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Kentucky Law Survey: Taxation

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By far the most significant recent development in Kentucky taxation has been the increased consideration given by top level state administrators to the need to restructure the Commonwealth's entire tax system. Kentucky has many kinds of taxes, each riddled with an accumulation of exemptions, exclusions, deductions, credits and other special provisions. The decline in federal revenue sharing and the expected drop in other revenue sources due to the lag in the general economy are additional reasons for the state to examine all existing taxes and explore new sources of revenue. Two major reforms were proposed in 1982. Early in the year, study was begun on a Business Activities Tax (BAT) designed as a potential replacement for all income and inheritance taxes. BAT, however, was abandoned after careful study. Then, in the winter of 1982-83, the executive branch announced its proposal for legislation that would simplify and reform Kentucky's individual income tax.
I. BUSINESS ACTIVITIES TAX

The business activities tax, or “turnover” tax, is essentially an excise tax based upon the value of goods as determined at each transaction after their growth or manufacture, i.e., at each wholesale and retail transaction through transfer to the ultimate consumer. As proposed, a uniform percentage tax rate would be imposed upon gross receipts from each transaction and the tax paid by the manufacturer or seller, as the case may be. The proposal did not provide for any exemptions. Although collected from businesses, the ultimate burden of this tax would fall upon the consumer in the form of higher prices. Since the tax would fall upon all consumption without exception, the percentage of income paid by those with low incomes would be higher than the percentage paid by those with higher incomes; therefore, the tax would be regressive.

The primary appeal of BAT is that more revenue can be collected from a low rate of tax. Revenue would be relatively stable and would increase with economic growth. It differs from the much used sales tax in that, as the name implies, the sales tax is applied only at the retail level and only once. A turnover tax also differs from a value added tax. Unlike the value added tax, for which the base is the value added to the existing value of property, at each transaction the BAT is imposed on a base consisting of the total value of the goods at each transaction, not merely the added value. Also, unlike the BAT tax, the total tax under a value added tax scheme cannot be applied to a base exceeding 100% of the final value of the goods.

The major disadvantages of the BAT were pointed out in a

5 The following textual discussion is based on D. Soule & S. Lile, Consumer Impact of the Kentucky Turnover Tax Proposal (Oct. 1, 1982) (unpublished manuscript prepared for the Kentucky Legislative Research Commission).
6 D. Soule & S. Lile, supra note 5, at 1. For other possible advantages to the turnover tax, see id. at 13-16A.
7 Id. at 1, 13.
study analyzing its desirability and feasibility in Kentucky. Most serious is its cascading effect; the same property value may be included in the tax base at many separate stages of processing and transfer, a defect not inherent in the value added tax. Furthermore, there is a tendency by each wholesaler or retailer to add to his or her cost an amount greater than the actual increase, thus pyramid ing excessive costs ultimately borne by the consumer. Finally, the tax would place Kentucky businesses at a disadvantage in competing with out-of-state businesses.

II. FLAT RATE INCOME TAX

In November of 1982, the Revenue Cabinet published its study entitled A Proposal to Reform and Simplify the Kentucky Tax System, urging adoption of a flat rate income tax. Public hearings were held and the Governor announced his intention to call a special session of the General Assembly to consider the proposal.

The proposed method would simplify the tax reporting process by using a two-sided, one-sheet form and imposing a flat rate of tax on the adjusted gross income figure on line 32 of the individual's federal tax return (less certain exclusions allowable under Kentucky law but not federal law). According to the study, the flat tax rate selected should be sufficient to produce the same revenue as is presently raised under the existing system. The study estimated that a rate of 3.65% would be sufficient, but subsequent discovery of a "computer error" resulted
in a revised estimated percentage of 4.1%. A separate Legislative Research Commission study estimated that 4.27% is required to produce the same revenue.

The proposed simplified form reveals that some existing inequities in the Kentucky system were intended to be preserved. Some, but not all, forms of state and governmental retirement pay are to be subtracted from the federal income amount to determine the Kentucky tax base. The chief forms of retirement pay escaping Kentucky tax are pensions earned by Kentucky legislators and judges and retiree's pay under the teachers' and the state and municipal retirement systems. Noticeably missing from the retirement pay exclusion is that of retired employees of the University of Kentucky, the University of Louisville and Northern Kentucky University.

The proposal has several other advantages in addition to simplification. Many low income taxpayers are taken off the rolls by the proposed raising of the minimum income floor below which individuals and families will not be required to file a return or to pay the tax. This is accomplished by two changes. First, the proposal permits subtraction of the standard deduction as for federal taxes; however, the privilege of itemizing any deductions

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19 Memorandum from C. Gilmore Dutton, Staff Administrator Appropriations and Revenue Committee, to Interim Joint Committee on Appropriations and Revenue Committee 36-37 (Dec. 22, 1982) (discussing Governor Brown's Proposal to Levy a Flat Rate Individual Income Tax) (memorandum prepared by Kentucky Legislative Research Commission) [hereinafter cited as Dutton Flat Rate Tax Memorandum]. See also Ryan, supra note 18, at A1, col. 5.

Two studies presented to the Legislative Research Commission prior to the present gubernatorial administration are worthy of study: D. Soule & S. Lile, Simplification and Modernization Options for the Kentucky Individual Income Tax (1979) (unpublished manuscript prepared for Kentucky Legislative Research Commission) [hereinafter cited as Simplification]; D. Soule, Two Plans for Integrating the Kentucky and Federal Income Taxes: Implications for Tax Burdens, Revenue Yield, and Simplification (Dec. 1979) (unpublished manuscript for Kentucky Legislative Commission) [hereinafter cited as Two Plans]. In the latter study two alternatives for simplification of the Kentucky tax were identified: 1) taxing at a rate equal to a percentage of the federal tax as the Kentucky tax; and 2) using a percentage of federal taxable income as the Kentucky tax base.

20 See PROPOSAL—A FLAT RATE, supra note 13, at 36.
21 Id.
22 See id. at 4-5.
in excess of the standard deduction is not allowed, unlike the federal tax.\textsuperscript{23} (A revised Revenue Cabinet proposal yet to be released will likely differ from the original with respect to some allowable deductions.\textsuperscript{24}) Second, it substitutes $1,000 personal and dependency exemptions for the long standing credits against the tax.\textsuperscript{25} The only deviation here from the federal system is that two additional exemptions are allowed for age and for blindness instead of the one exemption permitted by federal law.\textsuperscript{26} By virtue of these changes single persons with annual incomes under $3,301, married couples with less than $5,401\textsuperscript{27} and elderly couples with under $9,401 (assuming both spouses are over 65) would no longer be required to file or to pay the Kentucky tax.

Elimination of the deduction for federal income tax paid is a worthy reform.\textsuperscript{28} Denial of the federal tax as a deduction would eliminate the advantage whereby families with high incomes, who for federal purposes pay taxes at highly progressive federal rates, are able to reduce their Kentucky tax significantly more than do low income families. For example, the Kentucky tax on income which is subject to the fifty percent federal rate is only three percent, exactly half the nominal six percent rate now paid on relatively low Kentucky taxable income amounts of $8,000 and above.\textsuperscript{29} Furthermore, eliminating the federal tax deduction results in Kentucky collecting revenue which would otherwise go to the federal government. Kentucky would collect more,\textsuperscript{30} while the United States would receive less.\textsuperscript{31} Finally, a more stable rev-

\textsuperscript{23} Id. at 4, 11-12.

\textsuperscript{24} As of February of 1983, the revised official proposal had not been released by the Revenue Cabinet, but was expected soon. According to newspaper accounts, some itemized deductions—such as home mortgage-interest payments, catastrophic medical losses and non-reimbursed casualty losses—will be preserved in the revised proposal. Ryan, \textit{Some Deductions Survive Revision of Brown’s Tax Plan}, The Courier-Journal, Feb. 4, 1983, A1, at A10, col. 1 (Late Kentucky Edition).

\textsuperscript{25} \textit{PROPOSAL—A FLAT RATE}, supra note 13, at 13.

\textsuperscript{26} Id.

\textsuperscript{27} The revised proposal might adjust this standard deduction upward. Thus, a married couple would get $4,600 as a standard deduction. Ryan, supra note 24, at A10, col. 1.

\textsuperscript{28} For a discussion of the effect of eliminating the deduction of federal income taxes paid from Kentucky taxable income, see Dutton Flat Rate Tax Memorandum, \textit{supra} note 19, at 6-7.

\textsuperscript{29} KRS § 141.020(2) (1982).

\textsuperscript{30} \textit{Simplification}, supra note 19, at 3.

\textsuperscript{31} See generally Taylor, \textit{supra} note 4, at A1, col. 5; at A12, col. 6.
Revenue would result because fluctuations on the down side for Kentucky when prosperity results in high federal taxes (deductible against Kentucky tax) would no longer occur.

Another clear advantage of the flat rate income tax proposal is that it would automatically incorporate into the Kentucky system the frequent changes in federal law relating to what constitutes gross income. This would eliminate the deviation between Kentucky and federal law caused by failure or delay on the part of the state legislature in adopting for Kentucky the frequent changes which Congress makes in the Internal Revenue Code.

A necessary consideration is whether alternative methods might achieve simplification of the individual income tax system without sacrificing the ideals of fairness, equity and reform which have been developed over the years in the federal system and followed in the state system. One alternative method would apply the state rate (which could be either a flat rate or a mildly progressive rate such as the present two percent to six percent) to federal taxable income on line 37 of federal Form 1040, instead of adjusted gross income on line 32 as the Revenue Cabinet plan proposes. Another alternative would base the state tax on a percentage of the federal tax liability. Both methods would make it possible to qualify for "piggybacking" by entering into an agreement with the federal government for collection and enforcement of state income taxes under the Federal-State Tax Collection Act of 1972. The method applying a Kentucky tax to federal taxable income and the method simply adopting as the Kentucky tax a percentage of the federal tax have the same advantage of simplification as the 1982 Revenue Cabinet proposal. They have additional merit because they follow the federal law

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32 PROPOSAL—A FLAT RATE, supra note 13, at 11.
33 See Two Plans, supra note 19, at 1.
34 Id.
with respect to deductions and preserve more of the accepted concepts of fairness and equity for individual situations. The anticipated changes with respect to allowable personal deductions contained in the newly revised proposal apparently are more attuned to these equitable concerns.\footnote{See Ryan, supra note 24, at A10, col. 1. For a reference to the anticipated changes, see notes 24 \& 27 supra.}

III. SIMPLIFICATION AND CONFORMITY—TWIN GOALS

Simplification of the Kentucky income tax calculations is a desirable goal for two main reasons. First, it would reduce the cost to the state of administration and collection. Second, it should ease the burden of taxpayer compliance, improve taxpayer morale and prevent psychic frustration. As a Louisville Courier-Journal editorial aptly concluded about Kentucky's present tax system, "the next most painful experience to paying the income tax is preparing the tax return."\footnote{Piggybacking, supra note 35, at A20, col. 1.} This is because the Kentucky income tax statute, including its forms and calculations as developed by the Department of Revenue, is needlessly complex.\footnote{Kentucky's income tax law is codified at KRS §§ 141.010-.990. The law's complexity is discussed in Amending Kentucky's Individual Income Tax Law, supra note 35, at 48, and in Conformity, supra note 35.}

Compared with the frustration which has met attempts to simplify the federal system, simplification should be relatively easy to accomplish in a state income tax. To somewhat cursorily sum up the federal problem, goals such as equity or supposed equity, incentives, special relief, preferences for the poor or the rich, for labor or capital investment or for any categories, have usually prevailed over the goal of simplification. On the state level, however, Kentucky and other states generally have not placed disproportionate reliance on the income tax to satisfy revenue needs. Nor are the state rates as steeply progressive, Kentucky's top rate rising only to six percent for individuals.\footnote{See KRS § 141.020(2)(e) (1982).} And, like other states, Kentucky began to tap income as a source of

\footnote{See Ryan, supra note 24, at A10, col. 1. For a reference to the anticipated changes, see notes 24 \& 27 supra.}

\footnote{Piggybacking, supra note 35, at A20, col. 1.}

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\footnote{See KRS § 141.020(2)(e) (1982).}
revenue long after the federal government.\textsuperscript{40}

From the beginning, Kentucky's income tax laws reflected a basic policy of conformity with federal provisions. Kentucky's first income tax law was clearly intended to make full use of the federal model.\textsuperscript{41} In 1954, Kentucky's taxation statute provided that "[c]omputations of income for [state tax] purposes" should be "as nearly as practicable identical with the calculations required for Federal income tax purposes"\textsuperscript{42} and that the Department of Revenue should prescribe forms "substantially identical" with the federal forms, except to the extent that differences between the federal and state laws required differences in the forms.\textsuperscript{43} Furthermore, it was provided that "the administrative and judicial interpretations of the Federal income tax law" be applied "as far as practicable."\textsuperscript{44} The current statute, Kentucky Revised Statutes (KRS) section 141.050(1),\textsuperscript{45} maintains this goal of conformity between Kentucky and federal tax law.\textsuperscript{46}

The connection between simplification and conformity of the state system with the federal system is obvious: conformity

\textsuperscript{40} The first federal income tax was imposed in 1862 to finance the Civil War. After 10 years, it was repealed, and the next federal income tax statute, capable of withstanding constitutional challenges, was not enacted until 1913. J. CHOMMIE, FEDERAL INCOME TAXATION 1-3 (1973).

The first general individual income tax in Kentucky was enacted in 1936. 1936 CARROLL'S KY. REV. STAT. ANN. §§ 428lb-1 to -39 (Act of the Third Extraordinary Session of the General Assembly of 1936, ch. 7, 1936 Ky. Acts (Special Revenue Session)). For a good discussion of the difficulties encountered by legislators in their attempts to enact a Kentucky income tax see Lockyer, History of the Kentucky Income Tax, 43 KY. L.J. 461, 462-74 (1954-55).


\textsuperscript{43} Id.

\textsuperscript{44} Id. See generally Conformity, supra note 35, at 469.

\textsuperscript{45} KRS § 141.050(1) (1982) states:

Except to the extent required by differences between this chapter and its application and the federal income tax law and its application, the administrative and judicial interpretations of the federal income tax law, computations of gross income and deductions therefrom, accounting procedures, for purposes of this chapter shall be as nearly as practicable identical with those required for federal income tax purposes.

\textsuperscript{46} For a more comprehensive discussion of instances in which Kentucky income tax provisions have followed the federal provisions or deviated therefrom, see Conformity, supra note 35, at 461.
should accomplish simplification. With such an announced policy of full conformity of state with federal law, one might wonder how the state tax system, together with the forms for reporting, developed such a deviant character.

Unlike some states, Kentucky does not automatically incorporate changes in the federal income tax laws into its own tax regulations. Instead, the incorporation of such changes must come through passage of specific Kentucky legislation. Over the years, Kentucky has adopted some federal changes, has failed to adopt some others, and has adopted still others only in part. This piecemeal approach, necessitated by Kentucky's failure to provide for automatic incorporation, explains much of the deviation between the Kentucky and federal tax laws.

The best example of specific adoption of federal legislation is provided by Kentucky's adoption of the federal definition of gross income.\(^47\) Two recent adoptions of federal provisions by the Kentucky General Assembly illustrate other examples of conformity. First, Kentucky law incorporates section 172 of the federal Internal Revenue Code which deals with net operating loss carryback-carryforward deductions.\(^48\) Moreover, the amount to be carried back or forward has been administratively interpreted to be the amount of net operating loss as shown on the federal tax return rather than the loss on the Kentucky return after its adjustments.\(^49\) This is a commendable administrative interpretation in line with the announced statutory policy of conformity with the federal law wherever practicable.\(^50\) The second recent example of conformity with federal law is the ten-year averaging permitted for lump sum distributions from qualified pension plans.\(^51\) For this purpose, Kentucky allows the federal instruc-

\(^47\) KRS § 141.010(9) (Supp. 1982). The provision states that "gross income" for taxpayers other than corporations shall mean gross income as defined in the federal law with a few adjustments. \(\text{Id.}\) Kentucky also adopts the federal gross income definition in regard to corporate taxpayers but again with a few adjustments. \(\text{KRS} \, § \, 141.010(12) \, (\text{Supp.} \, 1982)\). The federal gross income definition appears at I.R.C. § 61 (1976).

\(^48\) KRS § 141.011 (1982).

\(^49\) \(\text{See} \, K\, Y. \, \text{TAX ALERT, June 1982, at 2.}\) \(\text{Ky. TAX ALERT} \, \text{is published by the Kentucky Dept. of Revenue which was recently elevated to} \, \text{Cabinet status in a reorganization effected by executive order. The ALERT provides general information about Kentucky tax law, but does not have the authority of law.}\)

\(^50\) \(\text{See} \, K\, R\, S \, § \, 141.050 \, (1982)\). 

\(^51\) \(\text{Ky. TAX ALERT, June 1982, at 2.}\)
tions and federal Form 4972 to be used in calculating the Kentucky tax liability, with some modifications, however, to reflect differences between the state and federal income tax structures.52

Many times Kentucky has not followed the federal law. This is sometimes merely the result of legislative inertia, delay or oversight. Some failures to enact federal changes, however, are based upon deliberate policies designed to keep Kentucky law different from the federal law. The most glaring example of a conscious choice of state policy differing from the federal is the legislature's continued refusal to approve the joint return with fifty-fifty split between spouses irrespective of the actual source of the income between the spouses.53 Although the availability of the joint return erodes the progressive rates, the federal system has consistently provided this break for higher income taxpayers since 1948 in order to equalize the impact of the federal tax system on spouses in common law and community property states. This nonconformity forces many Kentucky couples with income belonging to each spouse to report the segregated income as separate figures for each spouse although the income was combined for federal tax return purposes.

Perhaps the best example of partial Kentucky conformity with federal provisions is the compromise adopted by the 1982 General Assembly relating to the new "Accelerated Cost Recovery System" (ACRS).54 This system was enacted on the federal level by the Economic Recovery Tax Act of 1981.55 The specter of double bookkeeping for state and federal tax purposes perturbed accountants and others. On the other hand, the loss of revenue which would result from full adoption of the federal ACRS created anxiety among Kentucky's revenue collection officials and budget estimators. Resolution of the dilemma resulted in a workable compromise enacted by the 1982 General Assembly

52 Id. As one difference, for example, the $2,300 standard deduction allowed on the federal return should be omitted in calculating the Kentucky tax.
and codified at KRS section 141.010(13)(b). Beginning in 1982, the total depreciation under the ACRS is to be shown on the Kentucky return for corporate income tax purposes, but for tax years beginning in 1982 and 1983 the total must be divided by a factor of 1.4. However, beginning July 1, 1984, corporations will be permitted the full deductions possible under the federal ACRS. Moreover, beginning July 1, 1984, and for the next five years, corporate taxpayers also may annually recover one-sixth of the full ACRS recovery they were denied by the 1.4 reduction of the previous years.

The General Assembly's action achieves workable conformity with the newly-adopted ACRS. However, some of the 1981 federal benefits of ACRS have now been restricted by the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982. TEFRA repeals the schedule acceleration in the cost recovery rates for personal property that was to apply to property placed in service in and after 1985. As a result, the current cost recovery rates for personal property based on the 150% declining balance and straight line methods are made permanent. One can only speculate whether Kentucky will enact new legislation to adopt the superseding TEFRA provisions.

One further example of Kentucky's failure to conform to all federal provisions should be noted. The deviation stems from the state revenue department's function in promulgating tax forms. The 1954 income tax statute specifically mandated conformity

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58 Id.

59 Id.


62 The Kentucky Department of Revenue (now Revenue Cabinet) is charged with prescribing Kentucky tax forms under KRS § 131.130(3) (1982).
even as to the tax forms where possible. Consistent with this mandate, Kentucky still retains federal schedules C, D and F as the schedules to be used on the Kentucky tax returns. But for reasons known only to the bureaucrats, the Department has written its own version of some other schedules, such as Schedule B (interest and dividends), necessitating independent calculations.

In the absence of statutory guidance on some tax questions, some wise state administrators have simply resolved any doubt in favor of following the federal law. An example might be the federal rule providing for no corporate income tax gain or loss when a corporation sells property pursuant to a plan of liquidation known as the "one year" liquidation under federal Internal Revenue Code section 337.

A positive development, however, is underway that may alleviate this informality, uncertainty and lack of conformity. Since elevation of the Department of Revenue to cabinet level, the Revenue Cabinet's Tax Policy Section has recently begun a complete compilation of Kentucky tax statutes, regulations, circulars and policy statements.

IV. OTHER INCOME TAX DEVELOPMENTS

A. Legislative

1. Federal Legislation

Rapidly changing federal income tax law and policy have a profound effect upon state income tax laws. This is especially true of states which automatically incorporate federal changes into their state income tax laws, but it also is true in Kentucky where new federal statutes must be specifically enacted by the state legislature to become a part of the state income tax law.

The federal Economic Recovery Tax Act of 1981 (ERTA) made many changes. It reversed many of the reform policies in

63 See notes 42-43 supra and accompanying text.
65 Governor John Y. Brown, Jr. signed an executive order elevating the former department to cabinet status. See KY. TAX ALERT, July 1982, at 1.
66 KY. TAX ALERT, Nov. 1982.
the Tax Reform Acts of 196968 and 197669 in favor of a policy of
tax reduction and business incentives in line with the supply
theory of economics.70 The statute reduced rates over a three-
year period, and, then, effective with calendar year 1985, pro-
vides that the federal rate schedules should be revised annually to
reflect changes in the Department of Labor's Consumer Price In-
dex.71 The 1982 TEFRA likewise makes significant changes in
federal law, many of which are intended to raise revenue and re-
strict some of the special benefits provided in ERTA.72

These federal changes affect planning under the Kentucky
tax laws despite the lack of automatic incorporation of federal
enactments into Kentucky income tax law. Of chief significance
to business, TEFRA changes the "safe harbor" rules for leasing,
and, as stated earlier, substantially withdraws the ERTA tax
benefits for personal property relating to the ACRS.73

2. Kentucky Legislation

The 1982 General Assembly added to the income laws cer-
tain incentive provisions to further the policy objective of full
employment. Subject to specified statutory conditions, a $100
credit against income tax is allowed to employers hiring persons
classified as unemployed.74 Furthermore, Kentucky has now em-
braced the concept of "enterprise zones" in order to stimulate the
economy.75 These zones are to be created out of economically de-

70 For discussion of the supply theory of economics, see Blough, Supply-Side Eco-
nomics, Tax Reduction, and Inflation, 13 TAX NOTES 403, 405-06 (1981); Davie, How the
71 I.R.C. § 1(f) (West Supp. 1982).
72 E.g., Congress limited ACRS benefits by requiring the basis of an asset placed in
service after 1982 to be reduced by one-half the amount of the investment credit allowed
on the asset unless the taxpayer elects to claim a reduced investment credit. See TEFRA,
73 For a summary of the TEFRA changes in these regards, see Tax Equity and Fiscal
Responsibility Act, Law and Explanation, STAND. FED. TAX REPORTS (CCH), Aug. 25,
74 KRS § 141.065 (Supp. 1982).
75 See generally KRS §§ 154.650-.700 (Supp. 1982). The policy behind creation of
such areas is expressed in KRS § 154.650 (Supp. 1982).
pressed areas,\textsuperscript{76} and if designated an official zone by the Commonwealth,\textsuperscript{77} will receive special developmental encouragement.\textsuperscript{78} One such encouragement will be exemption from income tax on gains from the sale of certain property.\textsuperscript{79} Eligible property includes real property in the zone used predominantly in the active conduct of a trade or business\textsuperscript{80} or real property used as the taxpayer's principal residence.\textsuperscript{81} Gains on sales of tangible personal property used predominantly in the active conduct of a trade or business also are exempt.\textsuperscript{82}

One other 1982 enactment provides for the exclusion from gross income of employee pension contributions picked up by the employer on account of compensation earned after August 1, 1982, upon a ruling of the Internal Revenue Service or a federal court to the effect that the contributions may be excluded from gross income and not taxed until distributed.\textsuperscript{83}

\textbf{B. Judicial}

Judicial developments concerning income tax law have been minimal. Two cases involve the corporation income tax. In \textit{Corning Glass Works v. Department of Revenue},\textsuperscript{84} the Department of Revenue had apportioned to Kentucky part of the total income of a multistate corporation. The issue involved was whether certain income was business or nonbusiness income as defined in KRS section 141.120(1). That section defines business income as that income arising from activities in the regular course of business. Corning Glass Works had omitted from its Kentucky return certain items it deemed nonbusiness income. The court of appeals held that income from certain rents and

\begin{footnotesize}
\textsuperscript{76} See KRS §§ 154.660-.665 (Supp. 1982).
\textsuperscript{77} The responsibility of designating the enterprise zones is given to a newly created Enterprise Zone Authority. See KRS §§ 154.675-.680 (Supp. 1982).
\textsuperscript{78} This special encouragement will come through "reduced taxes and the removal of unnecessary governmental barriers to the production and earnings of wages and profits and the creation of economic growth." KRS § 154.650 (Supp. 1982).
\textsuperscript{80} KRS § 154.655(4)(b)(2) (Supp. 1982). See also KRS § 154.690(1) (Supp. 1982).
\textsuperscript{81} KRS § 154.655(4)(a) (Supp. 1982). See also KRS § 154.690(1) (Supp. 1982).
\textsuperscript{82} KRS § 141.010(9)(d) (Supp. 1982).
\textsuperscript{84} 616 S.W.2d 789 (Ky. Ct. App. 1981), discretionary review denied (Ky. 1981).
\end{footnotesize}
royalties, capital gains and losses from sales, and patent royalties were properly included as business income derived from activities in the regular course of business and therefore subject to the statutory apportionment rules. The court stated that a multi-state corporation must allocate to Kentucky a fraction of its net business income regardless of whether the net income has an identifiable source within Kentucky.

In another corporate income tax case, *Department of Revenue v. The Early & Daniel Co., Inc.*, the Kentucky Supreme Court held the incomes of a parent company (operating within and without Kentucky) and its subsidiary (operating solely in Ohio) should be combined for apportionment purposes. The Court based its holding on its finding that the subsidiary was "a mere paper funnel created solely for federal tax purposes," and its agreement with the Department of Revenue's characterization of the parent and subsidiary as "unitary in nature." In upholding the combination of incomes, the Court noted that state statutes no longer adopt the source test requiring that taxable income must have an identifiable source within the state in order to be taxed by Kentucky.

An interesting case, *Department of Revenue v. Refiners Oil Corporation*, involved use of the federal definition of "dividend" for state income tax purposes. The question presented was whether cash distributions to the defendant could be considered dividends under KRS section 141.010(12). The defendant would not have to pay Kentucky income tax on the disbursements if they were found to be dividends. The court of appeals

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85 Id. at 792-94. Kentucky's apportionment formula is found at KRS § 141.120 (1982).
86 Id. at 794. Former state statutes did require that net taxable income have an identifiable source within the state. See id.
87 628 S.W.2d 630 (Ky. 1982).
88 Id. at 632, 631.
89 Id. at 632. By this rejection of the requirement that taxable net income have an identifiable source within the state, the Supreme Court confirmed the position of the court of appeals in *Corning Glass Works*, 616 S.W.2d at 791. The *Corning Glass Works* court stated that "[a]ssessments may now be made on business income produced from within and without the Commonwealth." Id.
90 612 S.W.2d 337 (Ky. 1981).
91 Id. at 337.
92 Id. KRS § 141.010(12) (1982) excludes dividends received from a corporation's gross income.
had held that the distributions were dividends under Kentucky statutory law. The Supreme Court inferred that the court of appeals had relied upon KRS sections 271A.225 and 271A.230 as constituting definitions of the word "dividend." The Supreme Court, however, viewed these provisions as irrelevant for definitional purposes, stating that "Kentucky does not have a statute defining dividends." The Supreme Court then held that in the absence of a Kentucky definition the provisions of the federal tax law should be applied. Under federal definition, distributions are "dividends" only to the extent of the corporation's present or accumulated earnings and profits. Thus, the portions of the cash distribution constituting a return of capital or capital gain were not excludible as dividends.

The Supreme Court correctly viewed the Kentucky corporation statute, KRS section 271A.225, as merely describing the dividends which may legally be declared and not constituting a definition of dividend for the purposes of determining the exclusion of dividend income under KRS section 141.010(12)(b). The decision furthers the long standing judicial policy that Kentucky should follow federal definitions and interpretations unless a clear legislative intention to deviate is shown.

V. ORGANIZATIONAL AND PROCEDURAL MATTERS

Considerable reorganization of the revenue arm of the state government took place in 1982. On July 1, 1982, the Department of Revenue became the Revenue Cabinet and the Commissioner of Revenue was promoted to the position of Secretary in the Governor's Cabinet. Three new Commissioners were appointed to head the Departments of Property Taxation, Processing and Enforcement, and Professional and Support Services within the

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93 612 S.W.2d at 338. For extensive discussion of the court of appeals decision see Vasek & Bradley, Kentucky Taxation, 68 Ky. L.J. 777, 782-90 (1979-80).
94 612 S.W.2d at 338.
95 Id.
96 Id. at 338-39.
97 See id. at 338; I.R.C. §§ 301, 316 (1976).
98 612 S.W.2d at 338-39.
99 See KRS § 141.050 (1982).
100 Exec. Order No. 82-445 (June 14, 1982); KY. TAX ALERT, July 1982, at 1.
Cabinet. In addition, the functions of the former Research Division in the Department have been divided between a new Office of Revenue Estimating and Economic Analysis and the Tax Policy and Legal Services Division which is attached to the Department of Professional and Support Services. The elevated Department of Revenue assumes the enhanced role of a major government agency designed to further its revenue raising function.

A number of changes were made to step up collections. Organizational changes include the creation of an Audit Enforcement Task Force and, in line with the federal Internal Revenue Service and business developments, a newly-established Telephone Collection Section. Use of the telephone to reach taxpayers has improved and expedited information gathering as well as the collection process.

As a matter of improving collections without statutory changes, the twenty-five cents per $100 ad valorem annual tax on the value of intangible property has been highlighted for better enforcement. Taxable intangibles include, inter alia, most stocks, bonds, receivables, royalties, patents, rights to receive income and deposits in out-of-state banks. The intangibles tax has been frequently misunderstood and evaded in the past because of widespread ignorance both with regard to the requirement of an annual assessment on intangibles and the kinds of property subject to the tax. In recent months, Kentucky revenue officials have improved both information about and collection of the tax.

Finally, important changes were made to improve collections by discouraging deliberate delay in payment of taxes. Beginning July 1, 1982, the interest rate on all delinquent taxes jumped to sixteen percent; and beginning January 1, 1983, interest on de-

101 Id.
102 Id.
107 See id. For reference on how to value intangible property, see KY. TAX ALERT, Sept. 1982, at 8.
Linquent taxes will be pegged to the prime rate charged by banks as determined for each calendar year in November of the previous year.\textsuperscript{108} Other changes in collection procedures bolster the authority of the Revenue Cabinet to collect delinquent taxes. These changes relate to the use of distraint and levy,\textsuperscript{109} redemption,\textsuperscript{110} liens,\textsuperscript{111} and proceedings against transferees of fraudulent conveyances,\textsuperscript{112} as well as expansion of criminal provisions covering issuance of certain cold checks to include checks for tax payments.\textsuperscript{113}

The first of these changes in collection is contained in amendments to KRS section 131.500. The amended statutes give the Commissioner of Revenue or a delegate the direct authority, after demand for unpaid taxes, to levy upon and sell the taxpayer's property together with interest and penalty.\textsuperscript{114} Previously, the sheriff has been the primary enforcement authority following issuance of a warrant.\textsuperscript{115}

New rules for redemption by the owner of property sold for taxes are provided in KRS section 131.530. Instead of the previous rights provided in the case of executions, the owner will be allowed 120 days to redeem upon payment of the amount paid plus twenty percent interest.\textsuperscript{116} Furthermore, a former penalty upon the Department for wrongful levies against property has been eliminated.\textsuperscript{117}

The other changes in collection procedures include: 1) a new procedure similar to that in the federal transferee liability system which allows assessment against the transferee of property fraudulently transferred by the taxpayer with intent to evade collection;\textsuperscript{118} 2) expanded tax liens which now cover all current and future tax liabilities so that the state revenue agency no longer is

\textsuperscript{108} KRS § 131.183 (Supp. 1982).
\textsuperscript{109} KRS § 131.500 (Supp. 1982).
\textsuperscript{110} KRS § 131.530 (Supp. 1982).
\textsuperscript{111} KRS § 134.420 (Supp. 1982).
\textsuperscript{112} KRS § 131.550 (Supp. 1982).
\textsuperscript{113} KRS § 514.040(5) (Supp. 1982).
\textsuperscript{114} KRS § 131.500 (Supp. 1982).
\textsuperscript{115} KRS § 131.500 (1982), amended by KRS § 131.500 (Supp. 1982).
\textsuperscript{116} KRS § 131.530(2) (Supp. 1982).
\textsuperscript{117} KRS § 131.540(4) (1982), amended by KRS § 131.540 (Supp. 1982).
\textsuperscript{118} KRS § 131.550 (Supp. 1982).
required to secure a new lien for each new tax liability;\textsuperscript{119} and 3) extension of the criminal sanction of theft by deception to cover issuing a check for payment of taxes with knowledge that there are insufficient funds.\textsuperscript{120}

Finally, in \emph{Commonwealth v. Collins & May},\textsuperscript{121} the court of appeals sanctioned use of distraint to collect money due to a delinquent taxpayer despite the state's failure to first exhaust the remedies provided in KRS chapter 134.\textsuperscript{122} The distraint remedy is contained in KRS chapter 135.\textsuperscript{123} Relying on analogous federal cases, the Court of Appeals held that the two chapters provided alternative means of collections, that neither chapter was interdependent nor exclusive, and that no unconstitutional denial of due process resulted from using the distraint process without first enforcing a tax lien pursuant to chapter 134.\textsuperscript{124}

\section*{VI. Property Taxation}

Problems persist concerning the uniform assessment of property throughout the state at full fair cash value pursuant to section 172 of the Kentucky Constitution.\textsuperscript{125} The Supreme Court of Kentucky in an important case, \emph{Allphin v. Butler},\textsuperscript{126} confronted a challenge to the Kentucky Commissioner of Revenue's authority over local property valuation administrators (PVAs). The Kentucky Department of Revenue (now the Kentucky Revenue Cabinet) issued a directive to all PVAs to increase their assessments of real property in their respective counties to correspond to the Department's estimate of the aggregate fair cash value of different classes of real property. Armed with power over the purse-

\begin{quote}
\textsuperscript{119} KRS § 134.420 (Supp. 1982).
\textsuperscript{120} KRS § 514.040(5) (Supp. 1982).
\textsuperscript{121} 593 S.W.2d 887 (Ky. Ct. App. 1980).
\textsuperscript{122} \textit{Id.} at 888. KRS ch. 134 is entitled Payment, Collection and Refund of Taxes.
\textsuperscript{123} KRS §§ 135.010-.020 (1982). KRS ch. 135 is entitled Collection of Public Claims by Action.
\textsuperscript{124} 593 S.W.2d at 889.
\textsuperscript{125} Under section 172, unless exempted by the constitution, all property "shall be" assessed at fair cash value estimated at the price the property would bring at a fair voluntary sale.
\textsuperscript{126} 619 S.W.2d 483 (Ky. 1981).
\end{quote}
strings, the Commissioner threatened to enforce his directive by withholding the PVAs' salaries. Most of the PVAs refused to correct their assessments to conform to the Department's estimate.

The Kentucky Supreme Court, in an opinion written by Justice Lukowsky, upheld the Department's authority. The Court justified this centralized authority over the PVAs as being necessary to achieve uniformity in assessments. The decision highlights the Supreme Court's understanding of the statewide property tax system. Given the constitutional requirement that all property within the state be assessed at 100% of fair cash value, the Revenue Cabinet's centralized authority over the local PVAs seems essential to achieving equity for the taxpayer and uniformity of administration throughout the state.

The legislature reacted to prevent too rapid a jump in the property owner's tax bill due to the 100% assessment requirement and the effects of inflation. Roughly, the statutory scheme enacted applies a formula which reduces the tax rates on assessed values; thus, the actual taxes paid shall not in any year exceed a percentage of the tax paid in the immediately preceding year. Further, both the homestead exemption amount and the difference between actual market value and the agricultural use valuation are excluded before calculating the amount upon which the rate applies.

In City of Louisville v. Fiscal Court of Jefferson County,
the issue before the Kentucky Supreme Court was the validity of a contract between the City of Louisville and property owners of annexed land. Under the contract terms, Louisville agreed to keep the ad valorem tax rate constant for twenty years with the possibility of de-annexation at the option of the property owners. Some of the land involved was agricultural and some was commercial. The Supreme Court construed section 172A of the Kentucky Constitution to permit variances in rates on urban land as well as agricultural land. But because no factual basis was set out in the agreement for the differences in rates, the Court held that the rate agreed upon had not been established as reasonable and therefore was not authorized under section 172A. Further, the attempt to set the tax rates for a period of twenty years, longer than the terms of office of the city's current Board of Aldermen, was against public policy and, therefore, void. Finally, because annexation and de-annexation procedures are statutory and must be precisely followed, the contract provision allowing de-annexation at the sole discretion of the property owner without regard for the statutory procedures was void.

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134 Section 172A states:
Notwithstanding contrary provisions of Section 161, 172, or 174 of this Constitution—The General Assembly shall provide by general law for the assessment for ad valorem tax purposes of agricultural and horticultural land according to the land's value for agriculture or horticultural use. The General Assembly may provide that any change in land use from agricultural or horticultural to another use shall require the levy of an additional tax not to exceed the additional amount that would have been owing had the land been assessed under Section 172 of this Constitution for the current year and the next preceding years.

The General Assembly may provide for reasonable differences in the rate of ad valorem taxation within different areas of the same taxing district on that class of property which includes the surface of the land. Those differences shall relate directly to differences between non-revenue-producing governmental services and benefits giving land urban character which are furnished in one or several areas in contrast to other areas of the taxing district.

135 623 S.W.2d at 223.

136 Id. at 224.

137 Id. ("A legislative body may not limit its power to act in the future in governmental, as opposed to proprietary, functions.")

138 Id. at 224-25.
In *Parrent v. Fannin*, the Kentucky Supreme Court construed section 171 of the Kentucky Constitution which states that taxes "shall be uniform upon all property of the same class," together with section 172 prescribing that all property shall be assessed at its "fair cash value." In that case, increases in property assessments in Franklin County for 1980 over 1979 ranged from one percent to 400%. The Department deemed these increases sufficient to bring the aggregate assessment of realty in the county up from eighty-two percent of full value in 1979 to 100% of fair value in 1980. The lower court and the court of appeals held the 1980 assessments violated section 171 because the variations in the increases constituted prima facie evidence of nonconformity.

The Kentucky Supreme Court reversed the lower courts and upheld the assessments. The Court reasoned that: 1) section 171 of the Kentucky Constitution merely compels legislative bodies to fix uniform rates for property of the same class, and 2) section 172 requires the use of uniform criteria to determine fair cash value but variation in increase of individual assessments is expected.

In another property tax case, *Travis v. Landrum*, the Kentucky Court of Appeals upheld exemption of the Kentucky Bar Association building in Frankfort from the Kentucky ad valorem tax on real property as "public property used for public purposes." The court reviewed the historical statutory provisions known as the "Bar Act" to demonstrate that the Kentucky Bar Association is an agency of the judicial branch of government performing a public function. The Kentucky Supreme Court

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139 616 S.W.2d 501 (Ky. 1981).
140 *Id.* at 503.
141 *Id.*
142 *Id.*
143 *Id.*
144 607 S.W.2d 124 (Ky. Ct. App. 1980), discretionary review denied (Ky. 1980).
145 607 S.W.2d at 124 (based on Ky. Const. § 170).
146 Ch. 3, 1934 Ky. Acts, repealed by ch. 58, § 12, 1976 Ky. Acts. The Bar Act provided that the court of appeals (then the Supreme Court) would adopt rules organizing and governing the bar association "as part of the judicial department." *Id.* Today the Kentucky Bar Association is governed by Ky. Sup. Ct. R. 2.000-3.700.
147 607 S.W.2d at 125.
used similar reasoning in *Ex Parte Auditor of Public Accounts*, holding that the Kentucky Bar Association cannot be audited by the Kentucky Auditor of Public Accounts. The decision was based on the judiciary’s exclusive authority to manage its own affairs, including the affairs of the Kentucky Bar Association.

In *Land v. Dolan*, a case now on appeal in the Kentucky Supreme Court, the Fayette Circuit Court invalidated the PVAs’ special use assessments of approximately 1,200 agricultural landowners. At issue are the special use assessment provisions passed by the 1976 General Assembly concerning agricultural horticultural land. One provision implements the requirement of section 172A of the Kentucky Constitution that agricultural and horticultural land be assessed at its value for farming purposes rather than at its fair cash market value. The tax break for farm land, however, is circumscribed by minimum acreage requirements and by exclusion of the dwelling and appurtenances such as lawns, driveways and gardens from the special use assessment.

The circuit court held that: 1) the method of assessment used by the PVA violated the constitutional requirement of uniformity in assessments; and 2) the statutes setting minimum acreage requirements and excluding portions of the “farms” unconstitutional.

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148 609 S.W.2d 682 (Ky. 1980).
149 Id. at 689.
150 Id. at 685. The Kentucky Bar Foundation, a non-profit organization, also survived scrutiny on the federal level in the United States Tax Court, which held that the association is exempt from taxation as a charitable organization under I.R.C. § 501(c)(3). Kentucky Bar Found., Inc. v. Commissioner, 78 T.C. 921 (1982), appeal pending. The case is discussed in Whitmer, *One More Word*, 46 Ky. BENCH & BAR 12 (July, 1982). Even though the exemption applies to agencies operating exclusively for the exempt purposes, the court applied the exemption despite “insubstantial” nonconforming activities. Id. at 923-24. The court was persuaded by the fact that the nonconforming activities were undertaken to “maintain public confidence in the legal system.” Id. at 930.
153 KRS § 132.450 (Supp. 1982). See note 134 supra for the text of KY. CONST. § 172A.
154 KRS § 132.010(9), (10) (Supp. 1982) (at least five contiguous acres if horticultural).
155 KRS § 132.450(2)(a) (Supp. 1982).
156 No. 81-CI-3113, slip op. at 4 (interpreting KY. CONST. § 172A). For the text of § 172A, see note 134 supra.
tionally restrict the definition of agricultural and horticultural land.\(^{157}\)

Changes in property tax statutes made by the 1982 General Assembly include codification of an extension of the homestead exemption\(^{158}\) to the totally disabled\(^{159}\) and classification, beginning July 15, 1982, of mobile homes as real estate even if not permanently affixed to the ground.\(^{160}\) The change in mobile home classification will result in a drop in the tax rate and insure that mobile homes can qualify for the homestead exemption if other requirements for the exemption are met.\(^{161}\)

A gnawing problem in the property tax area is a growing swell of opinion that the rate of state tax on unmined coal in the ground should be raised from the present one-tenth of one cent per one hundred dollars (.001) of value, a rate so low that any effort to collect is rarely made.\(^{162}\)

VII. THE SEVERANCE TAX

The Kentucky severance tax imposed on minerals extracted from the ground is now four-and-one-half percent of the gross value of coal severed and/or processed (with a minimum of fifty

\(^{157}\) No. 81-CI-3113, slip op. at 10. The statutes involved included KRS § 132.010(9)-(10) (Supp. 1982) (these subsections set out the minimum acreage requirements) and KRS § 132.450(2)(a) (Supp. 1982) (excludes "land used in connection with dwelling houses including, but not limited to, lawns, drives, flower gardens, swimming pools or other areas devoted to family recreation").

\(^{158}\) Originally, under the Kentucky Constitution, the homestead exemption applied only to people 65 years of age or older; today the constitution also exempts the totally disabled. KY. CONST. § 170 (amended Nov. 1981).

\(^{159}\) KRS § 132.810(2)(a) (Supp. 1982).

\(^{160}\) The Kentucky revenue officials apparently adopt this view, see KY. TAX ALERT, June 1983, at 2, although the statutory authority is contradictory. See KRS § 132.750 (Supp. 1982). Two conflicting versions of this statute were enacted. The first states: "If the wheels or mobile parts have been removed from a mobile home or recreational vehicle and the unit rests on a permanent, fixed foundation, it shall be classified as real estate." \(\text{Id.}\) Under the other version, "Mobile homes shall be classified as real estate for the purpose of the levy and assessment of taxes, regardless of whether the wheels or mobile parts have been removed and the unit rests on a permanent, fixed foundation." \(\text{Id.}\) (emphasis added).

\(^{161}\) See KRS § 132.810 (Supp. 1982).

cents per ton for each ton severed during a reporting period). In *Commonwealth v. Majestic Collieries Co.*, the Supreme Court of Kentucky held that the lessees, not the contract miners, are the parties responsible for reporting the value of the coal severed and paying the tax. The Court explained that because the lessees arranged with the contract miners to perform the mining and because the lessees paid the miners a per ton compensation, the lessees, not the miners, fit the statutory definition of "taxpayer" as one "engaged in severing coal." The dissent interpreted the facts differently and thought the tax should be collected from the contract miners because they were operating the mine independently, not merely as employees.

Also, the Kentucky Board of Tax Appeals has held that the coal valuation methods used for federal depletion purposes can be used to value coal for Kentucky severance tax purposes. The correct valuation for the state severance tax is its "fair market value, or uncontrolled sales price, less the value added to the coal by processing."

**VIII. SALES AND USE TAXES**

The Kentucky sales and use tax provisions have been riddled with exceptions and exclusions which occasionally reach the courts for interpretation.

In *Shelby County Board of Assessment Appeals v. Gro-Green*

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163 KRS § 143.020 (1982).
164 594 S.W.2d 877 (Ky. 1979) (interpreting the definition of "taxpayer" in KRS § 143.010(5) (1982)).
165 594 S.W.2d at 878.
166 *Id.* at 878-79 (Stephenson, J., dissenting).
168 *Id.*
170 In an unpublished decision, the court of appeals held that a bulldozer-tractor was not exempt from the sales and use tax as a pollution control facility because the equipment was not primarily used to convert solid waste into an item of economic value. Gibraltar Coal Corp. v. Department for Natural Resources & Envtl. Protection, (Ky. Ct. App. Nov. 4, 1981), (No. 28 Ky. L. Summ. 14, at 2), *modified on reh'g and ordered not to be published* (Ky. Ct. App. Dec. 18, 1981).
Chemical Co.,\textsuperscript{171} the Kentucky Supreme Court held that the local tax exemptions for machinery and raw materials used in manufacturing\textsuperscript{172} applied to a chemical company's fertilizer plant that blended various purchased elements into the correct proportion for sale to customers.\textsuperscript{173} The majority considered the process to be manufacturing.\textsuperscript{174} Justice Lukowsky, dissenting, would have denied the exemption because the mixing, in his opinion, did not qualify as a "manufacturing process."\textsuperscript{175}

In Genex/London, Inc. v. Kentucky Board of Tax Appeals,\textsuperscript{176} the Kentucky Supreme Court held that a Kentucky corporation engaged in highway construction should be excused from the penalty for failure to file sales or use tax returns\textsuperscript{177} when it reasonably relied upon the advice of attorneys and certified public accountants, "impartial competent tax counsel to whom all relevant facts" had been revealed.\textsuperscript{178} On the substantive issue, however, the taxpayer lost. The Court found the taxpayer was not entitled to a tax credit for sales or use taxes paid to another state on property purchased in another state, first used in the other state and then brought into Kentucky.\textsuperscript{179} In so finding, the Court upheld as a constitutional and reasonable classification the state statute that grants a tax credit on equipment purchased in

\begin{itemize}
\item \textsuperscript{171} 602 S.W.2d 155 (Ky. 1980).
\item \textsuperscript{172} KRS § 132.200(4) (1982 & Cum. Supp. 1982).
\item \textsuperscript{173} The Court explained:
\begin{quote}
When a business operation takes raw materials and combines them to make a viable substance which conforms to the wants and needs of a particular customer the business has, in effect, manufactured something new. Simply because the individual components are not chemically altered does not prevent the process from being labeled "manufacturing."
\end{quote}
602 S.W.2d at 156.
\item \textsuperscript{174} \textit{id.} at 155-56.
\item \textsuperscript{175} \textit{id.} at 156-58 (Lukowsky, J., dissenting). Lukowsky's opinion was based on Department of Revenue ex rel. Luckett v. Allied Drum Service, 561 S.W.2d 323 (Ky. 1978). The Luckett Court defined "manufacturing process" as: "Material having no commercial value for its intended use before processing [which] has appreciable commercial value for its intended use after processing by the machinery." \textit{id.} at 325-26.
\item \textsuperscript{176} 622 S.W.2d 499 (Ky. 1981).
\item \textsuperscript{177} See KRS § 139.980(2) (1982 & Cum. Supp. 1982) (if the taxpayer fails to file before the due date, a penalty is imposed unless the failure is due to a "reasonable" cause).
\item \textsuperscript{178} 622 S.W.2d at 501 (quoting the court of appeals opinion).
\item \textsuperscript{179} \textit{id.} at 501-04.
\end{itemize}
another state but first used in Kentucky.\footnote{Id. at 503-04. The statute involved was the credit provision of KRS § 139.510 (1982). Besides finding reasonable the clarification distinguishing machinery first used in Kentucky from machinery first used elsewhere, the Court found no unconstitutional burden upon interstate commerce resulting from Kentucky’s imposition of the sales or use tax upon construction machinery brought into the state. Id. at 504.}

The Kentucky Court of Appeals, in \textit{International Society for Krishna Consciousness, Inc. v. Commonwealth}\footnote{610 S.W.2d 910 (Ky. Ct. App. 1980), \textit{discretionary review denied} (Ky. 1981).} distinguished selling of personal property from evangelical religious activity. The religious society’s primary purpose in distributing literature at the state fair was the solicitation of memberships and donations. The society exchanged literature, candy, incense or flowers for donations. The court held that the Society’s activity was not equivalent to the retail sale of personal property; rather it was an exercise of the constitutional guarantee of freedom of speech.\footnote{Id. at 912.} Therefore, no license for conducting retail sales activity was required and no tax collection was permissible.

New legislation, effective June 1, 1982, now imposes an alcohol tax equal to nine percent of the gross receipts from wholesale sales on wholesalers of wine and distilled spirits and on distributors of beer.\footnote{KRS § 243.884 (Supp. 1982).} Beginning on the same date, retail sales of distilled spirits, wine, beer and ale not consumed on the premises are exempt from the Kentucky sales tax.\footnote{See KRS § 139.050(3)(g) (Supp. 1982).}

\textbf{IX. Kentucky Inheritance Tax}

The Kentucky inheritance tax takes on more significance relative to the federal transfer tax in light of recent changes in the latter. The changes limit the reach of the federal tax to a fraction of one percent of all estates. This federal development results from the 1981 Economic Recovery Tax Act (ERTA) which provided both an unlimited marital deduction for transfers to spouses\footnote{I.R.C. § 2056 (1981).} and a sliding scale increase in the exemption equivalent of the unified credit\footnote{I.R.C. § 2010 (1981).} so that all estates under $600,000 will be exempt from taxation by 1987. The top Kentucky inheritance tax
rate is ten percent or sixteen percent depending upon the relationship of the beneficiary to the decedent.\textsuperscript{187} Although considerably lower than rates under both the previous and present federal transfer tax, the state rates can be a serious burden. Most inheritances are subject to some Kentucky inheritance tax, and for most estates the Kentucky tax is the only one imposed because of the federal exemptions. Significant savings in Kentucky taxes can sometimes be achieved by: 1) distribution of testamentary property among different beneficiaries to whom different rates and exemptions apply; and 2) careful use of the Kentucky disclaimer provisions.\textsuperscript{188}

Two relatively minor statutory provisions affecting the inheritance tax were enacted by the 1982 Kentucky General Assembly. In cases of intestacy or renunciation of a will by the surviving spouse, the exemption from the state's claim for taxes and from creditors has been increased from $5,000 to $7,500.\textsuperscript{189} The legislature also extended the inheritance tax qualified pension plan exemption to benefits payable when an employee with an individual retirement account dies,\textsuperscript{190} thus bringing Kentucky law into more complete agreement with the federal statute.

Although the 1982 legislation affecting inheritance tax was quite limited in scope, there were numerous bills introduced which failed to pass. These are significant, at least insofar as they may portend future developments. They include: 1) a bill which would repeal completely the Kentucky inheritance tax;\textsuperscript{191} 2) a bill providing exemption of Kentucky estates from the tax to equal

\textsuperscript{187} KRS § 140.070 (1982).

\textsuperscript{188} For general discussions of inheritance tax aspects in tax planning, see Sturm, \textit{Powers of Appointment and the Kentucky Inheritance Tax—The Department of Revenue's Administration of KRS Section 140.040}, 61 Ky. L.J. 900 (1972-73); Whiteside, \textit{Aspects of Kentucky Inheritance Taxation—Relationships with ERTA}, in \textit{TAX INSTITUTE} (presented by the Office of Continuing Legal Education, University of Kentucky College of Law, Sept. 17-18, 1982); Whiteside & Buechel, \textit{Kentucky Taxation}, 65 Ky. L.J. 425, 426 (1976-77).

\textsuperscript{189} KRS § 391.030(1)(c) (Supp. 1982).

\textsuperscript{190} KRS § 140.063(3) (Supp. 1982). As originally enacted the statute exempted benefits paid by employers under pension plans qualifying under the Internal Revenue Code provisions. Ch. 141, § 1, 1974 Ky. Acts (current version in KRS § 140.063 (Supp. 1982)). The amended, current version brings the Kentucky law into "agreement" with the current federal statute, I.R.C. § 408 (1981).

\textsuperscript{191} H.B. 540, 1982 General Assembly.
the sliding scale exemption from the federal estate tax now provided by ERTA which by 1987 will exclude from taxation all estates under $600,000 and provide an unlimited marital deduction;\textsuperscript{192} and 3) several bills either raising the exemption or eliminating any Kentucky inheritance tax on property passing to a surviving spouse.\textsuperscript{193}

**CONCLUSION**

Judicial decisions interpreting tax laws are always important for the parties affected and for lawyers who must help clients plan future transactions. Noteworthy among the many court decisions discussed were those in the property tax field defining the roles of both Revenue Cabinet and Property Valuation Administrators and thus strengthening the principle of assessing property at its full fair market value.

Taxation, however, is a moving public law field with legislative decision-making predominant over the judicial. Several legislative developments should be highlighted. First, there has been an enhanced role of the revenue arm of state government, now elevated to Cabinet status. The Revenue Cabinet's efforts are being directed toward clarification of state revenue statutes and regulations as well as stepped up collection of taxes with the aid of legislation enacted by the legislature. Second, the executive branch through the Cabinet and the General Assembly through the Legislature Research Commission are working together toward simplification and reform of the state's income tax system. It is hoped that the Commonwealth's need for stable revenue can be achieved with fairness to all taxpayers.

All indications from the foregoing are that what is happening to taxation on the state level may be more significant than what has already taken place.

\textsuperscript{192} H.B. 27, 1982 General Assembly.
\textsuperscript{193} H.B. 168, 234, 1982 General Assembly.