reversed the DOR's ruling noting, "[t]here is no distinction in the statute for air pollution which is the byproduct of a manufacturing process and air pollution which is the byproduct of a demonstration process." The Board further stated:

> There is no qualification in the statute that the pollution being reduced must come from an industrial process before the component equipment can

> qualify—pollution is pollution under the statute. There is no question that the sole function of the equipment for which certification is sought is to reduce the existing pollution, from whatever source that pollution may derive. The property in question was designed for pollution control and is being used for that purpose.

The Board found the statute granting exemptions from sales and use taxes to pollution control facilities was not ambiguous, and that it was immaterial whether the pollution reduced by the equipment was created for demonstration purposes or was a result of the industrial process. Thus, the Board reversed the DOR's ruling and directed the DOR to grant Eco Power's application for a pollution control certificate for its demonstration facility.

The DOR appealed the Board's decision to the Franklin Circuit Court. The court reversed the Board finding that the Board's ruling was not supported by substantial evidence and a reasonable interpretation of the law. The court began by stating that tax exemptions are disfavored and should be construed narrowly. In interpreting exemptions, courts defer to the DOR for its interpretation. The court found that the exemption is premised not on how the property functions, but the primary purpose for which is was designed and installed. Eco Power installed the equipment at issue in order to demonstrate and market pollution control, rather than to control pollution itself. Therefore, the court found Eco Power was outside the statutory exemption. The court found the Board's lack of any deference to the DOR and failure to state a rational basis for its ruling supported the reversal. The court's decision was not appealed and is now final.

The authors' firm represented Eco Power.

5. Open Records - *Commonwealth of Kentucky, Department of Revenue v. Timothy J. Eifler*, Kentucky Court of Appeals, Case No. 2012-CA-000302 (September 20, 2013)*, mot. for discretionary review denied*, Kentucky Supreme Court, No. 2013-SC-000737 (August 13, 2014) (Final).

In this case involving Kentucky's utility gross receipts license tax, commonly known as the "school tax", the Franklin Circuit Court ordered the DOR to produce documents requested on behalf of a taxpayer by its attorney, Timothy J. Eifler. Mr. Eifler is a member of this firm.

The school tax is imposed by school districts across the Commonwealth at the rate of three percent (3%) of the total gross receipts derived from "*the furnishing, within the district, of utility services*." KRS § 160.613 (emphasis added). Although the school tax was originally administered by each individual school district, the DOR began administering the tax in 2005.

Taxpayer Delta Resources, Inc. ("Taxpayer") is a gas marketer that purchases gas from suppliers and resells that gas to commercial and industrial customers. The school district never attempted to collect the school tax from the Taxpayer. However, the DOR maintained that the Taxpayer was subject to the school tax. The DOR did not identify any substantive changes to the taxing statutes that would result in the Taxpayer being subject to the school tax from 2005 forward. However, the DOR alleged that other gas marketers were paying the tax. To verify the

DOR's claim, Mr. Eifler (on behalf of Taxpayer) made an open records request pursuant to Kentucky's Open Records Act, KRS § 61.870 *et seq.*

On July 19, 2010, Mr. Eifler requested the names, addresses and dates of registration of all taxpayers currently registered with the DOR for the school tax. If these records did not exist, Mr. Eifler requested "to inspect all documents, materials, computer software/databases or other records containing the names, addresses and/or dates of registration of all taxpayers currently registered" for the school tax. On July 23, 3010, the DOR denied Mr. Eifler's request, explaining that (1) a record of the names, addresses and date of registration of all taxpayers did not exist; (2) there was no existing method of extracting such information; (3) the DOR was not obligated to create a query to extract such information; and (4) the DOR did not need to release the entire database to Mr. Eifler because the requested information fell within an exemption to the open records law. In particular, the DOR claimed that the requested records constituted confidential taxpayer information that the DOR was prohibited from producing pursuant to statute. *See* KRS § 131.190(1)(a), § 131.081(15), and § 61.878.

Mr. Eifler appealed the DOR's ruling to the Kentucky Attorney General. The Attorney General overruled the DOR finding that the DOR maintained documents containing the requested information and that these documents should be produced for inspection. The Attorney General also found that the DOR violated the Open Records Act by applying an overbroad interpretation of the confidentiality statutes, KRS § 131.190(1)(a) and § 131.081(15), and that the registration applications of the taxpayers easily could have been redacted to comply with statutory privacy requirements. On appeal, the Franklin Circuit Court affirmed the decision of the Attorney General. *See Department of Revenue v. Eifler*, No. 10-CI-01640. The DOR then appealed to the Kentucky Court of Appeals.

On September 20, 2013, the Court of Appeals affirmed the decision of the circuit court. The Court found the DOR could have redacted the private information included in the documents requested by Mr. Eifler, noting that "courts continue to favor openness of records and the ability to redact private information which is exempt under the statute." Citing *Kenton County Fiscal Court v. Kentucky Enquirer*, 2010 WL 890012 (Ky. App. 2010), the Court noted that "it is in the interest of public policy to have access to occupational license applications however limited the information may be once redacted to provide the name and location of the business." The Court also agreed with both the Attorney General and the circuit court that the DOR's interpretation of KRS § 131.190(1)(a) and § 131.081(15) was overbroad. Accordingly, the Court held the records sought by Mr. Eifler were not exempt under the Open Records Act. The Court found the DOR may redact the private information from the database, but then, must allow Mr. Eifler to inspect the records.

The Kentucky Supreme Court denied the DOR's motion for discretionary review. This case is final.

6. Open Records - Office of the Attorney General, 12-ORD-216, appealed by the Department of Revenue to the Franklin Circuit Court, *Department of Revenue v. Sommer*, Case No. 12-CI-01582 (Pending).

In 12-ORD-216, the Attorney General was presented with the issue of whether a government agency violated the Open Records Act when it refused to produce the pleadings from a litigation in which it was involved. In August 2012, Mr. Mark Sommer requested from the Department any pleadings filed with the Board, the Franklin Circuit Court or the Kentucky Court of Appeals in *Insight Kentucky Partners II, L.P. v. Revenue Cabinet*, Civil Action No. 01-CI-01528 (Franklin Cir. Ct., Div. II). Citing to KRS § 26A.200(1), the Department denied the request stating the pleadings were court records and subject to the exclusive jurisdiction of the courts and thus exempt from the Open Records Act. Mr. Sommer appealed to the OAG.

The Attorney General found the Department violated the Open Records Act by denying Mr. Sommer's request without a legally recognized basis. The Attorney General found that an agency cannot argue it is not the custodian of its own records or deny a proper open records request on the basis that another agency is the "primary custodian" or that the records may be requested from another agency. The Attorney General also stated that mere possession of the records by the agency is enough to compel an agency to produce the records or explain why they are exempt.

The Attorney General proceeded to distinguish the authority cited by the Department finding KRS § 26A.200(1) and § 26A.220 do not exempt records of an agency merely because those records have been submitted to a court. The records held by an agency in the discharge of its duties are subject to inspection unless specifically exempted.

The Attorney General found the Department's reliance on *Ex Parte Farley*, 570 S.W.2d 617 (Ky. 1978) also improper. *Farley* involved a request for access to materials generated by the court incident to its decision-making process. Those records were deemed inseparable from the judicial function itself and excluded from the Open Records Act. Furthermore, the Department's reliance on 95-ORD-101 and 08-ORD-033 was misplaced. In those decisions, the Attorney General determined that the Monroe Circuit Court Clerk and the Kentucky Bar Association, respectively, were not subject to the Open Records Act and therefore, could not violate the Act in denying a request.

The Attorney General found that because the Department is subject to the Open Records Act and the requested documents were not exempt from the Act, the Department violated the Act in denying Mr. Sommer's request. The Department's appeal to the Franklin Circuit Court is pending.

7. Open Records - Office of the Attorney General, 12-ORD-225, appealed by Mark F. Sommer to the Franklin Circuit Court, *Mark F. Sommer and Tax Analysts v. Department of Revenue*, Case No. 13-CI-29 (August 26, 2014), post-decision motions have been filed by both parties (September 5, 2014) (Pending).

The Franklin Circuit Court recently ruled that a Kentucky tax attorney is entitled to final administrative rulings of the Department under the Kentucky Open Records Act. Attorney Mark F. Sommer submitted an Open Records Request to the Department in February of 2012 requesting final rulings issued by the Department from 2004 to the present. The Department denied Mr. Sommer's request, citing KRS § 61.878(1) and KRS § 131.190(1)(a), which provide that certain tax schedules, returns, or reports filed with the Department may not be disclosed if there is an expectation of taxpayer privacy. According to the Department, taxpayers only waive that expectation of privacy by appealing final rulings to the Board, at which point the final rulings become public record. The Department expressed concern that merely redacting a taxpayer's name would be insufficient to protect the taxpayer's privacy, and indicated that in some instances even underlying facts and legal issues discussed in the rulings would need to be redacted in order to prevent identification of the taxpayer.

Mr. Sommer appealed the Department's denial of his request to the Office of the Attorney General. On December 14, 2012, the Attorney General issued 12-ORD-225, affirming the denial of Mr. Sommer's request. The Attorney General relied upon KRS § 131.190(1)(a), § 131.081(15), and § 61.878(1)(l), which restrict disclosure of various public records, including certain taxpayer information. In upholding the Department's denial, the Attorney General noted, "The sweeping language of Kentucky's statutes relating to disclosure of taxpayer information, as well as the severity of the penalties imposed for unauthorized disclosure, compel us to affirm the agencies' position in this appeal."

Mr. Sommer then appealed to the Franklin Circuit Court. He sought a reversal of 12-ORD-225, an order requiring the Department to produce the requested information (with proper redactions), and attorneys' fees and penalties pursuant to KRS § 61.882(5) for the Department's willful violation of the Open Records Act. Mr. Sommer noted that other states regularly publish similar final rulings in redacted form. Tax Analysts, a non-profit news organization, sought and was granted leave to intervene in the action after the Department denied a nearly identical Open Records Request by Tax Analysts for the same reasons.

The circuit court reversed the Attorney General's ruling and ordered the Department to produce the requested information with appropriate redactions. The court found KRS § 131.190 and KRS § 131.081(15) grant taxpayers the right to privacy with respect to business affairs and returns and reports filed in response to an investigation by the Department. However, the court found these statutes "are silent as to information the taxpayer voluntarily submits when appealing the Department's ruling on tax liability." The court acknowledged KRS § 61.878 exempts certain records of a personal nature from production under the Open Records Act where disclosure would constitute an unwarranted invasion of privacy. Nevertheless, the court noted that "exceptions to disclosure are to be strictly construed in favor of open examination of

records" and "[t]he preference for openness and disclosure is an overwhelming trend in the Attorney General's Open Records Decisions."

The court found there "was simply no basis" for the Department to deny requests for final rulings that have been appealed to the Board. The court noted the Department's own administrative regulation provides that all records of proceedings before the Board shall be public records. The court found the Department's refusal to produce appealed rulings on the basis that it does not keep track of which rulings have been appealed to be incredible. The court stated, "If such minimal records are not maintained by the General Counsel of the Department, this Open Records request will provide a much needed, and apparently long overdue, incentive for the Department's management to identify, and keep track of, the cases [that] have been appealed."

With respect to final rulings that were not appealed, the court found that these rulings, too, were subject to disclosure. The court found KRS § 131.190 applies only to information the state compels the taxpayer to produce. According to the court, "[w]hen a taxpayer voluntarily initiates an administrative review of his tax liability and seeks a formal ruling of the Department, the broad rule of confidentiality does not fully apply." Indeed, according to the court, "[t]axpayers who contest their tax liability assessment, proceeding through formal tax administrative adjudication, at least partially waive their rights to confidentiality." The court noted that it had reviewed the final rulings submitted under seal and found "no legitimate basis to keep the vast majority of that information confidential."

The court stressed the importance of open disclosure as a means of keeping government in check; "Without public disclosure of the final rulings, there is no way for the public to know whether the Department has been fair and consistent or whether it has displayed political favoritism to some taxpayers over others. These considerations outweigh any privacy interest that may exist for taxpayers, especially when the names and identifying indicators have been redacted." Because the court found the Department's withholding of unappealed final rulings was not willful, the court denied Mr. Sommer's request for fees and penalties on that issue. However, the court granted Mr. Sommer's request for fees and penalties to the extent the requests sought disclosure of final rulings appealed to the Board.

8. Budget Reduction Measures - *Beshear v. Louisville Soccer Alliance, Inc., et al.,* Kentucky Supreme Court, Case No. 2012-SC-197 (June 19, 2014) (Final).

In this case, the Court of Appeals considered the appeal of Kentucky Governor, Steven L. Beshear and others of a lower court opinion holding that a 2008 Executive Order and General Fund Budget Reduction Order authorizing, in part, the Kentucky General Assembly to transfer $700,000 in excess funds from the charitable gaming regulatory account to the General Fund in an effort to balance the state budget, was unconstitutional. The Court held that the transfer of excess funds from the charitable gaming regulatory account to the General Fund in 2008 was constitutionally and statutorily authorized and that the suspension of the Charitable Gaming Act to allow the transfer did not convert the charitable gaming fee into an unconstitutional tax.

As background, in 1994, the Kentucky General Assembly enacted the Charitable Gaming Act ("Act") in response to a state constitutional amendment permitting charitable gaming, defined under KRS § 238.505(2) as bingo, charity game tickets, raffles and charity fundraising events, but excluding slot machines, electronic video gaming devices, wagering on live sporting events or simulcast broadcasts of horse races. Under the Act, a regulatory fee is imposed upon all licensed charitable gaming operations that fund the state oversight and regulation of charitable gaming and funds generated and not expended by year-end are carried forward to the next fiscal year per KRS § 238.570(2).

During fiscal year 2007-2008, the Office of the State Budget Director ("OSBD") projected a General Fund budget shortfall of $265 million. Governor Beshear then issued Executive Order 2008-11 and General Fund Budget Reduction Order 08-01, which effectively suspended numerous statutes, including KRS § 238.570(2), and directed the transfer of excess or surplus funds held in various trust and agency accounts into the state's General Fund to balance the budget. Because the charitable gaming regulatory account had a surplus at that time, $700,000 in excess funds were transferred to the General Fund. The General Assembly then ratified and codified Governor Beshear's Orders as part of the biennial budget bill beginning July 1, 2008. 2008 House Bill 406, p. 195.

The Appellee, Louisville Soccer Alliance, Inc., and several other not-for-profit organizations, ("Appellees") were all authorized to operate charitable gaming activities in Kentucky, and had paid license fees to the Department of Charitable Gaming. The Appellees challenged the Governor's Orders on the grounds that the fee increase was excessive, the Orders were improperly enacted in an even-numbered year, and that the fee increase was the direct result of the transfer of excess funds to the General Fund. The Franklin Circuit Court granted summary judgment in favor of the Appellees, concluding that the transfer of excess funds from the charitable gaming regulatory account to the General Fund was unconstitutional. The circuit court held that the transfer was unconstitutional, primarily because by suspending the no-lapse provision of KRS § 238.570(2) the charitable gaming license fee was converted into an unconstitutional tax in violation of Section 180 of the Kentucky Constitution. Section 180 provides that "no tax levied and collected for one purposed shall ever be devoted to another purpose." The circuit court also held that the transfer of funds violated Section 51 of the Kentucky Constitution, which provides: "No law enacted by the General Assembly shall relate to more than one subject, and that shall be expressed in the title, and no law shall be revised, amended, or the provisions thereof extended or conferred by reference to its title only, but so much thereof as is revised, amended, extended or conferred, shall be re-enacted and published at length."

On appeal, the Appellants argued that the General Assembly's transfer of public excess funds from regulatory and agency accounts, such as the charitable gaming account to the General Fund, is constitutional under both Section 51 and Section 180 of the Kentucky Constitution. They also asserted that KRS § 48.315 authorized the suspension of KRS § 238.570(2) and the transfer of the excess funds.

The Court first determined that the General Assembly had the authority to suspend KRS § 238.570(2) pursuant to Section 15 of the Kentucky Constitution, which provides: "No power to

suspend laws shall be exercised unless by the General Assembly or its authority." It next determined that the transfer of excess funds did not violate Section 51, relying primarily on the Kentucky Supreme Court's decision in *Commonwealth ex rel. Armstrong v. Collins,* 709 S.W.2d 437 (Ky. 1986), which held that the transfer of excess funds under the 1984 budget bill comported with the constitutional requirements of Section 51.

The Court next considered and rejected the Appellants' argument that the transfer of excess funds and the suspension of KRS § 238.570(2) violated Section 180. The Court determined that the circuit court erred in finding that the suspension and transfer converted the charitable gaming fee into an unconstitutional tax, in part, upon the finding that the fee revenue exceeded the actual cost of regulation. The Court discussed *Commonwealth v. Louisville Atlantis Community/Adapt, Inc.*, 971 S.W.2d 810 (Ky. App. 1997), which held that the imposition of the charitable gaming regulatory fee upon charitable organizations was a valid regulatory fee and not an unconstitutional tax, as claimed by the challenging charities. The Court in the instant case held that the Appellees had presented no evidence that the charitable gaming fee was not reasonably related to the cost of administering and enforcing the charitable gaming regulations, and there was no indication that the fee was intended to generate excess revenue for the state. The Court opined that "[s]imply because the revenue exceeded the expenditures in 2008 does not support the trial court's determination that the regulatory fee was somehow converted to an unconstitutional tax."

Finally, the Court examined the Appellants' argument that KRS § 48.315 provided for the transfer of funds to the General Fund. KRS § 48.315 lists specific statutes from which funds may be transferred to the General Fund; however, KRS § 238.570 is not included among them. However, KRS § 48.315 has the word "etc." at the end of the list of statutes allowing transfer. The Court held that the word "etc." means "[a]nd other things. The term [usually] indicates additional, unspecified items in a series," citing Black's Law Dictionary (7th ed. 1999). The Court therefore held that the inclusion of "etc." was evidence of the General Assembly's expressed intent to include other unspecified statutes and to hold otherwise would render inclusion of the word "meaningless and nonsensical."

The Court therefore reversed the judgment of the circuit court, and held that the transfer of excess funds from the charitable gaming regulatory account to the General Fund was constitutionally and statutorily authorized.

C. Administrative Developments

1. Implementation of Upgraded Automated Collection System (Kentucky Tax Alert, Vol. 33, No. 5 (September 2014))

In the September issue of Kentucky Tax Alert, the Department announced it will soon be implementing an upgraded version of its automated collection system. The new system–Computer Assisted Collection System for Government (CACS-G)–went live September 2, 2014.

The new system includes several upgrades and many benefits:

- The ability to automate many collections processes, freeing collectors to concentrate on taxpayer service.

- The ability to score cases and prioritize workload to allow collectors to concentrate on cases that require employee interaction to achieve a higher likelihood of success/collection. Cases likely to self-cure and those not likely to be collected at all will be handled in different streams with less employee interaction.

- The flexibility of a highly configurable workflow process that allows the DOR to control case flow, and timing and volumes of automated correspondence.

- A self-service Internet portal for taxpayers to make payments online.

- Real-time capability to review collector activities to facilitate training, coaching, and performance measures.

2. County Map for Enhanced Kentucky Business Investment Program Updated

The Kentucky Cabinet for Economic Development has updated the fact sheet for the Kentucky Business Investment (KBI) program. The fact sheet lists the enhanced incentive counties for 2014/2015, which include:

> Allen; Ballard; Bath; Bell; Boyle; Bracken; Breathitt; Breckinridge; Butler; Carroll; Carter; Casey; Christian; Clay; Clinton; Crittenden; Cumberland; Edmonson; Elliott; Estill; Fleming; Floyd; Fulton; Garrard; Grayson; Green; Harlan; Harrison; Hickman; Jackson; Johnson; Knott; Knox; Lawrence; Lee; Leslie; Letcher; Lewis; Lincoln; Magoffin; Marion; Marshall; Martin; Mason; McCreary; McLean; Meade; Menifee; Metcalfe;. Monroe; Morgan; Muhlenberg; Nicholas; Owsley; Pendleton; Perry; Pike; Powell; Robertson; Rockcastle; Russell; Taylor; Trigg; Trimble; Wayne; Whitley; and Wolfe Counties . (Kentucky Business Investment Fact Sheet, July 1, 2014, http://thinkkentucky.com/kyedc/pdfs/KBIFactSheet.pdf).

VI. BIOGRAPHIES

A. Timothy J. Eifler

Timothy J. Eifler is a Member in the Louisville office of Stoll Keenon Ogden PLLC. He serves as Chairperson of the State and Federal Tax Group, and also is a member of the firm's Business Litigation Practice Group. He is involved in all aspects of the firm's tax practice, but has concentrated in complex state and local tax planning, audit defense and federal, state and local tax controversies. A significant portion of Mr. Eifler's practice has also focused on tax-motivated transactional matters and the negotiation and implementation of state and local tax incentives, including corporate income tax credits, wage assessments and sales and use tax and property tax abatements.

In addition to handling matters before the federal, state and local taxing authorities, administrative tribunals and federal and state courts, Mr. Eifler has represented clients before the Kentucky General Assembly on legislative matters through testimony, drafting legislation and preparing comments for legislative hearings. He is AV® Preeminent™ Peer Review Rated by Martindale-Hubbell®, is listed in The Best Lawyers in America® for tax law, and is honored as a Kentucky Super Lawyer for his legal accomplishments in the field of tax law. Mr. Eifler is a member of the Louisville, Kentucky, Indiana, Tennessee, and American Bar Associations. Since 1994, he has been involved with the taxation sections of the Louisville, Kentucky and American Bar Associations. He also finds time to give back to the community by serving on the boards of directors of various nonprofit organizations.

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Erica L. Horn serves as Counsel to the Firm in Stoll Keenon Ogden's Lexington office. She is a member of the State & Federal Tax Practice, and represents Kentucky, multistate and multinational companies in matters before the Kentucky Department of Revenue, the Kentucky Board of Tax Appeals and the state and federal trial and appellate courts of Kentucky. Erica also represents clients with regard to a wide variety of state taxes including income, sales and use, property and severance.

For her many legal accomplishments, Ms. Horn is AV® Preeminent™ Peer Review Rated by Martindale-Hubbell®, listed in The Best Lawyers in America® in the areas of tax and commercial litigation and is honored as a Kentucky Super Lawyer for tax law. She is a frequent speaker on state and local tax topics. She has spoken across the United States at numerous conferences presented by the ABA Section of Taxation, Council on State Taxation ("COST"), Institute of Professionals in Taxation ("IPT") and others. Since 1985, Erica has been a licensed CPA. She is a practitioner member of COST and a member of IPT, the American, Kentucky and Fayette County Bar Associations, and the Kentucky Society of Certified Public Accountants ("KyCPA").

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Mr. Sherman completed his undergraduate work from the University of Notre Dame and his Juris Doctor from Ave Maria School of Law in Ann Arbor, Michigan. A former President and Secretary of the Federalist Society, Mr. Sherman also served as the Notes Editor for the Ave Maria Law Review. In 2008, he earned his Master of Laws in Taxation from the University of Florida Levin College.

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