October 15, 2001

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

Dear Governor Patton:

Enclosed is a detailed report of the tax expenditure items resulting from current Kentucky tax statutes. We have attempted to include all identifiable tax expenditures without making judgments relating to their value in modifying taxpayer behavior or in achieving policy objectives. Tax expenditures negatively impact the Commonwealth’s resources because they are not subject to review as a part of the biennial budget process. These expenditures need to be systematically reviewed, as they result in significant revenue losses to both the General Fund and the Road Fund.

This report contains important information for you and the members of the General Assembly. In addition to estimating the fiscal impact and legal basis for each identified tax expenditure, we have estimated the cost of excluding certain services from the sales tax base and the tax amount allocated to earmarked funds.

We will continue to monitor these items and report on their impacts during the coming biennium. Questions or comments about the report may be directed to the Office of the State Budget Director.

Sincerely,

James R. Ramsey
State Budget Director
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INTRODUCTION

What are tax expenditures?

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

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

Why publish a tax expenditure report?

Tax expenditures are increasingly used to encourage certain kinds of behavior or to provide financial aid to taxpayers in certain circumstances. Major objectives include economic recovery, equity, fiscal responsibility, and tax reform. The unintended result is an increase in the complexity of the tax laws. Individual taxpayers as well as tax experts have found it difficult to keep informed of these many changes. In many cases, these decisions lead to less similarity between state and federal laws and ultimately to even more complexity. When such provisions are enacted, the resulting tax loss reduces the revenue available to fund other programs, unless tax rates are raised or new taxes are enacted to compensate for the loss.
Unlike direct appropriations, which must be continuously reviewed and approved by the General Assembly to remain in effect, tax expenditures are usually not included in this review process. As a result, programs funded through tax expenditures receive priority funding over all other programs. In all probability, many “tax expenditure” programs would not receive the same priority if they had to compete with “direct funding” programs.

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

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

- “nominal” if its value is expected to be below $1 million,
- “substantial” if its value is expected to be above $1 million, or
- “indeterminable” if it is a new item and cannot be reliably estimated from any available information.

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

A number of states regularly compile tax expenditure reports and many have just started issuing the report in recent years. The results of such studies should be information leading to a fairer tax structure.

**How to Read This Report**

Each tax type contained in this report includes sections on:

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

Additionally, some tax types contain a heading titled “Tax Expenditures Enacted during Fiscal Years 2000 - 2001” which includes the most recently enacted tax expenditures, the date they went into effect, and the enacting legislative bill number.

In some past reports, services excluded from the sales tax base have been listed as tax expenditures. While we will continue to quantify the exemption of certain services from sales tax, they will no longer be listed as a tax expenditure. A list of specific services and the estimated costs of excluding them from the tax can be found on pages 110-112 of this report.

Some taxes are specially allocated to a particular fund or purpose. These items are not listed as tax expenditures. Rather, these allocations are listed under the heading “Earmarked Funds” and can be found on pages 120-123.

The Governor’s Office for Economic Analysis welcomes your comments and any questions you may have about this report.
OVERVIEW OF TAX EXPENDITURES: The following pie charts show taxes as a percentage of total estimated tax receipts and tax expenditures as a percentage of total estimated tax expenditures for Fiscal Year 2002.

Figure 1. General Fund Overview

Estimated FY2002 Tax Receipts*          Estimated FY2002 Tax Expenditures

Figure 2. Road Fund Overview

Estimated FY2002 Tax Receipts*          Estimated FY2002 Tax Expenditures

*Based on Official June 2001 Estimates
ALCOHOLIC BEVERAGE TAXES

Background

Alcoholic beverage consumption taxes on distilled spirits, beer, and wine became effective in 1936. The current rates are $2.50 per barrel of beer and 50 cents per gallon of wine. In 1982, a wholesale sales tax was imposed at the rate of 9 percent of the gross receipts derived from “sales at wholesale” or “wholesale sales of distilled spirits, wine, and beer”. Although insignificant from a revenue standpoint, each wholesaler pays a 5 cents per case tax on each case of distilled spirits sold within the state. In 1986, the tax rate was lowered to 25 cents per gallon on distilled spirits placed in containers for sale at retail, where the distilled spirits represent 6 percent or less of the total volume of the contents of such containers. Effective August 1, 1992, the liability for the excise tax on beer was shifted from the brewer to the distributor or retailer.

Total alcoholic beverage taxes were $69.8 million in FY01, which represents 1.05 percent of total General Fund revenue.

Current Rate Structure

The consumption tax is levied at a rate of $1.92 per wine gallon on distilled spirits, and 50 cents per wine gallon on wine. The minimum tax levied is 4 cents on any retail container of wine. If distilled spirits represent less than 6 percent of the total volume, the rate is 25 cents per wine gallon. The consumption tax on beer is $2.50 per barrel of thirty-one gallons, proportioned for lesser amounts. Each brewer producing beer in this state is entitled to a credit of 50 percent of the tax levied for each barrel sold in this state, up to 300,000 barrels per year.

In addition, each wholesaler pays a wholesale sales tax at a rate of 9 percent of gross receipts from sales at wholesale or wholesale sales of distilled spirits, wine, and beer within Kentucky.

Each wholesaler of distilled spirits also pays a 5 cents per case tax on all sales in Kentucky.
Tax Base

The consumption tax is a gallonage tax and becomes the liability of the distilled spirits and wine wholesaler when these beverages are sold to retailers or consumers within the state. The gallonage tax on beer is paid by the distributor selling in this state. The wholesale sales tax is based on gross receipts derived at the wholesale level. When reporting and paying the sales tax, the wholesaler, distributor, or anyone required to pay the tax is allowed to deduct 1 percent of the tax due as compensation. The wholesaler of distilled spirits in Kentucky pays the case sales tax.

Tax Due

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

Table 1. Total Alcoholic Beverage Tax Expenditures

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$780,000</td>
</tr>
<tr>
<td>2003</td>
<td>$790,000</td>
</tr>
<tr>
<td>2004</td>
<td>$790,000</td>
</tr>
</tbody>
</table>
Tax Expenditure Analysis

Tax Expenditures

1. **U.S. Government Exemption**
   
   *Regulation 103 KAR 40:035, effective 1982*

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

   - FY2002 .................................. $200,000
   - FY2003 .................................. $200,000
   - FY2004 .................................. $200,000

2. **Low Volume Distilled Spirits Taxed at Reduced Rate**
   
   *Kentucky Revised Statute 243.720, effective 1986*

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

   - FY2002 .................................. $30,000
   - FY2003 .................................. $30,000
   - FY2004 .................................. $30,000

3. **Allowance for Collecting and Reporting**
   
   *Kentucky Revised Statute 243.886, effective 1982*

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

   - FY2002 .................................. $550,000
   - FY2003 .................................. $560,000
   - FY2004 .................................. $560,000
CIGARETTE TAX

Background

Kentucky was the twentieth state to enact a tax on cigarettes, which became effective in 1936. The current rate of tax is three cents per package, with one-half cent earmarked to finance tobacco research programs.

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

For FY01, cigarette tax collections of $14 million were 0.21 percent of total General Fund tax receipts.

Current Rate Structure

The tax rate is three cents per package of twenty cigarettes.

Tax Base

The cigarette tax is paid through the purchase of stamps or meter units from the Revenue Cabinet. These stamps must be placed on each package of cigarettes as evidence that the tax has been paid. For affixing the tax evidence, the wholesaler is allowed the equivalent of a 9.09 percent discount when the evidence is purchased.

Tax Due

The wholesaler pays the tax at the time the tax stamps or meter units are purchased from the Revenue Cabinet. A monthly report is required by the twentieth of each month reflecting purchases and trafficking of cigarettes for the preceding month.
Table 2. Total Cigarette Tax Expenditures

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$1.9 million</td>
</tr>
<tr>
<td>2003</td>
<td>$1.9 million</td>
</tr>
<tr>
<td>2004</td>
<td>$1.9 million</td>
</tr>
</tbody>
</table>

Tax Expenditures

1. Compensation Allowed Wholesaler
   *Kentucky Revised Statue 138.146, effective 1982*

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

   FY2002..............................$1.7 million  
   FY2003..............................$1.7 million  
   FY2004..............................$1.7 million

2. U.S. Government Purchases
   *Regulation 103 KAR 41:130, effective 1975*

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

   FY2002..............................$200,000  
   FY2003..............................$200,000  
   FY2004..............................$200,000
COAL SEVERANCE AND PROCESSING TAX

Background

The coal severance tax was enacted in 1972. The tax base was increased in 1978 to tax both the severance and processing of coal in Kentucky. Transportation expense is an allowable exclusion from the gross value. A deduction from gross value is also allowed for coal purchased for the purpose of processing if the coal was purchased from a taxpayer registered with the Commonwealth for coal tax purposes. The 1974 session of the General Assembly, provided for a portion of the severance tax to be refunded to the counties in which the coal was severed. The Finance Cabinet administers the local refund program.

During FY01, the coal tax produced $141.6 million, which accounted for 2.1 percent of total General Fund receipts.

Current Rate Structure

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

Tax Base

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

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

Tax Due

The tax return and payment is due on the twentieth day of the month following the close of the taxable period.
Tax Expenditures Enacted During Fiscal Years 2000 - 2001

The following change was enacted by the 2000 General Assembly and became effective July 15, 2000.

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

Table 3. Total Coal Severance and Processing Tax Expenditures

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$11.4 million</td>
</tr>
<tr>
<td>2003</td>
<td>$11.6 million</td>
</tr>
<tr>
<td>2004</td>
<td>$11.5 million</td>
</tr>
</tbody>
</table>

Tax Expenditures

1. **Transportation Expense**

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

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

FY2002.................................$10.4 million
FY2003.................................$10.4 million
FY2004.................................$10.2 million
2. **Coal Used to Burn Solid Waste**  
*Kentucky Revised Statute 143.023, effective 1991*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2003</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2004</td>
<td>$-0-</td>
</tr>
</tbody>
</table>

3. **Thin Seam Tax Credit**  
*Kentucky Revised Statute 143.021, effective 2000*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$1.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$1.2 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$1.3 million</td>
</tr>
</tbody>
</table>
CORPORATION INCOME AND LICENSE TAXES

Background

The corporation license tax was first enacted in 1906 at the rate of 30 cents per $100 on the value of capital, represented by property owned and business transacted in the state. This annual tax is for the privilege of operating as a corporation in Kentucky. The current rate of $2.10 per $1000 of capital employed has been in effect since 1985. A credit of $1.40 per $1,000 is allowed for the first $350,000 of capital employed for corporations with a gross income of $500,000 or less. The minimum annual license tax is $30. This tax is filed on the same form and at the same time as the corporation income tax.

The corporation income tax was first levied in 1936. The rate was 4 percent of net income assigned to Kentucky after the deduction of federal income tax. Over the years the rates were restructured several times and in 1972 the deduction of federal income tax was removed. The current corporate income tax rates, which have been in effect since the 1985 Special Session of the General Assembly, are graduated between 4 and 8.25 percent of taxable income.

Corporate license tax receipts for FY01 were $147.5 million and accounted for 2.2 percent of total General Fund tax receipts. Corporate income tax receipts for FY01 were $289.9 million and accounted for 4.4 percent of total General Fund tax receipts.

Current Rate Structure

The current rate for corporate license tax is $2.10 per $1,000 of capital employed.

The current corporation income tax rates are graduated as shown in the table on the following page:
Table 4. Corporation Income Tax Rates

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>First - $25,000</td>
<td>4.00%</td>
</tr>
<tr>
<td>$25,001 - $50,000</td>
<td>5.00</td>
</tr>
<tr>
<td>$50,001 - $100,000</td>
<td>6.00</td>
</tr>
<tr>
<td>$100,001 - $250,000</td>
<td>7.00</td>
</tr>
<tr>
<td>Over - $250,000</td>
<td>8.25</td>
</tr>
</tbody>
</table>

Tax Base

The tax base for the corporation license tax is capital employed in the business, which is apportioned to Kentucky in the same manner as that used for the income tax. Capital employed includes capital stock, surplus, advances by affiliated companies, intercompany accounts, borrowed monies, or any other accounts representing additional capital used and employed in the business.

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

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

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

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

Every corporation 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 the state or having one or more individuals receiving compensation in this state must pay an annual license tax based on its capital employed in this state and a tax based on taxable net income. Kentucky is the only state that still requires a physical presence requirement in order to be subject to the corporate income and license tax.

The following corporations are specifically exempted from the license tax:

(a) State and national banks and trust companies;
(b) Savings and loan associations organized under the laws of Kentucky and under the laws of the United States and making loans to members only;
(c) Open-end registered investment companies organized under the laws of this state and registered under the Investment Company Act of 1940;
(d) Production credit associations;
(e) Insurance companies, including farmers’ or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;
(f) Public service companies subject to taxation under KRS 136.120;
(g) Corporations exempt under Section 501 of the IRC;
(h) Any property or facility that has been certified as an alcohol production facility as defined in KRS 247.910;
(i) Any property or facility which has been certified as a fluidized bed energy production facility as defined in KRS 211.390; and
(j) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit.

The following corporations are not subject to the corporate income tax:

(a) Electing small business corporations;
(b) State and national banks and trust companies;
(c) Savings and loan associations organized under the laws of Kentucky and under the laws of the United States and making loans to members only;
(d) Banks for cooperatives;
(e) Production credit associations;
(f) Insurance companies, including farmers’ or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;

(g) Corporations exempt under Section 501 of the IRC;

(h) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit; and

(i) Corporations having no individuals receiving compensation in Kentucky, and whose only owned or leased property located in Kentucky is located at the premises of a printer under contract, if such property consists of the final printed product, property which becomes a part of the final printed product, or copy from which the printed product is produced.

Tax Due

The taxable period for license tax is one year. The tax return and payment are due on the fifteenth day of the fourth month following the close of the taxable year.

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

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

Tax Expenditures Enacted During Fiscal Years 2000 – 2001

The following changes were enacted by the 2000 General Assembly and became effective July 15, 2000:

Kentucky Enterprise Zones - The definition of “qualified employees” was expanded to include seasonal employees. This will permit access to tax credits for some employers who had previously been denied the tax benefits of locating within an enterprise zone. HB 287
Kentucky Industrial Development Act – The maximum amount of tax credit allowed under this act is increased from 2 percent to 3 percent. HB 330

Coal Fired Electric Generation Plants – A credit is allowed against Corporate and Individual Income tax, Corporation License tax, and Public Service Corporation property tax for any electric power company or any entity that owns or operates a coal fired electric generation plant. The credit is computed by determining the number of tons of Kentucky coal burned in the base year (1999) and comparing that to the number of tons of Kentucky coal burned in the current year. The increase in tons burned over the base year, times $2, equals the amount of credit allowed. HB 805

Kentucky Industrial Revitalization Act – Credits allowable under this act are now allowed against corporate license tax in addition to corporate income tax. HB 996

The following changes were enacted by the 2001 General Assembly and became effective June 22, 2001:

Tax Increment Financing – Local governments can use this new program to fund the development of a new industrial area. The process determines the net increase in tax revenues attributable to an area above a base year. A portion of any increase may be returned to the locality for financing the development in the area. HB 238 Note: See separate section on Tax Increment Financing.

Kentucky Industrial Revitalization Act – Credits allowable under this act are extended to very large coal companies that have experienced a suspension or reduction in operations. HB 325

Kentucky Rural Economic Development Act – The eligibility for credits that may be granted under this act is extended to two years beyond the last year a county is certified for participation in the program. SB 34
Table 5. Total Corporation Income and License Tax Expenditures

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$142.6 million</td>
</tr>
<tr>
<td>2003</td>
<td>$150.6 million</td>
</tr>
<tr>
<td>2004</td>
<td>$159.2 million</td>
</tr>
</tbody>
</table>

Tax Expenditures

1. Net Operating Loss Deduction
   *Kentucky Revised Statute 141.010(13), 141.011, effective 1980*

In calculating Kentucky taxable income, corporations may carry back losses two years and then carry forward for twenty years, in order to reduce income in profit years.

   FY2002 ......................................$36.0 million
   FY2003 ......................................$36.8 million
   FY2004 ......................................$37.6 million

2. Exemption of Dividend Income
   *Kentucky Revised Statute 141.010(12)(b), effective 1969*

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

   FY2002 ......................................$27.8 million
   FY2003 ......................................$28.9 million
   FY2004 ......................................$30.2 million
3. **Exclusion of 50 Percent of Coal Royalties**  
*Kentucky Revised Statute 141.010(12)(d), effective 1962*

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

- FY2002 .................. Minimal
- FY2003 .................. Minimal
- FY2004 .................. Minimal

4. **Deductibility of the Excess of Percentage Over Cost Depletion**  
*Kentucky Revised Statute 141.010(13), IRC Sec. 611 through 614, effective 1954*

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

- FY2002 .................. $4.1 million
- FY2003 .................. $4.1 million
- FY2004 .................. $4.1 million

5. **Deduction for Charitable Contributions**  
*Kentucky Revised Statute 141.010(13), IRC Sec. 170, effective 1954*

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

- FY2002 .................. $3.4 million
- FY2003 .................. $3.6 million
- FY2004 .................. $3.8 million
6. **Deductibility of Patronage Dividends**  
*Kentucky Revised Statute 141.010(13), IRC Sec. 521, effective 1954*

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

- FY2002: Minimal
- FY2003: Minimal
- FY2004: Minimal

7. **Unemployment Tax Credit**  
*Kentucky Revised Statute 141.065, effective 1982*

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

- FY2002: $0
- FY2003: $0
- FY2004: $0

8. **Exemption for Credit Unions**  
*Kentucky Revised Statute 290.115, effective 1954*

Credit unions are exempt from corporation income tax.

- FY2002: $4.5 million
- FY2003: $4.5 million
- FY2004: $4.6 million
9. **Coal Conversion Credit**  
*Kentucky Revised Statute 141.041, effective 1984*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$200,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$200,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

10. **Double Weighted Sales Factor**  
*Kentucky Revised Statute 141.120(8), effective 1985*

Double weighting of the sales factor for multistate corporations.

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$15.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$15.3 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$15.7 million</td>
</tr>
</tbody>
</table>

11. **Recycling Credit**  
*Kentucky Revised Statute 141.390, effective 1991*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$8.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$8.5 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$9.0 million</td>
</tr>
</tbody>
</table>
12. Enterprise Zone Credit  
*Kentucky Revised Statute 154.45-090, effective 1992*

A credit of 10 percent of the wages paid to each employee, who has been unemployed for at least ninety days, or has received public assistance benefits for at least ninety days prior to employment. The credit is limited to $1,500 per qualified employee.

FY2002 ......................................$200,000  
FY2003 ......................................$200,000  
FY2004 ......................................$200,000

13. (KREDA) Economic Development Credit  
*Kentucky Revised Statute 141.347, effective 1988, 1998*

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

FY2002 ......................................$15.0 million  
FY2003 ......................................$16.5 million  
FY2004 ......................................$18.5 million

14. (KIDA) Economic Development Credit  
*Kentucky Revised Statute 141.400, effective 1992*

A 100 percent credit is allowed against the income of an approved company generated by or arising out of the economic development project. The credit can be carried forward for up to ten years, but cannot exceed, in any fiscal year, the total debt service paid during the same fiscal year in connection with the economic development project.

FY2002 ......................................$16.0 million  
FY2003 ......................................$17.8 million  
FY2004 ......................................$19.5 million
15. (KIRA) Economic Development Credit
   
   *Kentucky Revised Statute 141.403, effective 1992*

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

   
   FY2002...............................$1.5 million  
   FY2003...............................$1.7 million  
   FY2004...............................$1.9 million

16. (KJDA) Economic Development Credit

   *Kentucky Revised Statute 141.407, effective 1992*

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

   
   FY2002...............................$4.2 million  
   FY2003...............................$4.4 million  
   FY2004...............................$4.7 million

17. Kentucky Investment Fund Tax Credit

   *Kentucky Revised Statute 154.20, effective 1998*

   An investor making a cash contribution to a qualified investment fund is allowed a credit equal to 40 percent of the contribution against the corporate income or license tax liability.

   
   FY2002...............................$2.5 million  
   FY2003...............................$3.0 million  
   FY2004...............................$3.0 million
18. Skills Training Investment Tax Credit  
*Kentucky Revised Statute 154, effective 1998*

A credit of 50 percent of the approved cost of a company in connection with its skills training program is allowed against the corporate income tax liability.

- FY2002...................................$900,000
- FY2003...................................$900,000
- FY2004...................................$900,000

19. Real Estate Investment Trust  
*Kentucky Revised Statute 141.010(14), effective 1998*

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

- FY2002...................................$-0-
- FY2003...................................$-0-
- FY2004...................................$-0-

20. (KYOZ) Economic Development Credit  
*Kentucky Revised Statute 154.23, effective 2000*

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

- FY2002...................................Indeterminable
- FY2003...................................Indeterminable
- FY2004...................................Indeterminable
21. Limited Liability Companies; Limited Liability Partnerships

Kentucky Revised Statute 275, effective July 15, 1994

Entities who choose to organize as limited liability companies or limited liability partnerships are not subject to Kentucky corporate license tax.

FY2002.................................$3.3 million
FY2003.................................$4.2 million
FY2004.................................$5.3 million
GASOLINE TAX

Background

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

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

For FY01, gasoline tax collections totaled $318.4 million. This accounted for 29.9 percent of total Road Fund tax receipts.

Current Rate Structure

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

Tax Base

The tax is levied on the average wholesale price per gallon with a minimum wholesale price of $1.11 per gallon. The tax becomes a liability of the dealer when the gasoline is received or enters the dealer’s storage facility. In reporting and paying the tax, the dealer is allowed a deduction to cover evaporation, shrinkage, unaccountable losses, collection costs, bad debts, and handling and reporting the tax. An exemption is allowed for sales to the federal government, transfers to other licensed dealers, and for amounts exported out of state or lost through
accountable losses. Refunds are allowed for amounts used in agriculture, aircraft, motorboats, city and suburban buses and taxicabs, senior citizen transportation programs, and nonprofit buses.

**Tax Due**

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$9.0 million</td>
</tr>
<tr>
<td>2003</td>
<td>$9.2 million</td>
</tr>
<tr>
<td>2004</td>
<td>$9.2 million</td>
</tr>
</tbody>
</table>

**Table 6. Total Gasoline Tax Expenditures**

**Tax Expenditures**

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

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

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

   
   FY2002 ...................................... $7.2 million  
   FY2003 ...................................... $7.3 million  
   FY2004 ...................................... $7.3 million
2. **U.S. Government Exemption**  
   *Kentucky Revised Statute 138.240(2), effective 1956*

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

- FY2002: $170,000
- FY2003: $175,000
- FY2004: $180,000

3. **Agricultural Refund**  
   *Kentucky Revised Statute 138.344(1), effective 1946, revised 2000*

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

- FY2002: $400,000
- FY2003: $420,000
- FY2004: $440,000

4. **Aircraft Refund**  
   *Kentucky Revised Statute 138.341, effective 1942*

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

- FY2002: $215,000
- FY2003: $220,000
- FY2004: $225,000

5. **Watercraft Refund**  
   *Kentucky Revised Statute 138.445, effective 1960*

100 percent of the tax paid is refunded to qualified boat dock operators if the gasoline is used to operate or propel watercraft.

- FY2002: $750,000
- FY2003: $760,000
- FY2004: $770,000
6. **Bus, Taxicab and Certain Senior Citizen’s Programs Refunds**

*Kentucky Revised Statute 138.446, effective 1978*

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

- FY2002 .................................. $320,000
- FY2003 .................................. $325,000
- FY2004 .................................. $330,000
INDIVIDUAL INCOME TAX

Background

The individual income tax was first imposed in Kentucky in 1936. From 1943 to 1960, it was the most productive General Fund revenue source. From 1960 through 1986, it was second only to the sales and use tax. In 1987, it again became the most productive revenue source and continues so today. In FY88 the individual income tax became Kentucky’s first billion-dollar tax. Collections from the tax totaled $2,779 million in FY01, a growth of 2.8 percent over the prior year.

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

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

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

Kentucky income tax law provides for essential tax rates, credits, a standard deduction, interest and penalties, withholding procedures, and certain other items, independent of the federal law. It encourages husbands and wives to file separately on a combined return because usually a tax savings is involved. The individual income tax return is filed by individuals, including sole proprietors, shareholders in an S corporation, partners in a partnership, and individual members of a limited liability company.
Current Rate Structure

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

Table 7. Individual Income Tax Rates

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>2%</td>
</tr>
<tr>
<td>$3,001 - $4,000</td>
<td>3</td>
</tr>
<tr>
<td>$4,001 - $5,000</td>
<td>4</td>
</tr>
<tr>
<td>$5,001 - $8,000</td>
<td>5</td>
</tr>
<tr>
<td>Over - $8,000</td>
<td>6</td>
</tr>
</tbody>
</table>

A low income credit is allowed based on Kentucky adjusted gross income. For purposes of the credit, adjusted gross income is computed on a joint rather than an individual basis. The credit is computed as a percentage of tax liability as follows:

Table 8. Low Income Tax Credit

<table>
<thead>
<tr>
<th>Adjusted Gross Income</th>
<th>Credit Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,000 - Or Less</td>
<td>100%</td>
</tr>
<tr>
<td>$5,001 - $10,000</td>
<td>50</td>
</tr>
<tr>
<td>$10,001 - $15,000</td>
<td>25</td>
</tr>
<tr>
<td>$15,001 - $20,000</td>
<td>15</td>
</tr>
<tr>
<td>$20,001 - $25,000</td>
<td>5</td>
</tr>
<tr>
<td>Over - $25,000</td>
<td>0</td>
</tr>
</tbody>
</table>
Tax Expenditure Analysis

Individual Income

Tax Base

The individual income tax is levied on taxable income. Basically, taxable income is computed by reducing gross income by trade or business expenses, and the standard deduction ($1,700 for 2000) or, at the option of the taxpayer, itemized deductions. Gross income is defined as gross income under the 1999 federal internal revenue code with certain adjustments.

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

Taxable Unit

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

Tax Due

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

The tax return and payment of any remaining tax liability are due on the fifteenth day of the fourth month following the close of the taxable period, April 15 for calendar-year taxpayers. Extensions of time for filing the return are available under limited circumstances.
Tax Expenditures Enacted During Fiscal Years 2000 – 2001

The following tax expenditures were enacted by the 2000 General Assembly.

Adoption of the Internal Revenue Code - The Kentucky income tax reference to the IRC was updated to December 31, 1999, for tax years beginning on or after January 1, 2000. The numerous tax expenditures that are affected by this update are listed separately below. Effective for tax years beginning after December 31, 2000.  

HB 176

Job Development Fee - The maximum credit allowed under the Kentucky Industrial Development Act (KIDA) increased from 2 percent to 3 percent. Effective for tax years beginning after December 31, 2000.  

HB 330

Coal Fired Electric Generation Plants - A credit is allowed against Corporate and Individual Income tax, Corporation License tax, and Public Service Corporation property tax for any electric power company or any entity that owns or operates a coal fired electric generation plant. The credit is computed by determining the number of tons of Kentucky coal burned in the base year (1999) and comparing that to the number of tons of Kentucky coal burned in the current year. The increase in tons burned over the base year, times $2, equals the amount of credit allowed.  

HB 805

The following changes were enacted by the 2001 General Assembly and became effective June 22, 2001:

Tax Increment Financing - Two separate initiatives became law. The first establishes a process whereby the net increase in tax revenues attributable to an area may be returned to the locality for financing the development in the area. The second establishes a “job development assessment fee” that is withheld from an employee’s pay, and then refunded to the employee by the state income tax. This fee is paid to the locality; the amount is not dependent on any debt or other costs incurred.  

HB 238 and SB 47

Kentucky Industrial Revitalization Act - Credits allowable under this act are extended to very large coal companies that have experienced a suspension or reduction in operations.  

HB 325
Kentucky Rural Economic Development Act - the eligibility for credits that may be granted under this act is extended to two years beyond the last year a county is certified for participation in the program.  SB 34

Table 9. Total Individual Income Tax Expenditures

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$1,781.6 million</td>
</tr>
<tr>
<td>2003</td>
<td>$1,840.7 million</td>
</tr>
<tr>
<td>2004</td>
<td>$1,898.0 million</td>
</tr>
</tbody>
</table>

Tax Expenditures

1. Net Exclusion of Pension Contributions and Earnings
   Internal Revenue Code Section 401 and 414, effective 1983

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

   FY2002.............................$252.0 million
   FY2003.............................$259.0 million
   FY2004.............................$265.0 million

2. Personal and Dependent Tax Credits
   Kentucky Revised Statute 141.020(3), effective 1961

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

   FY2002.............................$73.2 million
   FY2003.............................$74.4 million
   FY2004.............................$75.6 million
3. **Deductibility of Home Mortgage Interest**  
*Internal Revenue Code Section 163(a), effective 1954*

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

FY2002.................................$115.1 million  
FY2003.................................$118.4 million  
FY2004.................................$121.4 million

4. **Deductibility of State and Local Taxes Other Than Home Property Taxes**  
*Internal Revenue Code Section 164(a), effective 1979 and 1990*

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

FY2002.................................$35.6 million  
FY2003.................................$36.4 million  
FY2004.................................$37.2 million

5. **Exclusion of Employer Contributions for Medical Insurance Premiums and Care**  
*Internal Revenue Code Section 105(b) and 106, effective 1954*

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

FY2002.................................$214.7 million  
FY2003.................................$220.1 million  
FY2004.................................$225.3 million

*Revenue Ruling 70-217, effective 1954*
Social Security benefits paid to retired workers and their dependents, to persons who are survivors of deceased workers, and to disabled workers and their dependents are not taxed. Kentucky has not adopted IRC Sec. 86 which taxes a portion of these payments if the taxpayer’s income is above a certain level.

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$292.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$300.8 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$309.8 million</td>
</tr>
</tbody>
</table>

7. **Deductibility of Property Tax on Owner-Occupied Homes**  
*Internal Revenue Code Section 164(a), effective 1954*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$35.8 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$38.1 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$39.9 million</td>
</tr>
</tbody>
</table>

8. **Deductibility of Charitable Contributions**  
*Internal Revenue Code Section 170(c)(b), effective 1978*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$70.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$72.5 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$73.9 million</td>
</tr>
</tbody>
</table>

9. **Exclusion of Interest on Life Insurance Savings**  
*Internal Revenue Code Section 101(a), effective 1978*

Interest received on life insurance savings because of death is exempt.
10. Exclusion of Capital Gains at Death

*Internal Revenue Code Section 1014, effective 1954*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$78.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$81.9 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$86.0 million</td>
</tr>
</tbody>
</table>

11. Deductibility of Individual Retirement Accounts

*Internal Revenue Code Section 219 (a)(b), effective 1982*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$10.6 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$10.8 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$11.0 million</td>
</tr>
</tbody>
</table>

12. Deductibility of Keogh Plans

*Internal Revenue Code Section 404(a)(8), effective 1963*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$4.3 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$4.5 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$4.6 million</td>
</tr>
</tbody>
</table>
13. Exclusion of Federal and Military Retirement Income  
*Kentucky Revised Statute 141.021, effective 1990*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Exclusion Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$43.6 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$44.9 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$46.2 million</td>
</tr>
</tbody>
</table>

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

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Exclusion Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$6.7 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$6.9 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$7.1 million</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Exclusion Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$640,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$650,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$650,000</td>
</tr>
</tbody>
</table>

15. Exclusion of Worker’s Compensation Benefits  
*Internal Revenue Code Section 104(a), effective 1954*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Exclusion Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$9.4 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$9.7 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$10.0 million</td>
</tr>
</tbody>
</table>
16. **Exclusion of Veteran’s Disability Benefits**  
*Internal Revenue Code Section 104(a)(4), effective 1954*

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

FY2002: $6.8 million  
FY2003: $6.8 million  
FY2004: $6.7 million

17. **Credit for Child and Dependent Care Expenses**  
*Kentucky Revised Statute 141.067, effective 1990*

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

FY2002: $5.8 million  
FY2003: $6.0 million  
FY2004: $6.3 million

18. **Deductibility of Foreign Income Tax**  
*Kentucky Revised Statute 141.010(11)(a), effective 1974*

Foreign income tax is allowed as an itemized deduction.

FY2002: $3.4 million  
FY2003: $3.4 million  
FY2004: $3.5 million

19. **Exclusion of Income Earned Abroad by U.S. Citizens**  
*Internal Revenue Code Section 911(a)(1) and 911(b)(2), effective 1985*

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

FY2002: $6.7 million  
FY2003: $6.9 million  
FY2004: $7.1 million
20. Deductibility of Excess of Percentage Over Cost Depletion

*Internal Revenue Code Section 613, effective 1981*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Deduction (in USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$630,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$630,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$640,000</td>
</tr>
</tbody>
</table>

21. Deductibility of Medical Expenses

*Internal Revenue Code Section 213, effective 1990*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Deduction (in USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$38.8 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$40.1 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$42.3 million</td>
</tr>
</tbody>
</table>

22. Deductibility of Net Operating Losses

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

The Kentucky net operating loss deduction is permitted in computing adjusted gross income.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Deduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>Substantial</td>
</tr>
<tr>
<td>FY2003</td>
<td>Substantial</td>
</tr>
<tr>
<td>FY2004</td>
<td>Substantial</td>
</tr>
</tbody>
</table>

23. Exclusion of Employee Meals and Lodging on Employer Premises

*Internal Revenue Code Section 119, effective 1978*

The value of meals and lodging, furnished to the employee by the employer on the business premises for the employer’s convenience, is not included in the income of the employee and is deductible by the employer.
24. Exclusion of Railroad and Supplement Railroad Retirement System Benefits

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

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$9.8 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$10.1 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$10.4 million</td>
</tr>
</tbody>
</table>

25. Exclusion of State Employee Pension Benefits and Contributions

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

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$38.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$39.5 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$41.1 million</td>
</tr>
</tbody>
</table>

26. Exclusion of Private Pensions and Individual Retirement Accounts

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

An exemption, up to a maximum of $37,500 for tax year 2001 (indexed for inflation), is allowed for benefits received from private pensions and Individual Retirement Accounts.
27. Exclusion of Scholarship and Fellowship Income

*Internal Revenue Code Section 117, effective 1954*

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

FY2002..............................$3.3 million  
FY2003..............................$3.5 million  
FY2004..............................$3.7 million

28. Exclusion of Public Assistance Benefits

Public assistance or welfare benefits are not taxed. These include Aid to Families with Dependent Children (AFDC) and Supplemental Security Income (SSI) benefits.

FY2002..............................$1.6 million  
FY2003..............................$1.6 million  
FY2004..............................$1.6 million

29. Credit for Hiring Unemployed

*Kentucky Revised Statute 141.065, effective 1982*

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

FY2002..............................$-0-  
FY2003..............................$-0-  
FY2004..............................$-0-

30. Exclusion of Special Benefits for Disabled Coal Miners

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

Coal miners or their survivors may exclude payments for disability or death from black lung disease.
31. Exclusion of GI Bill Benefits

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

GI bill benefits are excluded from gross income.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$310,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$320,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$320,000</td>
</tr>
</tbody>
</table>

32. Deductibility of Expenses of Certain Capital Outlays

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

Taxpayer may elect to treat the cost of qualifying property, up to $20,000, as an expense rather than a capital expenditure subject to depreciation. Soil and water conservation expenditures can be expensed limited to 25 percent of gross farm income.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$1.2 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$1.3 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$1.4 million</td>
</tr>
</tbody>
</table>

33. Low Income Tax Credit

*Kentucky Revised Statute 141.066, effective 1990*

Kentucky residents are allowed a low income tax credit based on adjusted gross income. The credit is a percent of tax liability.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$56.5 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$57.9 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$59.7 million</td>
</tr>
</tbody>
</table>

34. Exclusion of Benefits Provided Under Cafeteria Plans

*Internal Revenue Code Section 125, effective 1978*
Qualified benefits paid under a cafeteria plan are excluded from income, except in the case of highly compensated employees.

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$16.5 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$17.6 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$18.7 million</td>
</tr>
</tbody>
</table>

35. Exclusion of Miscellaneous Fringe Benefits  
*Internal Revenue Code Section 132, effective 1992*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$20.8 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$21.7 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$22.7 million</td>
</tr>
</tbody>
</table>

36. Deductibility of Casualty and Theft Losses  
*Internal Revenue Code Section 165, effective 1954*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$750,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$750,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$760,000</td>
</tr>
</tbody>
</table>

37. Credit for Recycling and/or Composting Equipment  
*Kentucky Revised Statute 141.390, effective 1991*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$6.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$6.2 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$6.4 million</td>
</tr>
</tbody>
</table>
38. **Job Development Credit**  
*Kentucky Revised Statute 154.22-070, 154.24-110, 154.26-100, effective 1992*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$35.5 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$38.0 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$40.7 million</td>
</tr>
</tbody>
</table>

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

Medicare benefits received for hospital insurance are not taxed.

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$50.5 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$53.7 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$55.5 million</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$31.8 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$33.9 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$35.7 million</td>
</tr>
</tbody>
</table>

40. **Deductibility of Moving Expenses**  
*Internal Revenue Code Section 217, effective 1964*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$5.3 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$5.4 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$5.5 million</td>
</tr>
</tbody>
</table>
41. Gain on the Sale of a Personal Residence
*Internal Revenue Code Section 121, effective 1997*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$20.4 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$21.8 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$23.3 million</td>
</tr>
</tbody>
</table>

42. Savings Incentives Match Plans for Employees (SIMPLE)
*Internal Revenue Code Section 408(k), effective 1997*

Employers of small businesses that make contributions to a retirement plan on behalf of their employees are allowed to deduct the contributions as a business expense.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2003</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2004</td>
<td>Minimal</td>
</tr>
</tbody>
</table>

43. Health Insurance Premiums Paid by Self-Employed
*Internal Revenue Code Section 162(l), effective 1997*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2003</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2004</td>
<td>Minimal</td>
</tr>
</tbody>
</table>

44. Health Insurance Premiums
*Kentucky Revised Statute 141.010(10), effective 1999*

Premiums paid by the taxpayer for himself, his spouse or his dependents are an allowable deduction. This deduction increased to 100 percent for tax years beginning after June 30, 1999.
45. Roth IRA
*Internal Revenue Code Section 408A, effective 1997*

Qualified distributions from a Roth IRA are exempt from Kentucky income tax. (A qualified distribution must satisfy a five-year holding period.)

FY2002 ......................... $-0-
FY2003 ......................... $-0-
FY2004 ......................... $-0-

46. Interest on Educational Loans
*Internal Revenue Code Section 62(a), effective 1997*

Up to $1000 of interest paid on qualified educational loans is deductible.

FY2002 ......................... $900,000
FY2003 ......................... $950,000
FY2004 ......................... $980,000

47. Precinct Workers
*Kentucky Revised Statute 141.010(10), effective 1997*

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

FY2002 ......................... Minimal
FY2003 ......................... Minimal
FY2004 ......................... Minimal

48. Tobacco Settlement
*Kentucky Revised Statute 141.010(10), effective 1998*

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

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

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

- FY2002................................... Minimal
- FY2003................................... Minimal
- FY2004................................... Minimal

50. Long-Term Care Insurance

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

Premiums paid for long-term care insurance are excludable from gross income if not previously excluded under the internal revenue code.

- FY2002................................... $1.2 million
- FY2003................................... $1.2 million
- FY2004................................... $1.4 million

51. Financial Institutions Structured as S Corporations

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

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

- FY2002................................... $1.0 million
- FY2003................................... $1.0 million
- FY2004................................... $1.0 million
INHERITANCE AND ESTATE TAX

Background

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

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

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

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

The 2001 Federal Tax Act accelerated the exemption from federal estate tax allowed to an estate. The exemption increased to a phased-in amount of $1 million in 2002, increasing to $3.5 million in 2009, with a complete repeal of the tax in 2010. Additionally, the highest rate drops to 50 percent in 2002 and decreases to 45 percent by 2007 before the repeal of the tax in 2010. The credit allowed at the federal level for death taxes paid to a state is phased out in 25 percent increments from 2002 to 2004. The increase in the federal exemption and the removal of the credit for state death taxes will decrease and then eliminate the amount of state revenues from estate tax.

During FY01, the inheritance and estate taxes produced $83.5 million in General Fund revenues. This was a 12.0 percent increase from the prior year and accounted for 1.3 percent of the total General Fund tax receipts.
Tax Base

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

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

The estate tax or “pickup tax” consists solely of the excess of Kentucky’s share of the state death tax credit allowed on the federal estate tax return over the Kentucky inheritance tax liability.

Taxable Unit

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

(a) Class A includes parents, the surviving spouse, children by blood, step-children, children adopted during infancy, children adopted during adulthood who were reared by the decedent during infancy, grandchildren who are the issue of children by blood, of stepchildren, or of children adopted during infancy, and, as of July 1, 1995, brothers, sisters, half-brothers, and half-sisters;

(b) Class B includes nephews, nieces, nephews and nieces of the half-blood, daughters-in-law, sons-in-law, aunts, uncles, and great-grandchildren who are grandchildren of children by blood, stepchildren, or children adopted during infancy; and,

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

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

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

Tax Due

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$ 93.6 million</td>
</tr>
<tr>
<td>2003</td>
<td>$ 114.8 million</td>
</tr>
<tr>
<td>2004</td>
<td>$ 136.7 million</td>
</tr>
</tbody>
</table>

*Many of the inheritance and estate tax expenditures could not be reasonably estimated.*
Tax Expenditure Analysis

Tax Expenditures

1. **Class A Beneficiaries**
   *Kentucky Revised Statute 140.080(1)(b) and (c), effective 1990, 1995*

   For dates of death on or after July 1, 1998, class A beneficiaries are totally exempt.
   
   FY2002..............................$74.2 million
   FY2003..............................$83.1 million
   FY2004..............................$93.1 million

2. **Transfers to Educational, Religious, Charitable, or Certain Governmental Organizations**
   *Kentucky Revised Statute 140.060, effective 1916*

   Transfers to these types of organizations are exempt.
   
   FY2002..............................$6.8 million
   FY2003..............................$7.0 million
   FY2004..............................$7.2 million

3. **Discount for Early Payment of Tax**
   *Kentucky Revised Statute 140.210(1), effective 1924*

   A 5 percent discount is allowed on inheritance tax paid within nine months of the date of death.
   
   FY2002..............................$1.3 million
   FY2003..............................$1.3 million
   FY2004..............................$1.4 million

4. **Class B Beneficiaries**
   *Kentucky Revised Statute 140.080((1)(d), effective 1948*

   Class B beneficiaries receive an exemption of $1,000.
5. Class C Beneficiaries

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

Class C beneficiaries are granted a $500 exemption.

FY2002.................................Minimal
FY2003.................................Minimal
FY2004.................................Minimal

6. Life Insurance Proceeds

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

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

FY2002.................................Minimal
FY2003.................................Minimal
FY2004.................................Minimal

7. Assessment of Land at its Agricultural or Horticultural Value

*Kentucky Revised Statute 140.300.360, effective 1978*

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

FY2002.................................Minimal
FY2003.................................Minimal
FY2004.................................Minimal
8. **Certificates of Deposit from the Contemplation of Death Rule**
   *Kentucky Revised Statute 140.020(3), effective 1978*

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

   FY2002.................................Minimal  
   FY2003.................................Minimal  
   FY2004.................................Minimal  

9. **Annuities Under Qualified Retirement Plans**
   *Kentucky Revised Statute 140.063, effective 1974*

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

   FY2002.................................Minimal  
   FY2003.................................Minimal  
   FY2004.................................Minimal  

10. **Individual Retirement Accounts**
    *Kentucky Revised Statute 140.063(3) and (4), effective 1982*

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

   FY2002.................................Minimal  
   FY2003.................................Minimal  
   FY2004.................................Minimal  

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

*Kentucky Revised Statute 140.095, effective 1948*

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

- FY2002...................................Minimal
- FY2003...................................Minimal
- FY2004...................................Minimal

12. Lifetime Transfers

Kentucky has no gift tax. A tax expenditure results in that lifetime transfers are preferred over transfers at death and contemplation of death transfers.

- FY2002...................................Substantial
- FY2003...................................Substantial
- FY2004...................................Substantial


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

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

- FY2002...................................Minimal
- FY2003...................................Minimal
- FY2004...................................Minimal

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

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

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

*Kentucky Revised Statute 140.130*

Kentucky’s estate tax is a “pickup” tax, meaning the amount of the tax is the amount allowed as a credit or reduction on the federal estate tax return if that amount is paid to the state. (The estate pays no more tax, it just pays part of the total to Kentucky.) Effective with FY02, the amount of the credit allowed on the federal return is reduced by 25 percent each year, until the credit is removed in FY05.

- FY2002: $11.3 million
- FY2003: $23.4 million
- FY2004: $36.0 million
LIQUEFIED PETROLEUM GAS TAX

Background

“Liquefied petroleum gas” means and includes any material which is composed predominantly of any of the following hydrocarbons, or mixtures of them, whether in the liquid or gaseous states: propane, propylene, butane (normal butane and isobutane), and butylene, and which are used to propel vehicles of any kind upon the public highways. A tax on liquefied petroleum gas was first levied in 1960. In 1980, like gasoline and special fuels, the base was changed to the average per gallon wholesale price of gasoline. The “supplemental highway user tax” became effective July 1, 1986.

The tax is imposed for the privilege of using the highways of the state. Consequently, the tax proceeds are deposited in the Road Fund. For FY01, the liquefied petroleum gas collections were $80,000 which accounts for 0.008 percent of total Road Fund tax receipts.

Current Rate Structure

The tax is 9 percent of the average wholesale price of a liquid petroleum gas rounded to the third decimal place. In no case can the “average wholesale price” be deemed to be less than $1.11 per gallon. Consequently, the tax rate can be no less than 10 cents per gallon. The “supplemental highway user tax” rate is 5 cents per gallon.

Tax Base

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

Taxable Unit

The unit for levying the liquefied petroleum gas tax is a “per gallon” basis.
Tax Due

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

Table 11. Total Liquefied Petroleum Gas Tax Expenditures

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$800</td>
</tr>
<tr>
<td>2003</td>
<td>$800</td>
</tr>
<tr>
<td>2004</td>
<td>$800</td>
</tr>
</tbody>
</table>

Tax Expenditures

1. Dealer’s Monthly Reporting Allowance
   *Kentucky Revised Statute 234.320(1), effective 1972*

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

   FY2002...................................$800
   FY2003...................................$800
   FY2004...................................$800

2. Approved Carburetion Systems
   *Kentucky Revised Statute 234.321(1), effective 1972*

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

   FY2002...............................$-0-
   FY2003...............................$-0-
   FY2004...............................$-0-
MOTOR VEHICLE USAGE TAX

Background

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

The tax is paid to the county clerk when a vehicle is first registered in the owner’s name. The proceeds derived from the tax are deposited in the Road Fund to be used in the construction and maintenance of Kentucky’s roads.

During FY01, motor vehicle usage tax collections were $396.8 million, a 3.1 percent decline from the previous year. These receipts constituted 37.3 percent of total Road Fund tax receipts.

Current Rate Structure

The motor vehicle usage rate is based on 6 percent of the retail price. The definition of retail price was changed significantly in 1998 (please see “Tax Base” below). A credit against the tax is allowed for substantially identical taxes paid to another state or foreign country on vehicles previously registered in such state or country, provided that the other state or country grants a similar credit for taxes paid in Kentucky.

Tax Base

The retail price for new motor vehicles is the actual selling price as provided in a notarized affidavit signed by both the buyer and seller. If an affidavit is not submitted, 90 percent of the Manufacturer’s Suggested Retail Price, including all standard and optional equipment, and transportation charges, will be used. No trade-in allowance is permitted in determining the retail price of a new vehicle. In the case of trucks with gross weight in excess of 10,000 pounds, the tax base is 81 percent of MSRP.
For used vehicles, the retail price is the total consideration paid. A trade-in credit is allowed. The total consideration paid must be disclosed in a notarized affidavit signed by both buyer and seller. If an affidavit is not submitted, the price is defined as the value appearing in the automotive reference manual prescribed by the Revenue Cabinet. For an older used vehicle whose value no longer appears in the reference manual, the retail price is as stated in a signed affidavit or at a minimum of $100.

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

**Taxable Unit**

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

**Tax Due**

The tax is paid to the county clerk when the vehicle is registered. The clerk deposits the tax in a Revenue Cabinet bank account on a daily basis and makes reports to the Revenue Cabinet on a weekly basis.

**No Enactments During 2000 - 2001**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$75.4 million</td>
</tr>
<tr>
<td>2003</td>
<td>$76.7 million</td>
</tr>
<tr>
<td>2004</td>
<td>$78.3 million</td>
</tr>
</tbody>
</table>
Tax Expenditures

1. **Trade-In Allowance on Used Vehicles**  
   *Kentucky Revised Statute 138.450(4), effective 1976*

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

   - FY2002: $41.1 million  
   - FY2003: $42.1 million  
   - FY2004: $43.0 million

2. **Immediate Family Member**  
   *Kentucky Revised Statute 138.470(6), and (14), effective 1976, 1992, and 1994*

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

   - FY2002: $13.2 million  
   - FY2003: $13.4 million  
   - FY2004: $13.7 million

3. **Governmental Exemption**  
   *Kentucky Revised Statute 138.470(1), effective 1968*

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

   - FY2002: $8.2 million  
   - FY2003: $8.3 million  
   - FY2004: $8.3 million
4. **Enterprise Zone Exemption**  
*Kentucky Revised Statute 154.45-090(4)and (5), effective 1982*

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

- FY2002: $3.3 million  
- FY2003: $3.3 million  
- FY2004: $3.4 million

5. **Military Exemption**  
*Kentucky Revised Statute 138.470(4), effective 1968*

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

- FY2002: $3.2 million  
- FY2003: $3.2 million  
- FY2004: $3.3 million

6. **Repossessed Exemption**  
*Kentucky Revised Statute 138.470(13), effective 1972*

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

- FY2002: $850,000  
- FY2003: $860,000  
- FY2004: $860,000

7. **Transfers by Will or Court Order**  
*Kentucky Revised Statute 138.470(9), effective 1970, 1990*

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

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

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

- FY2002................................... $800,000
- FY2003................................... $810,000
- FY2004................................... $820,000

9. Enterprise Zone Exemption – U Drive-It Tax

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

The wording of this exemption is interpreted to exempt receipts derived from short-term rentals of motor vehicles, by qualified businesses within an enterprise zone.

- FY2002................................... $2.7 million
- FY2003................................... $2.7 million
- FY2004................................... $2.8 million

10. Commercial Motor Vehicle Exemption

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

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

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

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$200,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$200,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$200,000</td>
</tr>
</tbody>
</table>

12. Transfers Between a Limited Liability and its Partners

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

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2003</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2004</td>
<td>$-0-</td>
</tr>
</tbody>
</table>

13. Transfers Between A Subsidiary and a Parent Corporation

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

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$200,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$200,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$200,000</td>
</tr>
</tbody>
</table>
14. Partnership Interests  
*Kentucky Revised Statute 138.470(12), effective 1970*

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

- FY2002 $-0-$
- FY2003 $-0-$
- FY2004 $-0-$

15. Insurance Company Transfers  
*Kentucky Revised Statute 138.470(14), effective 1976*

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

- FY2002 $-0-$
- FY2003 $-0-$
- FY2004 $-0-$

16. Adapted Equipment for Physically Handicapped Persons  
*Kentucky Revised Statute 139.450(4)(a), effective 1992*

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

- FY2002 Minimal
- FY2003 Minimal
- FY2004 Minimal
NATURAL RESOURCES SEVERANCE AND PROCESSING TAX

Background

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

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

KRS 42.450(2) and 42.470(2) require that one-half of the taxes collected on the sale of minerals, other than coal, be distributed among the mineral producing counties. While the natural resources tax is not a major revenue producer, revenues from the tax of $30.0 million represent 0.5 percent of total FY01 General Fund tax receipts.

Current Rate Structure

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

Tax Base

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

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

### Taxable Unit

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

### Tax Due

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

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$6.5 million</td>
</tr>
<tr>
<td>2003</td>
<td>$6.7 million</td>
</tr>
<tr>
<td>2004</td>
<td>$6.7 million</td>
</tr>
</tbody>
</table>

### Tax Expenditures

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

Expenses incurred in transporting minerals are excluded from gross value.
2. Limestone Sold in Interstate Commerce
   
   *Kentucky Revised Statute 143A.035, effective 1984*

   A credit is allowed equal to the tax on the gross value of limestone sold in interstate commerce. The credit extends only to those taxpayers who sever or process limestone through the rip-rap, construction aggregate, or agricultural limestone stages, and who sell at least 60 percent of such stone in interstate commerce.

   FY2002 ................................... $1.6 million
   FY2003 ................................... $1.7 million
   FY2004 ................................... $1.7 million

3. Limestone Sold or Used for Agricultural Purposes
   
   *Kentucky Revised Statute 143A.030, effective 1984*

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

   FY2002 ................................... $200,000
   FY2003 ................................... $200,000
   FY2004 ................................... $200,000

4. Ball Clay, Fluorspar, Lead, Zinc, Tar Sands, Barite, and Stone Used for Privately Maintained but Publicly Dedicated Roads
   
   *Kentucky Revised Statute 143A.020 and 143A.030, effective 1980, 1984*

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

   FY2002 ................................... $500,000
   FY2003 ................................... $500,000
   FY2004 ................................... $500,000
5. **Limit on Tax from Clay**  
*Kentucky Revised Statute 143A.037, effective 1991*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2003</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2004</td>
<td>$-0-</td>
</tr>
</tbody>
</table>

6. **Clay Used in Landfill Construction**  
*Kentucky Revised Statute 143A.037, effective 1991*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$100,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$100,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$100,000</td>
</tr>
</tbody>
</table>

7. **Inactive Crude Oil and Natural Gas Wells**  
*Kentucky Revised Statute 143A, effective 1998*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2003</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2004</td>
<td>$-0-</td>
</tr>
</tbody>
</table>
PROPERTY TAXES

Background

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

In 1793, the property tax represented over 86 percent of all state government receipts. That percentage has declined dramatically over the past 200 plus years. Much of the recent decline can be attributed to legislation passed during the 1979 Special Session of the General Assembly. House Bill 44, enacted during this session, generally limited growth from the tax levied on real property to 4 percent per year. This was done out of a fear that the rate of inflation was causing property values, and the resulting tax, to rise too dramatically. Thus, to compensate for rapidly growing values, the tax rate must be adjusted annually to ensure that the growth in tax receipts does not exceed the legal limits. This restriction remains in effect at the present time.

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

In FY01, total property tax collections of $407.5 million accounted for 6.1 percent of total General Fund tax receipts. The pie chart on the following page shows the allocation between real, tangible and intangible property tax receipts.
Current Rate Structure

The state tax rate for real property must be adjusted annually to comply with the provisions of House Bill 44. For 2001, the rate was set at 13.6 cents per $100 of assessed value. The rate in effect prior to House Bill 44 was 31.5 cents per $100 of assessed value. It must be noted that an increase in the tax base will necessitate a corresponding decrease in the rate. Consequently, any estimates of the cost of exemptions in the real property area are based on the assumption that House Bill 44 would not affect the outcome. The normal state rates applicable to tangible and intangible personal property are 45 cents and 25 cents per $100 of assessed value, respectively. The General Assembly has reduced the rates for some classes of tangible and intangible personal property over the years. These reduced rates give rise to many of the expenditures detailed later.

Tax Base

The property tax is levied on the fair cash value of all real, tangible, or intangible property unless a specific exemption exists in the Kentucky Constitution.
or in the case of personal property, has been granted by the General Assembly. Taxpayers who are 65 years of age or older or are classified as totally disabled qualify for a Homestead Exemption. This exemption, applied against the assessed value of a qualifying single-unit residential property, is adjusted every two years in accordance with the cost of living index. The homestead exemption amount for 2001 and 2002 is $26,800.

**Tax Due**

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

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

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

**No tax expenditures were enacted during 2000-2001.**

**Table 14. Total Property Tax Expenditures**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$856.4 million</td>
</tr>
<tr>
<td>2003</td>
<td>$883.6 million</td>
</tr>
<tr>
<td>2004</td>
<td>$916.2 million</td>
</tr>
</tbody>
</table>
The property tax expenditures have been categorized between real property, tangible personal property and intangible personal property.

**Real Property Tax Expenditures**
(Real property is defined as land and improvements and all rights inherent in real estate)

1. **State Real Property Tax Yearly Revenue Ceiling**
   *Kentucky Revised Statute 132.020(7), effective 1979*

   Prior to House Bill 44, the real property tax rate was 31.5 cents per $100. The adjusted rate, for tax year 2001 is 13.6 cents per $100 of assessment.

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$256.3 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$280.3 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$306.5 million</td>
</tr>
</tbody>
</table>

2. **Alcohol Production Facilities**
   *Kentucky Revised Statute 132.020(1), effective 1980*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2003</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2004</td>
<td>$-0-</td>
</tr>
</tbody>
</table>

3. **Leasehold Interests of Industrial Revenue Bonds**
   *Kentucky Revised Statute 132.020(1), effective 1978*

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$1.6 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$1.7 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$1.9 million</td>
</tr>
</tbody>
</table>
4. **Homestead Exemption**  
*Section 172 of the Kentucky Constitution and KRS 132.810, effective 1972, 1992, 1999*

A taxpayer 65 years of age or older or totally disabled, is allowed an exemption against the assessed value of a single-unit residence. In 2001 and 2002 this exemption is $26,800.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$13.2 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$14.1 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$15.1 million</td>
</tr>
</tbody>
</table>

5. **Agricultural and Horticultural Land**  
*Kentucky Revised Statute 132.450, effective 1999*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2003</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2004</td>
<td>Minimal</td>
</tr>
</tbody>
</table>

6. **Intrastate Railroads and Railway Companies**  
*Kentucky Revised Statute 132.020(10), effective 1990*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$18,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$18,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$18,000</td>
</tr>
</tbody>
</table>
Tangible Property Tax Expenditures
(The normal tangible rate is 45 cents per $100 of value)

7. Business Inventories

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

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

FY2002 ................................... $56.6 million
FY2003 ................................... $55.3 million
FY2004 ................................... $55.3 million

8. Leasehold Interests

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

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

FY2002 ................................... $5.3 million
FY2003 ................................... $5.9 million
FY2004 ................................... $6.5 million

9. Manufacturing Machinery, Pollution Control Equipment and Radio Television and Telephonic Equipment

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

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

FY2002 ................................... $52.1 million
FY2003 ................................... $50.8 million
FY2004 ................................... $50.8 million
10. **Livestock and Machinery Used in Farming, Livestock and Poultry**  
*Kentucky Revised Statute 132.020(1), effective 1917*

Machinery used in farming is taxed at a reduced rate of 1/10 of a cent per $100.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$22.5 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$22.5 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$22.5 million</td>
</tr>
</tbody>
</table>

11. **Agricultural Products**  
*Kentucky Revised Statute 132.020(1), effective 1950*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$300,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$300,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$300,000</td>
</tr>
</tbody>
</table>

12. **Foreign Trade Zone**  
*Kentucky Revised Statute 132.020(1), effective 1982*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$14.6 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$14.6 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$14.6 million</td>
</tr>
</tbody>
</table>

13. **Historic Vehicles**  
*Kentucky Revised Statute 132.020(1), effective 1984*

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$250,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$250,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$250,000</td>
</tr>
</tbody>
</table>
14. Intrastate Railroads and Railway Companies

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

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$300,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$300,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$300,000</td>
</tr>
</tbody>
</table>

15. Interstate Trucks, Tractors, Semi-Trailers and Buses

*Kentucky Revised Statute 136.1873, effective 1990*

Commercial vehicles that have routes or systems partly within this state and partly within another state or states are taxed at a reduced rate. This rate is computed annually. The rate in effect January 1, 2000 was 23.21 cents per $100.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$2.8 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$2.9 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$3.2 million</td>
</tr>
</tbody>
</table>

16. Carlines

*Kentucky Revised Statute 136.120, effective 1990*

Any company, other than a railroad company, which owns, uses, furnishes, leases, rents, or operates to, from, through, in, or across this state or any part thereof, any kind of railroad car is taxed at a reduced rate. The rate is computed annually. The rate in effect January 1, 2000 was 22.1 cents per $100.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$2.2 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$2.2 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$2.2 million</td>
</tr>
</tbody>
</table>
17. Aircraft

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

Airplanes, not used in the business of transporting persons or property for compensation or hire, are taxed at the reduced state rate of 1.5 cents per $100. This provision, which was originally passed in the 1996 budget bill, was due to expire.

- FY2002: $1.1 million
- FY2003: $1.1 million
- FY2004: $1.1 million

18. Federally Documented Vessels

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

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

- FY2002: Minimal
- FY2003: Minimal
- FY2004: Minimal

19. Floor Plan Machinery and Equipment

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

Machinery and Equipment held in inventory in the regular course of business for sale or lease and originating under a floor plan financing arrangement is taxed at a reduced state rate of 5 cents per $100.00.

- FY2002: Minimal
- FY2003: Minimal
- FY2004: Minimal

20. In-Transit Goods

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

Goods shipped into Kentucky and placed in a warehouse or distribution center with the purpose of continued shipment outside of Kentucky within six months is taxed at a reduced state rate of 1/10 of a cent per $100.
21. Motor Vehicles With a Salvage Title  
*Kentucky Revised Statute 134.810, effective 1999*

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

- FY2002: Minimal
- FY2003: Minimal
- FY2004: Minimal

22. Certain Classes of Intangible Properties  
*Kentucky Revised Statute 132.020(2), effective 1968*

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

- FY2002: $23.5 million
- FY2003: $23.5 million
- FY2004: $23.5 million

23. Bank Deposits  
*Kentucky Revised Statute 132.030(1), effective 1917*

Bank deposits are taxed at a reduced rate of 1/10 of a cent per $100.
24. **Exemption of Stock from Intangible Tax**

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

_Herschel St. Ledger, et al. V. Commonwealth of Kentucky Revenue Cabinet, et al._

The Kentucky Supreme Court declared KRS 136.030 (1), which exempted stock of companies in which the corporation paid taxes to Kentucky on a least 75 percent of its property, unconstitutional. As a result, all stock is exempt from intangible property tax. (Does not include retirement accounts.)

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Exempted Amount ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$223.9 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$223.9 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$223.9 million</td>
</tr>
</tbody>
</table>

25. **Retirement Plans**

*Kentucky Revised Statute 132.043, effective 1966*

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

*Note: Includes stock holdings previously reported in No. 24 above.*

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Exempted Amount ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$50.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$51.5 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$53.0 million</td>
</tr>
</tbody>
</table>

26. **Banks for Cooperatives, Production Credit and Domestic Savings and Loans Associations**

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

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

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

Annuities or rights to receive income are taxed at a reduced rate of 1/10 of a cent per $100.

FY2002................................... $2.9 million
FY2003................................... $2.9 million
FY2004................................... $2.9 million

28. Credit Union Accounts and Shares

*Kentucky Revised Statute 290.635, effective 1984*

Deposits and shares are totally exempt from tax.

FY2002................................... $6.8 million
FY2003................................... $7.1 million
FY2004................................... $7.5 million

29. Broker’s Accounts Receivables

*Kentucky Revised Statute 132.050, effective 1948*

Broker’s accounts receivables are taxed at a reduced rate of 10 cents per $100.

FY2002................................... $880,000
FY2003................................... $880,000
FY2004................................... $880,000
30. Reserves of Domestic Life Insurance Companies

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

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

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$750,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$750,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$750,000</td>
</tr>
</tbody>
</table>

31. Capital of Domestic Life Insurance Companies

*Kentucky Revised Statute 136.320, effective 1990*

The rate applicable to domestic life insurance companies capital will decrease in the future from a rate of $0.42 per $100 value in 2001 to $0.001 per $100 value in 2004.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2003</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2004</td>
<td>Minimal</td>
</tr>
</tbody>
</table>
SALES AND USE TAX

Background

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

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

From its inception in 1960 until 1986, the sales and use tax was the most productive tax in the General Fund. In 1986, it was surpassed by the individual income tax and continues to be the second most productive today. Receipts for FY99 totaled $2,086 million, which was a growth of 5.3 percent over the prior year. This tax represented 33.7 percent of total General Fund tax receipts in FY99.

Current Rate Structure

Sales and use taxes are imposed at the rate of 6 percent of gross receipts or purchase price.

Tax Base

The tax base for the sales tax is gross receipts derived from both retail sales of tangible personal property and sales of certain services to the final consumer in Kentucky. Retail sales are defined as any sales other than sales for resale. The lease and rental of tangible personal property for a consideration is considered a sale or purchase, the receipts of which are subject to the sales and use tax.

The tax base for the use tax is the purchase price of tangible personal property purchased for storage, use, or other consumption in Kentucky. The use tax is a “back stop” for sales tax and generally applies to property purchased out-
side the state for storage, use, or consumption within the state. The purchaser’s liability for the use tax is not extinguished until the tax has been paid to the state, either by the purchaser or by the retailer from whom the property was purchased. However, the purchaser will not be held liable for the tax provided a receipt is obtained from a retailer engaged in business in this state, or from a retailer authorized to collect Kentucky use tax, showing that the tax was collected by the retailer as a separately stated charge and the receipt is maintained in the purchaser’s files.

**Taxable Unit**

The sales tax is imposed on gross receipts from the sale, lease, or rental price of retail sales of tangible personal property and certain services in Kentucky. The use tax is imposed on the storage, use, or other consumption of tangible personal property in Kentucky, measured by the purchase price.

**Tax Due**

The tax must normally be reported and remitted on a monthly basis. In some cases, the taxpayer may be permitted to file on a quarterly or annual basis. For most taxpayers, the tax return and payment of the tax liability are due on the twentieth day of the month following the close of the tax period. Large taxpayers must file monthly returns and include an estimate of the first fifteen days of the following calendar month. The return is due on the twenty-fifth day following the close of the calendar period. The Revenue Cabinet notifies taxpayers required to file on this alternate basis of their obligation.

**Tax Expenditures Enacted During Fiscal Years 2000 – 2001**

The following tax expenditures became enacted by the 2000 General Assembly.

**Tourism Attraction** - The definition of tourism attraction was expanded to allow a historic building that is renovated into a lodging facility to qualify for the exemption. *HB 43*
Enterprise Zones - Expanded the definitions to allow seasonal employees to be used in calculating whether a business operating within an enterprise zone will qualify for sales tax exemptions. *HB 287*

Agricultural Exemptions – Expanded the definitions to exempt domestic cervids (deer and elk), and the equipment and supplies used in a related farming operation, from sales tax. *HB 502*

Retail Exemption - Provided a specific exemption for the sale of retail metal fixtures purchased for storage, use and consumption outside this state. *HB 660*

Emissions Control Equipment and Supplies - An exemption from the sales tax is allowed for purchases of machinery, limestone, and chemicals used to control emissions in the production of electricity. *HB 806*

Medical Supplies - Expanded the definitions to exempt wheelchair repair and replacement parts, and urostomy and ileostomy supplies from sales tax. *SB 86*

The following tax expenditures became enacted by the 2001 General Assembly.

Drug Samples - Expanded the definitions to exempt free drug samples distributed to or from a physician’s office from sales and use taxes. *HB 370*

Table 15. Total Sales And Use Tax Expenditures*

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$2,187.9 million</td>
</tr>
<tr>
<td>2003</td>
<td>$2,265.5 million</td>
</tr>
<tr>
<td>2004</td>
<td>$2,340.1 million</td>
</tr>
</tbody>
</table>

*Many of the sales and use tax expenditures could not be reasonably estimated.
The total sales and use tax exemptions do not include the cost of excluding services from the sales tax. These sales were never included in the tax base, are generally not part of most states’ sales tax base and therefore do not meet the technical qualifications of a tax expenditure. We have continued to estimate the amount of lost revenue from excluding certain services from the tax and have listed these on pages 110-112 in the back of this section. They are not considered tax expenditures for the purpose of this publication.

**Tax Expenditures**

1. **Food Items**

   *Kentucky Revised Statute 139.485, effective 1972, 1986*

   Food for human consumption is exempt from sales and use tax. The exemption does not apply to meals served in restaurants, to meals served on or off the premises, or to meals sold on a “take out” or “to go” basis. This exemption does include purchases made with food stamps.

   - FY2002..............................$398.1 million
   - FY2003..............................$408.8 million
   - FY2004..............................$418.7 million

2. **Non-profit Educational, Charitable and Religious Institutions**

   *Kentucky Revised Statute 139.495, effective 1976**

   Sales to resident, nonprofit educational, charitable, and religious institutions qualified for exemption from federal income taxation under Section 501(c)(3) of the Internal Revenue Code, for use solely within their exempt function, are exempt.

   - FY2002..............................$207.5 million
   - FY2003..............................$213.1 million
   - FY2004..............................$218.2 million
3. Labor or Services Used in Property Sold  
*Kentucky Revised Statute 139.050(3)(c), effective 1960*

A separately stated price received for labor or services used in installing or applying property sold is exempt from sales and use tax.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$233.7 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$240.0 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$245.8 million</td>
</tr>
</tbody>
</table>

4. Residential Utilities  
*Kentucky Revised Statute 139.470(8), effective 1979*

Sales of sewer services, water, and fuel to Kentucky residents for use in heating, cooking, lighting, and other residential uses are exempt from sales and use tax.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$106.6 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$110.8 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$115.3 million</td>
</tr>
</tbody>
</table>

5. Prescription Medicine, Prosthetic Devises and Physical Aids  
*Kentucky Revised Statute 139.472, effective 1971*

Prescription medicine, prosthetic devices, and physical aids are exempt from sales and use tax. Prosthetic devices include artificial limbs, artificial eyes, hearing aids, crutches, and wheelchairs.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$214.6 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$225.2 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$236.5 million</td>
</tr>
</tbody>
</table>

6. Machinery for New and Expanded Industry and Certain Industrial Machinery  
*Kentucky Revised Statute 139.170 and 139.480(10), effective 1960*
Machinery for new and expanded industry that is used directly in manufacturing or processing and which is incorporated for the first time into plant facilities in this state, and which does not replace machinery in such plant, is exempt.

*Kentucky Revised Statute 139.487, effective 1982*

Industrial machinery manufactured in Kentucky is exempt from sales tax when the industrial machinery is delivered to a manufacturer or processor or their agent for use out-of-state.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$33.3 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$34.8 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$36.2 million</td>
</tr>
</tbody>
</table>

7. **Coal Used in the Manufacture of Electricity**

*Kentucky Revised Statute 139.480(2), effective 1960*

Coal used in the manufacturing of electricity is exempt.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$58.4 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$59.5 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$60.1 million</td>
</tr>
</tbody>
</table>

8. **Energy and Energy Producing Fuels**

*Kentucky Revised Statute 139.480(3), effective 1960*

Energy and energy producing fuels used in manufacturing, processing, mining, or refining, to the extent that the cost of the energy or energy producing fuels used exceeds 3 percent of the cost of production, are exempt.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$37.5 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$38.5 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$39.4 million</td>
</tr>
</tbody>
</table>

9. **Retailers’ Compensation for Collecting and Remitting the Tax**

*Kentucky Revised Statute 139.570, effective 1960*
As reimbursement for the cost of collecting and remitting tax, the taxpayer shall deduct 1.75 percent of the first $1,000 of tax due and 1 percent of the tax due in excess of $1,000 if the amount due is not delinquent at the time of payment.

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$32.8 million</td>
<td>$33.4 million</td>
<td>$34.1 million</td>
</tr>
</tbody>
</table>

10. Enterprise Zones

*Kentucky Revised Statute 154.45-090(2)(3), effective 1992*

Building materials used in remodeling, rehabilitation, or new construction in a qualified enterprise zone and new and used equipment and machinery purchased by a qualified business for use in the enterprise zone are exempt.

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$19.5 million</td>
<td>$21.2 million</td>
<td>$23.7 million</td>
</tr>
</tbody>
</table>

11. State, Cities, Counties and Special Districts

*Kentucky Revised Statute 139.470(1)(7), effective 1960 and 1976*

Sales to any cabinet, department, bureau, commission, board, or other statutory or constitutional agency of the state, and to cities, counties, and special districts defined in KRS 65.005 are exempt.

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$135.2 million</td>
<td>$140.6 million</td>
<td>$146.2 million</td>
</tr>
</tbody>
</table>

12. Textbooks

*Kentucky Revised Statute 139.480(17), effective 1978*

Textbooks, related workbooks, and other course material purchased for use in a course of study conducted by an institution, which qualifies as a non-profit educational institution are exempt.
FY2002...............................$2.2 million
FY2003...............................$2.3 million
FY2004...............................$2.3 million

13. Recycling Machinery and Equipment

*Kentucky Revised Statute 139.170, 139.480(23), effective 1991*

Replacement machinery that will increase the consumption of recycled materials by not less than 10 percent and machinery and equipment purchased or leased by a business, industry or organization in order to collect, source separate, compress, bale, shred or otherwise handle waste materials and if the machinery or equipment is primarily used for recycling purposes are exempt.

FY2002...............................$4.7 million
FY2003...............................$4.8 million
FY2004...............................$5.0 million

14. Pollution Control Facilities

*Kentucky Revised Statute 139.480(12), effective 1974*

Property certified as a pollution control facility as defined by KRS 224.01-300 is exempt.

FY2002...............................$13.3 million
FY2003...............................$13.4 million
FY2004...............................$13.4 million

15. Tombstones and Other Grave Markers

*Kentucky Revised Statute 139.480(13), effective 1976**

Tombstones and other grave markers are exempt.

FY2002...............................$2.5 million
FY2003...............................$2.6 million
FY2004...............................$2.7 million
16. Lodgings of Thirty Days or More

*Kentucky Revised Statute 139.100(2)(a), effective 1992*

Rooms, lodging or accommodations supplied for a continuous period of 30 days or more to an individual are exempt.

- FY2002: $2.4 million
- FY2003: $2.5 million
- FY2004: $2.7 million

17. Garage or Yard Sales

*Kentucky Revised Statute 139.496, effective 1976*

Sales and use tax does not apply to the first $1000 of sales made in any calendar year by an individual or nonprofit organization not engaged in the business of selling.

- FY2002: $2.4 million
- FY2003: $2.5 million
- FY2004: $2.6 million

18. Semi-Trailers and Trailers

*Kentucky Revised Statute 139.050(3)(f), effective 1978*

The sales of semi-trailers and trailers as defined by KRS 189.010(12) and KRS189.010(17) are exempt.

- FY2002: Substantial
- FY2003: Substantial
- FY2004: Substantial

19. Vessels and Maritime Supplies

*Kentucky Revised Statute 139.483, effective 1966*

Ships and vessels, including their repair and construction, supplies and fuel used in their operation and supplies consumed by crew members aboard such ships and vessels, used principally in transporting property for hire are exempt.
20. Sales by Elementary and Secondary Nonprofit, School-Sponsored Clubs and Organizations

Kentucky Revised Statute 139.497, effective 1984

Sales made by elementary and secondary schools, nonprofit elementary or secondary school-sponsored clubs and organizations and/or nonprofit elementary or secondary school affiliated groups such as parent/teacher organizations and booster clubs are exempt.

FY2002 .................................. Substantial
FY2003 .................................. Substantial
FY2004 .................................. Substantial

21. Interstate Cargo and Passenger Aircraft, Parts and Supplies

Kentucky Revised Statute 139.480(19), effective 1982

Aircraft and their repair and replacement parts and supplies for the direct operation of aircraft in interstate commerce and used exclusively for the conveyance of property or passengers for hire are exempt from sales and use tax. Nominal intrastate use will not subject the property to sales and use tax.

FY2002 .................................. Substantial
FY2003 .................................. Substantial
FY2004 .................................. Substantial

22. Sales by Nonprofit Higher Educational School-Sponsored Clubs and Organizations.

Kentucky Revised Statute 139.495(4), effective 1980

Sales made by nonprofit school-sponsored clubs and organizations, provided such sales do not include tickets for athletic events, are exempt.
23. **Sales to Motion Picture Companies**

*Kentucky Revised Statute 139.538-.5386, effective 1986*

Motion picture production companies filming or producing motion pictures in Kentucky are exempt from the tax. The exemption is accomplished by granting a refundable credit of taxes paid on purchases made in Kentucky in connection with the filming or producing of a motion picture in this state.

- FY2002..............................Minimal
- FY2003..............................Minimal
- FY2004..............................Minimal

24. **Historical Sites**

*Kentucky Revised Statute 139.482, effective 1976*

Sales of admissions and purchases made by an historical site operated by a non-profit corporation, society, or organization and listed by the United States Department of Interior in the National Register are exempt.

- FY2002..............................Substantial
- FY2003..............................Substantial
- FY2004..............................Substantial

25. **Credit Unions**

*Kentucky Revised Statute 290.365, effective 1984*

Sales to credit unions organized under Kentucky law are exempt.

- FY2002..............................Substantial
- FY2003..............................Substantial
- FY2004..............................Substantial
26. **Coin-Operating Bulk Vending Machines**  
*Kentucky Revised Statute 139.470(6), effective 1966, 1998*

Vending machine sales of 50 cents or less are exempt from tax. Prior to the 1998 legislative change the amount exempt was 25 cents or less.

- FY2002: Substantial
- FY2003: Substantial
- FY2004: Substantial

27. **Non-returnable and Returnable Containers**  
*Kentucky Revised Statute 139.470(2), effective 1960*

Non-returnable and returnable containers sold without contents to persons who place the contents in the containers and sell contents and containers together, and returnable containers sold with the contents at retail or sold for refilling are exempt.

- FY2002: Substantial
- FY2003: Substantial
- FY2004: Substantial

28. **Occasional Sales**  
*Kentucky Revised Statute 139.070, 139.470(4), effective 1960*

Casual or isolated sales of property not held or used by a seller in the course of an activity for which he is required to hold a seller’s permit are exempt.

- FY2002: Substantial
- FY2003: Substantial
- FY2004: Substantial

29. **Locomotives and Rolling Stock**  
*Kentucky Revised Statute 139.480(1), effective 1960*

Locomotives or rolling stock, including materials for their construction, repair, or modification or fuel and supplies for the direct operation of locomotives and trains used in interstate commerce are exempt.
30. **Procurement, Processing, or Distribution of Blood or Human Tissue**  
*Kentucky Revised Statute 139.125, effective 1968*

Whole blood, plasma, blood products, tissues such as corneas, bones, or organs for the purpose of injecting, transfusing, or transplanting any of them into the human body are exempt.

FY2002 ................................ Substantial  
FY2003 ................................ Substantial  
FY2004 ................................ Substantial

31. **Rate Increase for School Taxes added to Residential Telephone Bills**  
*Kentucky Revised Statute 139.470(9), effective 1979*

Any rate increase for school taxes and any other charges or surcharges added to the total amount of a residential telephone bill is exempt.

FY2002 ................................ Substantial  
FY2003 ................................ Substantial  
FY2004 ................................ Substantial

32. **Raw Materials and Industrial Supplies**  
*Kentucky Revised Statute 139.470(11), effective 1990**

Raw materials and industrial supplies are exempt from sales and use tax if they enter into and become an ingredient or component part of the manufactured product or they are directly used in manufacturing or industrial processing.

FY2002 ................................ $471.2 million  
FY2003 ................................ $492.2 million  
FY2004 ................................ $512.7 million
33. Federal Taxes Imposed on Sales of Tangible Personal Property

*Kentucky Revised Statute 139.050(3)(d), 139.130(3)(d), effective 1960*

Taxes (not including any manufacturer’s excise or import duty) imposed by the United States upon or with respect to retail sales are exempt.

- FY2002 .......................................Substantial
- FY2003 .......................................Substantial
- FY2004 .......................................Substantial

34. Sales to Common Carriers Under a Bill of Lading

*Kentucky Revised Statute 139.470(5), effective 1960*

Gross receipts from sales of tangible personal property to a common carrier, shipped by the seller via the purchasing carrier under a bill of lading, whether the freight is paid in advance or the shipment is made freight charges collect, to a point outside this state and the property is actually transported to the out-of-state destination for use by the carrier in the conduct of its business as a common carrier are exempt.

- FY2002 .......................................$-0-
- FY2003 .......................................$-0-
- FY2004 .......................................$-0-

35. Lease or Rental of Films by Commercial Theaters

*Kentucky Revised Statute 139.484, effective 1990*

The lease or rental of films by commercial motion picture theaters, when the lease or rental is for the sole purpose of use in the normal course of business, if an admission fee is charged and if the commercial motion picture theater collects and remits all other applicable sales and use taxes, are exempt.

- FY2002 .......................................Substantial
- FY2003 .......................................Substantial
- FY2004 .......................................Substantial
36. Tourism Attraction Project  
*Kentucky Revised Statute 139.536, effective 1996 – Kentucky Revised Statute 154, effective 1998*

A credit is allowed against the sales tax generated by or arising from a tourism attraction project.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$1.8 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$2.8 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$3.8 million</td>
</tr>
</tbody>
</table>

37. Alcohol Production Facilities  
*Kentucky Revised Statute 139.480(18), effective 1980*

Any sale, use, storage or consumption of tangible property certified as an alcohol production facility as defined in KRS 247.910 is exempt.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2003</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2004</td>
<td>$-0-</td>
</tr>
</tbody>
</table>

38. Property Certified as a Fluidized Bed Energy Production Company  
*Kentucky Revised Statute 139.480(20), effective 1986*

Any sale, use, storage or consumption of tangible property, which has been certified as a fluidized bed energy production facility, as defined in KRS 211.390 is exempt.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2003</td>
<td>$-0-</td>
</tr>
<tr>
<td>FY2004</td>
<td>$-0-</td>
</tr>
</tbody>
</table>

39. Catalogs and Newspaper Inserts Shipped Outside Kentucky  
*Kentucky Revised Statute 139.470, effective 1988*

Catalogs and Newspaper Inserts purchased for storage, use or other consumption outside this state and delivered by the seller's own vehicle, postal service, common carrier or contract carrier to a location outside this state are exempt.
40. **4-H Sales**

*Kentucky Revised Statute 139.497, effective 1998*

Sales made by nonprofit educational youth programs affiliated with a land grant university cooperative extension service are exempt if the net proceeds from the sales are used solely for the benefit of the affiliated programs.

- FY2002.................................Minimal
- FY2003.................................Minimal
- FY2004.................................Minimal

41. **Jet Fuel**

*Kentucky Revised Statute 144.120, effective 1992; repealed July 1, 2000*

Certified air carriers are allowed a credit after payment of the first $4 million in sales and use tax on the purchase of aircraft fuel including jet fuel. Beginning July 1, 2000 the tax cap is reduced to $1 million.

- FY2002....................................$7.0 million
- FY2003....................................$7.0 million
- FY2004....................................$7.1 million

**Sales Tax Exemptions for Farmers**

The following tax expenditures pertain to the farming industry.

42. **Livestock, Poultry, Ratite Birds, Embryos and Semen, Alpacas, Llamas, Buffalos, Farm Work Stock and Feed, Seeds and Fertilizers**

*Kentucky Revised Statute 139.480(4),(5),(6),(7),(9),(24),(25),(26), and (29) effective 1960, 1994,1996*

Livestock that ordinarily constitutes food for human consumption, provided the sales are made for breeding or dairy purposes and by or to a person regularly
engaged in the business of farming; poultry for use in breeding or egg production; ratite birds and eggs to be used in an agricultural pursuit for the breeding and production of ratite birds, feathers, hides, breeding stock, eggs, meat, and ratite by-products; embryos and semen used in the reproduction of livestock; llamas and alpacas used as beasts of burden or in the breeding and production of hides, breeding stock, fiber and wool products, meat, and llama and alpaca by-products; and farm work stock for use in farming operations are exempt from the tax. Seeds, feed, and fertilizer, the products of which ordinarily constitute food for human consumption or which are to be sold in the regular courses of business are exempt.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Exemption Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$135.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$138.6 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$142.0 million</td>
</tr>
</tbody>
</table>

43. Horses Purchased for Breeding

*Kentucky Revised Statute 139.531(2)(a), effective 1976**

The sales and use tax does not apply to horses, interests in horses, or shares in horses, provided the purchase or use is made for breeding purposes only.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Exemption Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$15.1 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$15.3 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$15.5 million</td>
</tr>
</tbody>
</table>

44. Farm Machinery, Attachments, and Replacements, On-Farm Grain Storage Facilities, and On-Farm Facilities for Raising Chickens, Livestock, Ratite Birds, Llamas and Alpacas, and Buffalos

Farm machinery and repair and replacement parts for the operation of farm machinery are exempt. *Kentucky Revised Statute 139.480(11), effective 1968*

On-farm facilities used exclusively for grain or soybean storing, drying, processing or handling, including all construction, renovation, or repair materials, parts, and equipment, are exempt. *Kentucky Revised Statute 139.480(14), effective 1978*
On-farm facilities used exclusively for raising chickens and livestock, ratite birds, and llamas and alpacas, the products of which ordinarily constitute food for human consumption, including equipment, machinery, attachments, repair and replacement parts, and any materials incorporated into the construction, renovation, or repair of the facility. *Kentucky Revised Statute 139.480(15), (24), (26), and (29), effective 1990, 1994, and 1996*

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$20.0 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$20.8 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$21.3 million</td>
</tr>
</tbody>
</table>

### 45. Fuel Used for Farm Purposes

*Kentucky Revised Statute 139.480(16), effective 1978, 1998*

Gasoline, special fuels, and liquefied petroleum gas used to operate or propel stationary engines or tractors for agricultural purposes are exempt.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$10.8 million</td>
</tr>
<tr>
<td>FY2003</td>
<td>$11.2 million</td>
</tr>
<tr>
<td>FY2004</td>
<td>$11.4 million</td>
</tr>
</tbody>
</table>

### 46. Water Used for Farm Purposes

*Kentucky Revised Statute 139.480, effective 1998*

Water sold to persons regularly engaged in the business of farming and used in the production of crops, milk for sale, or raising and feeding livestock, poultry, ratites, llamas, alpacas, buffalo or aquatic organisms is exempt.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2003</td>
<td>Minimal</td>
</tr>
<tr>
<td>FY2004</td>
<td>Minimal</td>
</tr>
</tbody>
</table>

### 47. Equine Water

*Kentucky Revised Statute 139.470, effective 1998*

Water used in the equine-raising business is exempt.
48. Aquaculture  
*Kentucky Revised Statute 139.480, effective 1998*

Aquatic organisms sold directly to or raised by a person regularly engaged in the business of producing products of aquaculture for sale and items necessary for the production of aquatic organisms are exempt.

FY2002.............................Minimal  
FY2003.............................Minimal  
FY2004.............................Minimal  

49. Bailing Twine and Wire  
*Kentucky Revised Statute 139.480, effective 1998*

Baling twine and baling wire used for the purpose of baling hay and straw is exempt.

FY2002.............................Minimal  
FY2003.............................Minimal  
FY2004.............................Minimal  

50. Horses Less Than Two Years of Age  
*Kentucky Revised Statute 139.531(2)c, effective 1976**

Sales of horses less than two years of age at the time of sale, provided the sale is made to a nonresident of Kentucky, and the horse is transported out of state, either immediately following the sale or immediately following training within the state are exempt.

FY2002.............................$17.9 million  
FY2003.............................$18.6 million  
FY2004.............................$18.5 million
51. Farm Chemicals

*Kentucky Revised Statute 139.480(8),(24) and (26), effective 1992, 1994, 1996**

Insecticides, fungicides, herbicides, rodenticides, and other farm chemicals used in the production of crops as a business, or in the raising and feeding of ratite birds, llamas and alpacas, or livestock and poultry, the products of which ordinarily constitute food for human consumption are exempt.

FY2002 ................................... $11.3 million  
FY2003 ................................... $11.6 million  
FY2004 ................................... $11.9 million  

Table 16. Subtotal for Farming Tax Expenditures

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$210.2 million</td>
</tr>
<tr>
<td>2003</td>
<td>$216.2 million</td>
</tr>
<tr>
<td>2004</td>
<td>$220.7 million</td>
</tr>
</tbody>
</table>

** Although codified into law at various times, these items have been exempted by regulation since July 1, 1996.

Exclusion of Services

*Kentucky Revised Statute 139.100 and 139.160, effective 1960*

Services are excluded from the sales and use tax by the definition of “retail sale” or “sale at retail” as a sale of tangible personal property.
(a) Personal services.

FY2002 ................................... $53.4 million
FY2003 ................................... $57.4 million
FY2004 ................................... $61.7 million

(b) Business services.

FY2002 ................................... $151.9 million
FY2003 ................................... $163.2 million
FY2004 ................................... $175.5 million

(c) Health services.

FY2002 ................................... $379.5 million
FY2003 ................................... $407.9 million
FY2004 ................................... $438.4 million

(d) Legal services.

FY2002 ................................... $67.1 million
FY2003 ................................... $72.2 million
FY2004 ................................... $77.6 million

(e) Educational services.

FY2002 ................................... $4.5 million
FY2003 ................................... $4.8 million
FY2004 ................................... $5.2 million

(f) Social services.

FY2002 ................................... $12.3 million
FY2003 ................................... $13.2 million
FY2004 ................................... $14.2 million

(g) Engineering, accounting, research, management.
Tax Expenditure Analysis

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$659.2 million</td>
</tr>
<tr>
<td>2003</td>
<td>$698.4 million</td>
</tr>
<tr>
<td>2004</td>
<td>$740.1 million</td>
</tr>
</tbody>
</table>

Table 17. Total for Excluded Services
SPECIAL FUELS TAX

Background

The term “special fuels” is defined to include all combustible gases and liquids, capable of being used in motor vehicles, except gasoline, as defined in KRS 138.210, and liquefied petroleum gas, as defined in KRS 234.100. A tax on special fuels was first enacted in 1952. When the base was changed for gasoline in 1980 to the average per gallon wholesale price, the special fuels tax base was changed accordingly. This provided that the special fuels rate would be a function of the wholesale price of gasoline, and as the price of gasoline rose, the rate on special fuels would rise proportionately. The “supplemental highway user tax” became effective July 1, 1986.

In 1988, the General Assembly made a major change in the special fuels law. The new law requires that the tax be levied on the dealer at the point of receipt of the fuels (as is the case for gasoline) instead of the point of sale by the dealer. Generally, special fuels used for off-highway purposes are subject to a refund of the tax, provided proper applications are filed and other procedures are followed.

The tax is imposed for the privilege of using the highways of the state, therefore, the receipts are deposited in the Road Fund. For FY01, the special fuels tax collections were $89.9 million, which was 8.4 percent of total Road Fund tax receipts.

Current Tax Rate

The current tax rate is a minimum of 10 cents per gallon. As the price of the fuel increases above $1.11 per gallon, the tax increases accordingly. The current rate for the supplemental highway tax is 2 cents per gallon thereby increasing the total minimum rate on special fuels to 12 cents per gallon.

Tax Base

The tax is based on the average wholesale price per gallon of special fuel with a minimum wholesale price of $1.11 per gallon. The tax becomes a liability of the dealer when the special fuel is received or enters the dealer’s storage facility.
The dealer is allowed a deduction of 2.25 percent to cover evaporation, shrinkage, unaccountable losses, collection costs, bad debts, and handling and reporting the tax. Numerous exemptions and credits are given to the tax, these are listed in detail in the “Tax Expenditures” section.

**Taxable Unit**

The unit for levying the special fuels tax is a “per gallon” basis.

**Tax Due**

Returns and payments of the tax are due monthly. The tax must be remitted to the Revenue Cabinet on or before the twenty-fifth day of the month.

**Table 18. Total Special Fuels Tax Expenditures**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$35.8 million</td>
</tr>
<tr>
<td>2003</td>
<td>$37.0 million</td>
</tr>
<tr>
<td>2004</td>
<td>$38.4 million</td>
</tr>
</tbody>
</table>

**Tax Expenditures**

1. **Non-highway Use**

*Kentucky Revised Statute 138.344(1), effective 1988, 2000*

Special fuels used exclusively for non-highway use by qualified purchasers are exempt sales. In 2000 some purchasers who previously paid the tax and then applied for a refund, were exempted from paying the tax when the fuel was purchased.

- FY2002...................................$28.2 million
- FY2003...................................$29.1 million
- FY2004...................................$30.2 million
2. Railroad Companies  
*Kentucky Revised Statute 138.240(2)(f), effective 1988*

Railroad companies principally engaged in the business of transporting property for others as a common carrier or in the conveyance of persons are exempt.

- FY2002 .................... $3.5 million
- FY2003 .................... $3.6 million
- FY2004 .................... $3.7 million

3. Agricultural Use  
*Kentucky Revised Statute 138.358(2), effective 1988*

A credit is allowed for special fuels used for non-highway agricultural purposes.

- FY2002 .................... $400,000
- FY2003 .................... $400,000
- FY2004 .................... $400,000

4. Dealer’s Monthly Reporting Allowance  
*Kentucky revised Statute 138.270(1)(b), effective 1958*

An allowance of 2.25 percent of the net tax due is allowed a dealer on a timely filed and paid monthly return. This allowance is given to offset the costs of evaporation, shrinkage, unaccountable losses, collection costs, bad debts and handling and reporting the tax.

- FY2002 .................... $2.1 million
- FY2003 .................... $2.2 million
- FY2004 .................... $2.2 million
5. **Residential Heating**  
*Kentucky Revised Statute 138.358(1), effective 1988*

A credit is allowed for special fuels used exclusively for heating personal residences.

- FY2002: $1.0 million
- FY2003: $1.1 million
- FY2004: $1.2 million

6. **Bus, Taxicab and Certain Senior Citizen’s Programs Refunds**  
*Kentucky Revised Statute 138.446, effective 1978*

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

- FY2002: $325,000
- FY2003: $340,000
- FY2004: $360,000

7. **State and Local Government Use**  
*Kentucky Revised Statute 138.358(3), effective 1988*

A credit is allowed for sales to qualifying state and local government agencies for non-highway use.

- FY2002: $100,000
- FY2003: $110,000
- FY2004: $115,000
8. Religious, Charitable or Educational Use

*Kentucky Revised Statute 138.358(3), effective 1988*

A credit is allowed for sales to qualifying non-profit religious, charitable or educational organizations for non-highway use.

- FY2002 .......................................................... $20,000
- FY2003 .......................................................... $25,000
- FY2004 .......................................................... $30,000

9. Watercraft

*Kentucky Revised Statute 138.455, effective 1960*

One hundred percent of the tax paid on special fuels to operate or propel watercraft is refunded to qualified boat dock operators.

- FY2002 .......................................................... $40,000
- FY2003 .......................................................... $40,000
- FY2004 .......................................................... $40,000

10. U.S. Government Exemption

*Kentucky Revised Statute 138.240(2), effective 7/1/88*

Special fuels sold to the U.S. Government are exempt.

- FY2002 .......................................................... $200,000
- FY2003 .......................................................... $200,000
- FY2004 .......................................................... $200,000
EARMARKED FUNDS

Earmarked funds are dollars that have been set aside to be spent only on a particular program. The taxpayer is still liable for the tax, and the state is still collecting these revenues. The fact that the revenues are earmarked for special purposes does not qualify them as tax expenditures.

Earmarked Funds Enacted During Fiscal Years 2000 – 2001

The following change was enacted by the 2000 General Assembly and became effective July 15, 2000:

Tax Increment Financing - A county containing a city of the first class, or a city of the first class, may create a development area. If the development area receives state approval, the locality may receive a payment of part of the increase in tax revenues within the development area. Most tax types can be included, with sales, corporate income, and individual income withholding expected to be utilized most often. *S.B. 372*

The following change was enacted by the 2001 General Assembly and became effective June 22, 2001:

Tax Increment Financing - Localities creating development areas and receiving state approval for participation may receive a payment of part of the increase in tax revenues within the development area. Most tax types can be included, with sales, corporate income, and individual income withholding expected to be utilized most often. The legislation requires a ‘net positive economic impact’ for the state before a project can be approved for state participation. *HB 238*
Table 19. Total Earmarked Funds

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>$22.1 million</td>
</tr>
<tr>
<td>2003</td>
<td>$22.3 million</td>
</tr>
<tr>
<td>2004</td>
<td>$22.8 million</td>
</tr>
</tbody>
</table>

Earmarked Funds

1. Thoroughbred Development Fund - Pari-Mutuel Tax
   *Kentucky Revised Statute 138.510, effective 1990*

Three quarters of one percent (.75%) of all pari-mutuel wagering at thoroughbred horse tracks under the jurisdiction of the Kentucky Racing Commission and 2 percent of wagering at receiving tracks in intertrack wagering, as well as telephone account wagering is deducted from the pari-mutuel tax and deposited in this fund.

FY2002 ................................ $9.0 million  
FY2003 ................................ $9.2 million  
FY2004 ................................ $9.4 million

2. Equine Industry Program Trust and Revolving Fund - Pari-Mutuel Tax
   *Kentucky Revised Statute 138.510(3), effective 1990*

One fifth of one percent (0.2%) of the total amount wagered on live racing in Kentucky and .05 percent of the total amount wagered on intertrack wagering is deducted from the pari-mutuel tax and deposited in this fund. The fund is used for the equine industry program at the University of Louisville.

FY2002 .................................. $600,000  
FY2003 .................................. $600,000  
FY2004 .................................. $650,000
3. **Higher Education Equine Trust and Revolving Fund - Pari-Mutuel Tax**  
*Kentucky Revised Statute 138.510(4), effective 1992*

One-tenth of one percent (0.1%) of the total amount wagered in Kentucky is deducted from the pari-mutuel tax to be deposited in this fund. The fund is used for construction, expansion or renovation of facilities or the purchase of equipment for equine programs at state universities.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$600,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$600,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$650,000</td>
</tr>
</tbody>
</table>

4. **Standardbred Development Fund - Pari-Mutuel Tax**  
*Kentucky Revised Statute 230.265(3), effective 1990*

One percent of all pari-mutuel wagering at harness host tracks under the jurisdiction of the Kentucky Racing Commission and 2 percent of wagering at receiving tracks in intertrack wagering, as well as telephone account wagering is deducted from the tax and deposited in this fund.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$425,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$425,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$425,000</td>
</tr>
</tbody>
</table>

5. **Teen Tobacco Enforcement Program - Cigarette Tax**  
*Kentucky Revised Statute 438.335, effective 1996*

One tenth of one cent of the three-cent per pack revenue collected from the state excise tax on cigarettes is earmarked for the Department of Agriculture to enforce the laws aimed at the prevention of sales of tobacco products to minors.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2002</td>
<td>$550,000</td>
</tr>
<tr>
<td>FY2003</td>
<td>$550,000</td>
</tr>
<tr>
<td>FY2004</td>
<td>$550,000</td>
</tr>
</tbody>
</table>
6. Kentucky Transportation Center - Motor Fuels Tax
   *Kentucky Revised Statute 177.320(4), effective 1986*

   The Kentucky Transportation Center receives 0.1 percent of all revenues arising from the imposition of taxes on gasoline, special fuels and liquefied petroleum gas. The receipts are limited to $190,000 in any fiscal year.

   FY2002.................................$190,000
   FY2003.................................$190,000
   FY2004.................................$190,000

7. Tobacco Research Trust Fund - Cigarette Tax
   *Kentucky Revised Statute 248.540, effective 1970*

   One-sixth of the tax collected is earmarked for the Tobacco Research Trust Fund.

   FY2002.................................$2.9 million
   FY2003.................................$2.9 million
   FY2004.................................$2.9 million

8. Agricultural Diversification and Development Fund - Cigarette Tax
   *Kentucky Revised Statute 248.652, effective 1998*

   Any additional increases in the cigarette tax are earmarked for the Agricultural Diversification and Development Council to be distributed to various diversification and health-related programs.

   FY2002.................................Indeterminable
   FY2003.................................Indeterminable
   FY2004.................................Indeterminable

9. Equine Drug Research - Pari-Mutuel Tax
   *Kentucky Revised Statute 230.265(3), effective 1982*

   An amount equal to 0.1 percent of the total amount wagered in Kentucky shall be deducted from the pari-mutuel tax to be used in financing drug research and testing.

*Kentucky Revised Statute 141.071 and 141.072, effective 1996*

Each individual may designate $2 to be paid to a political party if there is at least a $2 (or $4 for a joint return) tax liability.

FY2002...............................$200,000
FY2003...............................$200,000
FY2004...............................$200,000

11. Kentucky Aviation Economic Development Fund - Sales Tax

*Kentucky Revised Statute 183.525, effective July 1, 2000*

All sales and use tax collected on the sale of aircraft fuel will be deposited in this fund beginning July 1, 2000.

FY2002...............................$7.0 million
FY2003...............................$7.0 million
FY2004...............................$7.1 million

12. Tax Increment Financing - Various Taxes

*Kentucky Revised Statute 65.495, effective July 14, 2000 and*  
*Kentucky Revised Statute 65.703, effective June 21, 2001*

A locality may create a development area and, with state approval, receive payment of part of the increase in tax revenues within the development area to help offset the cost of development. Potentially all taxes could be involved, although it is expected that sales and income taxes would be most utilized because of the dollar volume.

FY2002...............................Substantial
FY2003...............................Substantial
FY2004...............................Substantial
TAX INCREMENT FINANCING

Background

Tax expenditures can usually be identified as a particular item of relief from a particular tax, usually targeted to a particular group of taxpayers. In 2000, the General Assembly decided to take a different approach from previous tax expenditures. Instead of granting tax relief to an identified group of people, certain funds were identified that could be dedicated to a particular purpose. This new direction involves a technique commonly identified as ‘tax increment financing’, and usually involves dedicating a portion of the increase in tax revenues from a particular area to pay for the development of the area (usually called a ‘tax increment financing’ district, or a TIF district).

In the 2000 General Assembly, Senate Bill 372 was passed. This bill was limited to the Louisville/Jefferson County area, and provided for a ‘pilot project’ to use a TIF district to develop a specific area of Jefferson County.

Senate Bill 372 was followed in the 2001 General Assembly by two bills:

♦ House Bill 238, which expanded the reach of the previous bill to include all of Kentucky, and
♦ Senate Bill 47, which provided for direct withholding by local governments of a fee, to be repaid from income taxes owed to the Commonwealth.

The taxes involved in Senate Bill 372 and House Bill 238 are not specifically limited, but must be agreed upon and approved by the Commonwealth, presumably as a financial incentive for some form of economic development. As a practical matter, the taxes that generate a significant volume of receipts will be most often targeted. Senate Bill 47 is limited to an offset to individual income tax.
Current Credit Structure

Senate Bill 372 and House Bill 238 require the identification of existing tax revenues within an identified area and a measurement of the increase in those revenues after the area is identified as a TIF district. An agreed upon portion of the increase in revenues, not less than 50 percent nor more than 80 percent is then paid to the local government for use in paying for the cost of development.

Senate Bill 47 permits the assessment of a ‘job development assessment fee’ against all employees within a designated area. The amount of income tax remitted by employers to the state is then reduced by the fee and the employee claims the fee as if it were income tax paid when the employee files an individual income tax return. The fee may be up to 3 percent of the gross pay of each employee.

How Credits are Paid

Under Senate Bill 372 and House Bill 238, the taxes involved are actually collected by the Commonwealth and then paid over to the TIF district. Under Senate Bill 47, the TIF district collects the appropriate amount from taxpayers located within the district and the taxpayers reduce the amount of income taxes that are remitted to the state.

Tax Expenditures Enacted during Fiscal Years 2000-2001

The following change was enacted by the 2000 General Assembly and became effective July 15, 2000:

**Tax Increment Financing** – A county containing a city of the first class, or a city of the first class, may create a development area. If the development area receives state approval, the locality may receive a payment of part of the increase in tax revenues within the development area. Most tax types can be included with sales, corporate income, and individual income withholding expected to be utilized most often. *SB 372*

The following changes were enacted by the 2001 General Assembly and became effective June 22, 2001:
**Tax Increment Financing** – Localities creating development areas and receiving state approval for participation may receive a payment of part of the increase in tax revenues within the development area. Most tax types can be included with sales, corporate income, and individual income withholding expected to be utilized most often. The legislation requires a ‘net positive economic impact’ for the state before a project can be approved for state participation. *HB 238*

**Job Development Assessment Fee** – Localities creating development areas and receiving state approval for participation may assess a ‘job development assessment fee’ against the wages of all employees within the development area. The legislation requires a ‘net positive economic impact’ for the state before a project can be approved for state participation. *SB 47*

### Table 20. Tax Increment Financing Tax Expenditures

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Tax Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>Substantial</td>
</tr>
<tr>
<td>2003</td>
<td>Substantial</td>
</tr>
<tr>
<td>2004</td>
<td>Substantial</td>
</tr>
</tbody>
</table>

## Tax Expenditures

1. **Tax Increment Financing – Various taxes**  
   *Kentucky Revised Statute 65.495, effective July 14, 2000, and*  
   *Kentucky Revised Statute 65.703, effective June 21, 2001*

A locality may create a development area and with state approval receive payment of part of the increase in tax revenues within the development area to help offset the cost of development. Potentially, all taxes could be involved although it is expected that sales and income taxes would be most utilized because of the dollar volume.
2. **Job Development Assessment Fee – Individual Income Tax**

*Kentucky Revised Statute 65.6851, effective June 21, 2001*

A locality may create a development area and with state approval withhold from each employee within the development area a job development assessment fee of up to 3 percent of gross wages. Employers would pay the fee directly to the local government, and employees would claim the fee as a credit against their individual income tax.

FY2002 ....................Substantial
FY2003 ....................Substantial
FY2004 ....................Substantial