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

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

Direct expenditures are evaluated during each budget cycle, and are approved, adjusted, or rejected during the budget process. Tax expenditures, however, are evaluated and approved only when the statutory adjustment is made. There is no requirement to revisit or re-evaluate tax expenditures once they are passed and placed within statute. So direct expenditures receive regular review and re-approval, while tax expenditures rarely receive any additional review once placed within statute.

This report itemizes tax expenditures by tax type. The report quantifies the amount of potential tax revenue within each tax type that is foregone because of the statutory implementation of these expenditures.

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

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

? ***Alcoholic Beverage Taxes*** – Various taxes assessed on all types of alcoholic beverages. First assessed in 1936, rates vary significantly based on the type of beverage and the percent of alcohol the beverage contains. The tax is paid by the wholesaler or distributor of the product. For FY03, alcoholic beverage taxes generated $75.9 million in Kentucky. Tax expenditures within this tax type are estimated at $835,000 for FY04.

? ***Cigarette Tax*** – A tax on each pack of cigarettes, it was first assessed in 1936. The rate of tax is three cents per pack, and is paid by the wholesaler, who purchases stamps to affix to each pack of cigarettes. For FY03, the cigarette tax generated $16.4 million in Kentucky. Tax expenditures within this tax type are estimated at $3.2 million for FY04.

? ***Coal Severance and Processing Tax*** – Assessed against the severance (removal) and processing of coal, this tax was first utilized in 1972. The tax is assessed at the rate of 4.5% of the gross value of the coal, with a minimum of fifty cents per ton. The tax is assessed against the person or entity severing or processing the coal. For FY03, this tax generated $141.7 million; tax expenditures for this tax type are estimated at $9.1 million for FY04.

? ***Corporation Income and License Taxes*** – Income tax was first assessed in 1936, against the net income attributable to Kentucky. Current rates of tax range from 4% to 8.25% of net income. License tax was first assessed in 1906, against capital employed (the combined value of owners' equity accounts and most borrowed monies). The current tax rate is $2.10 per $1,000 of capital employed, with credits allowed for smaller taxpayers. For FY03, corporation income and license taxes generated $430.6 million. Tax expenditures for these taxes are estimated at $183.3 million for FY04.

? ***Gasoline Tax*** – First levied in 1920, this tax is assessed on gallons of gasoline sold. The current minimum tax is fifteen cents per gallon; if the wholesale price rises significantly, the tax rate may also rise. For FY03, this tax generated $333.9 million; tax expenditures for this tax are estimated at $9.0 million for FY04.

? ***Individual Income Tax*** – First imposed in 1936, this tax is the most productive revenue source to Kentucky. The top tax rate of 6% is applied to taxable income above $8,000. Employers withhold income tax from employees' wages; non-wage income is subject to estimated payments by the taxpayer. For FY03, this tax generated $2,746 million; tax expenditures for this tax are estimated at $2,091.2 million for FY04.

? ***Inheritance and Estate Tax*** – First adopted in 1906, this tax is assessed against the value transferred from the estates of deceased Kentuckians. The tax rate and the amount subject to tax are based on the 'class' of the beneficiary. For FY03, this tax generated $95.9 million; tax expenditures for this tax are estimated at $153.7 million for FY04.

? ***Liquefied Petroleum Gas Tax*** – Implemented in 1960 as a 'companion' to the gasoline tax, this tax is assessed on gallons sold. The current minimum tax is fifteen cents per gallon; if the wholesale price rises significantly, the tax rate may also rise. For FY03, this tax generated $207,000; tax expenditures for this tax are estimated at $1,000 for FY04.

? ***Motor Vehicle Usage Tax*** – First assessed in 1936, the current tax rate is 6% of the retail price of motor vehicles. This tax is similar to a 'sales' tax, but proceeds are deposited into the Road Fund. For FY03, this tax generated $432.9 million; tax expenditures are estimated at $94.7 million for FY04.

? ***Natural Resources Severance and Processing Tax*** – First assessed in 1980, this tax is levied against the gross value of all minerals severed or processed in Kentucky, excluding coal and oil. For FY03, this tax generated $27.3 million; tax expenditures are estimated at $6.8 million for FY04.

? ***Property Taxes*** – Kentucky has had a property tax since becoming a state on June 1, 1792. Property is assessed at its fair market value; rates vary depending upon the type of property. For FY03, property taxes generated $434.8 million; tax expenditures are estimated at $941.1 million for FY04.

? ***Sales and Use Tax*** – The sales and use tax was first levied in its current form in 1960. The tax is collected on retail sales within the state, at a rate of 6% of the sales price. For FY03, this tax generated $2,364.2 million; tax expenditures are estimated at $2,269.7 million for FY04.

? ***Special Fuels Tax*** – This tax includes fuels other than gasoline that are used in motor vehicles. The current minimum tax is fifteen cents per gallon; if the wholesale price rises significantly, the tax rate may also rise. For FY03, this tax generated $104.5 million; tax expenditures for this tax are estimated at $49.1 million for FY04.

? ***Earmarked Funds*** – These items are included for informational purposes only. They do have a negative impact on the General Fund, but are technically not a tax expenditure since the tax is still collected from the taxpayer. Identified earmarked funds that are not deposited into the General Fund are estimated at $20.9 million for FY04.

What are tax expenditures?

Tax expenditures are provisions such as special exemptions, exclusions, deductions, credits, deferrals, and preferential rates in tax law that result in a loss of tax revenue. 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 development, equity, fiscal responsibility, and tax reform. The unintended result is an increase in the complexity of the tax laws. Individual taxpayers as well as tax experts have found it difficult to keep informed of these many changes. In many cases, these decisions lead to less similarity between state and federal laws and ultimately to even more complexity. When such provisions are enacted, the resulting tax loss reduces the revenue available to fund other programs, unless tax rates are raised or new taxes are enacted to compensate for the loss.

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

A tax expenditure analysis can be used to evaluate the cost to state government of the many programs funded through tax expenditures. This analysis identifies, quantifies 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, including Bureau of the Census statistics, federal tax expenditure estimates, Bureau of Labor Statistics data, information from federal tax returns, and other studies.

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

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

How to Read This Report

This report catalogs or accumulates the various tax expenditures differently than in previous reports. New to the report is a recap of tax expenditures by tax type, to provide a more concise listing for quicker reference and comparison.

This report also contains the traditional method of identifying each expenditure by statute, with an estimate of the impact of that particular item, whether deduction, credit, exemption, rate reduction or other means utilized to alter or reduce a taxpayer's liability.

Within the traditional sections of the report, each identified tax type 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 2002 - 2003” which includes the most recently enacted tax expenditures, the date they went into effect, and the enacting legislative bill number.

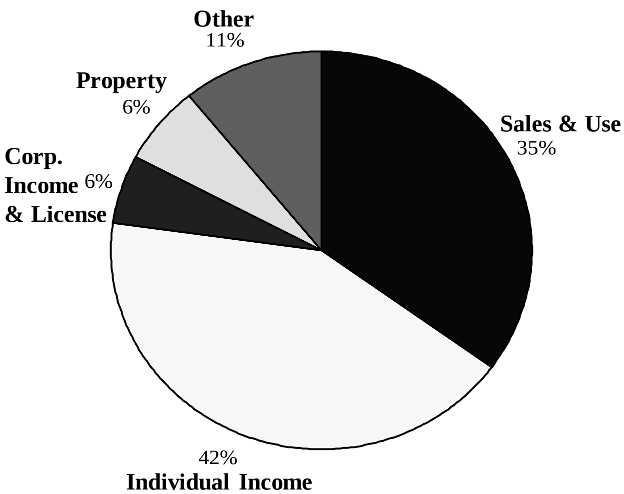
In some past reports, services excluded from the sales tax base have been listed as tax expenditures. While we will continue to quantify the exemption of certain services from sales tax, they will no longer be listed as a tax expenditure. A list of specific services and the estimated costs of excluding them from the tax can be found on pages 122-124 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 131-135.

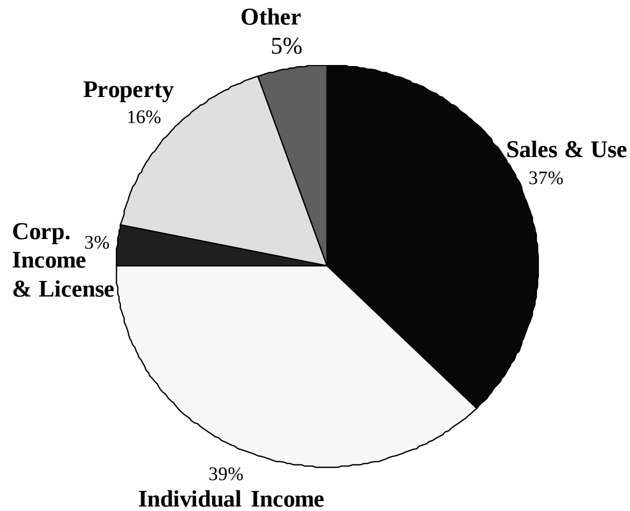
The Governor’s Office for Economic Analysis welcomes your comments and any questions you may have about this report.

OVERVIEW OF TAX EXPENDITURES: The following 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 2004.

Figure 1. General Fund Overview

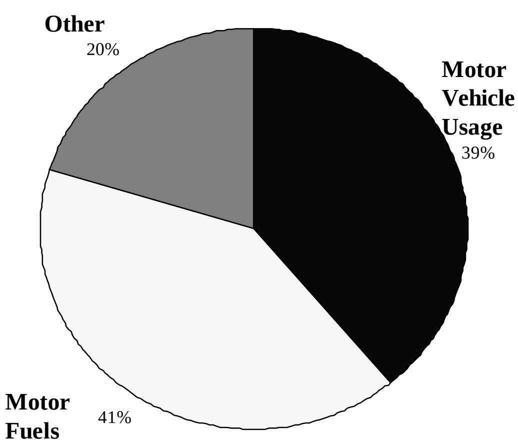


Estimated FY2004 Tax Receipts*

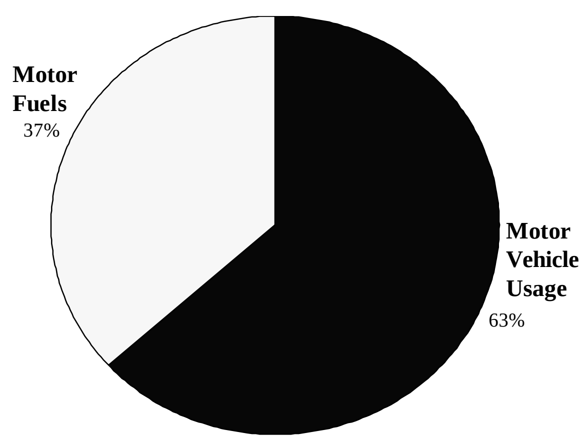


Estimated FY2004 Tax Expenditures

Figure 2. Road Fund Overview



Estimated FY2004 Tax Receipts*



Estimated FY2004 Tax Expenditures

*Based on Official January 2003 Estimates

New to this issue of the Tax Expenditure Analysis is a condensed presentation of Tax Expenditure items in table format. This table is a recap of the traditional tax expenditures analysis in a condensed form that is much easier to review and reference. It lists each statutory exemption, deduction, credit, rate adjustment, or other tax reduction by major tax type. Within each tax type, expenditures are generally listed from those in existence the longest to those most recently granted.

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

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

Tax Expenditures by Tax Type *($ millions)*

	FY04	FY05	FY06
Alcoholic Beverage Taxes			
U.S. Government Exemption	0.20	0.21	0.21
Reduced Rate for 'Low Volume' spirits	0.04	0.04	0.04
Wholesaler Compensation for Collection of Tax	0.60	0.60	0.60
Total Alcoholic Beverage Tax Expenditures	**0.84**	**0.85**	**0.85**
Cigarette Tax			
U.S. Government Exemption	2.30	2.30	2.30
Wholesaler Compensation for Collection	0.90	2.00	2.00
Total Cigarette Tax Expenditures	**3.20**	**4.30**	**4.30**
Coal Severance and Processing Tax			
Transportation Expense	9.00	9.00	9.00
Coal Used to Burn Solid Waste	0.00	0.00	0.00
Thin Seam Credit	0.10	0.10	0.10
Total Coal Severance and Processing Tax Expenditures	**9.10**	**9.10**	**9.10**
Corporation Income and License Taxes			
Net Operating Loss Deduction	40.00	41.00	42.50
Exemption of Dividend Income	27.70	28.20	29.10
Exclusion of 50% of Coal Royalties	0.10	0.10	0.10
Excess of Percentage over Cost Depletion	5.20	5.20	5.20
Charitable Contribution Deduction	5.20	5.20	5.30
Patronage Dividend Deduction	0.10	0.10	0.10
Unemployment Tax Credit	0.00	0.00	0.00
Income Exemption for Credit Unions	5.10	5.10	5.20
Coal Conversion Credit	0.20	0.20	0.20
Double Weighted Sales Factor	32.00	33.00	34.00
Recycling Credit	1.20	1.40	1.40
Enterprise Zone Credit - Unemployed hiring	0.15	0.05	0.05
KREDA Economic Development Credit	12.00	12.80	13.40
KIDA Economic Development Credit	11.50	12.10	12.60
KIRA Economic Development Credit	1.20	1.30	1.50
KJDA Economic Development Credit	8.30	8.50	8.90
Kentucky Investment Fund Credit	0.80	1.50	1.70
Skills Training Investment Credit	2.00	2.00	2.10
Real Estate Investment Trust	0.00	0.00	0.00
KYOZ Economic Development Credit	0.00	0.00	0.00
LLC/LLP Not Subject to License Tax	29.90	31.30	32.70
Coal Incentive Tax Credit	0.60	0.90	1.10
Total Corporation Income and License Tax Expenditures	**183.25**	**189.95**	**197.15**
Gasoline Tax			
U.S. Government Exemption	0.10	0.10	0.10
Agricultural Exemption	0.15	0.15	0.16
Aircraft Refund	0.22	0.23	0.23
Watercraft Refund	0.75	0.76	0.77
Bus, Taxicab, and Certain Senior Citizen's Program Refund	0.30	0.31	0.31
Dealer's Monthly Reporting Allowance	7.50	7.50	7.60
Total Gasoline Tax Expenditures	**9.02**	**9.05**	**9.17**
Individual Income Tax			
Pension Contributions by Employer	265.30	273.10	281.30
Personal and Dependent Tax Credits	75.90	77.30	78.70
Standard Deduction	92.00	93.40	94.70
Home Mortgage Interest Deduction	132.80	135.10	138.20
Property Tax on Home	45.90	48.20	51.80
Taxes Other Than Home Property Tax	37.40	38.30	39.30
Medical Insurance Provided by Employer	260.10	278.30	297.80

	FY04	FY05	FY06
Social Security Benefits Not Taxable	309.00	330.60	353.80
Charitable Contributions Deduction	78.80	80.10	82.20
Exclusion of Interest Growth in Life Insurance	55.00	56.10	57.40
Exclusion of Capital Gains at Death	82.00	83.90	85.80
Deduction for Individual Retirement Accounts	17.10	17.40	17.70
Deduction for KEOGH Retirement Accounts	6.60	6.70	6.80
Exclusion of Federal and Military Retirement Income	54.80	58.60	62.70
Exclusion of Premiums on Group Term Life Ins.	4.50	4.60	4.80
Exclusion of Worker’s Compensation Benefits	7.50	7.70	7.90
Exclusion of Veteran’s Disability Benefits	6.10	6.10	6.20
Credit for Child and Dependent Care Expenses	5.80	5.90	5.90
Deduction for Foreign Income Tax	0.00	3.30	3.30
Exclusion of Income Earned Abroad by US Citizens	4.80	4.80	4.90
Excess of Percentage over Cost Depletion	1.10	1.10	1.10
Deduction for Medical Expenses	22.80	24.00	25.10
Net Operating Loss Deduction	40.00	40.00	40.00
Employer Provided Meals and Lodging	1.50	1.50	1.60
Railroad and Supplemental Railroad Retirement	9.90	10.30	10.60
Exclusion of State Employee Pension Benefits	47.20	51.20	55.60
Exclusion of Private Pensions and IRA’s	133.10	145.00	158.10
Exclusion of Scholarship & Fellowship Income	3.20	3.50	3.80
Exclusion of Public Assistance Benefits	1.90	1.90	1.90
Credit for Hiring the Unemployed	0.01	0.01	0.01
Exclusion of Special Benefits for Coal Miners	3.70	3.70	3.60
Exclusion of GI Bill Benefits	0.30	0.30	0.30
Deduction for Certain Capital Outlays (Sec. 179)	13.40	13.60	13.80
Low Income Tax Credit	47.50	47.50	47.50
Exclusion of ‘Cafeteria Plan’ Benefits	23.80	24.80	25.90
Exclusion of Miscellaneous Fringe Benefits	10.10	10.80	11.50
Deduction for Casualty and Theft Losses	0.55	0.55	0.55
Credit for Recycling and Composting Equipment	1.00	1.10	1.10
Job Development Assessment Fees (Economic Dev.)	57.00	63.50	68.00
Untaxed Medicare Benefits - Hospital Insurance	49.80	51.00	52.60
Untaxed Medicare Benefits - Medical Care Insurance	27.50	28.20	29.00
Deduction for Moving Expenses	5.00	5.10	5.10
Exclusion of Gain on Sale of Personal Residence	27.50	29.00	30.60
Savings Incentives Match Plans for Employees	0.10	0.10	0.10
Deduction for Self-Employed Health Insurance	4.60	4.70	4.80
Health Insurance Premiums - Private Policies	8.80	9.20	9.60
Roth IRA distributions	0.00	0.00	0.00
Deduction for Educational Loans Interest	1.50	1.60	1.70
Exemption of Income of Precinct Workers	0.08	0.08	0.08
Tobacco Settlement Funds Exclusion	5.00	5.00	5.00
No Capital Gains on Eminent Domain Takings	0.11	0.12	0.13
Deduction for Long-Term Care Insurance Premiums	0.75	0.60	0.45
Distribution from ‘S-Corp’ Financial Inst. not taxable	1.00	1.00	1.00
Total Individual Income Tax Expenditures	**2,091.20**	**2,189.56**	**2,291.42**
Inheritance and Estate Tax			
Class A Beneficiary Exclusion	68.20	71.50	75.00
Educational, Religious, Charitable Transfers	5.30	3.80	2.80
Early Payment Discount	1.20	0.80	0.60
Class B Beneficiary Exclusion	0.10	0.10	0.10
Class C Beneficiary Exclusion	0.05	0.05	0.05
Life Insurance Proceeds	25.00	25.00	25.00
Assessment of Land at Agricultural Value	0.60	0.60	0.60
CD’s Exempt from Contemplation of Death Rule	0.25	0.25	0.25
Exclusion of Annuities of Qualified Retirement Plans	0.10	0.10	0.10
Exclusion of Certain Individual Retirement Accounts	0.05	0.05	0.05

	FY04	FY05	FY06
Recurring Assessment Tax Credits	0.10	0.10	0.10
Lifetime Transfer Exclusion	28.80	20.30	13.50
Exclusion of Benefits Under Military Retirement Plans	0.05	0.05	0.05
Time of War Benefits are Excluded	0.01	0.01	0.01
Reduction of Federal Estate Tax Credit	23.90	37.70	52.90
Total Inheritance and Estate Tax Expenditures	**153.71**	**160.41**	**171.11**
Liquefied Petroleum Gas Tax			
Dealer's Monthly Reporting Allowance	0.00	0.00	0.00
Approved Carburetion System Exclusion	0.00	0.00	0.00
Total Liquefied Petroleum Gas Tax Expenditures	**0.00**	**0.00**	**0.00**
Motor Vehicle Usage Tax			
Trade-In Allowance on Used Vehicles	54.10	55.50	57.00
Immediate Family Member Transfer Not Taxable	14.50	14.90	15.20
Governmental Exemption	7.50	7.70	7.90
Enterprise Zone Exemption	3.80	1.30	1.10
Military Serviceperson Exemption	3.50	3.60	3.70
Repossessed Exemption	0.70	0.71	0.72
Transfers by Will or Court Order	1.60	1.70	1.70
Educational and Charitable Organizations	0.80	0.81	0.82
Enterprise Zone Exemption - U-Drive-It Tax	2.40	1.80	1.60
Commercial Motor Vehicle Exemption	0.00	0.00	0.00
Change in Business Structure Exemption	0.25	0.25	0.25
Transfers between LLC/LLP and Owners	0.10	0.10	0.10
Transfers between Subsidiary and Parent	0.15	0.15	0.15
Partnership Transfers	0.00	0.00	0.00
Insurance Company Transfers	4.20	4.20	4.20
Adapted Equipment for Handicapped Not Taxable	0.06	0.06	0.06
Large Truck Exclusion	1.00	2.60	2.80
Total Motor Vehicle Usage Tax Expenditures	**94.66**	**95.38**	**97.30**
Natural Resources Severance and Processing Taxes			
Transportation Expense Deduction	4.10	4.20	4.30
Limestone Sold in Interstate Commerce is Exempt	1.80	1.80	1.80
Limestone Sold for Agricultural Purposes	0.20	0.20	0.20
Miscellaneous Special Minerals Exemption	0.45	0.45	0.45
Limit on Tax from Clay	0.15	0.15	0.15
Clay Used in Landfills	0.10	0.10	0.10
Tax Credit for Recovering Inactive Oil and Gas Wells	0.00	0.00	0.00
Total Severance and Processing Tax Expenditures	**6.80**	**6.90**	**7.00**
Property Tax			
State Real Property Tax Yearly Revenue Ceiling (HB 44)	291.60	311.60	333.00
Alcohol Production Facilities	0.00	0.00	0.00
Leasehold Interests in Industrial Revenue Bond Bldgs.	2.50	2.80	3.00
Homestead Exemption	12.60	13.30	14.10
Agricultural Land Assessment Protection	0.10	0.10	0.10
Intrastate Railroads and Railway Companies - Real Prop.	0.02	0.02	0.02
Business Inventories	54.80	57.60	60.50
Leasehold Interests	2.80	2.80	2.80
Manufacturing Machinery, Pollution Control, Radio &TV	57.20	60.40	63.70
Machinery Used in Farming, Livestock and Poultry	22.50	22.50	22.50
Agricultural Products Reduced Rate	0.26	0.26	0.26
Foreign Trade Zone Property	24.40	24.40	24.40
Historic Vehicles	0.09	0.09	0.09
Intrastate Railroads and Railway Companies - Tangible	0.33	0.33	0.33
Interstate Trucks, Tractors, Semi-Trailers, and Buses	3.30	3.50	3.70
Special Railroad Carlines	3.20	3.20	3.20

	FY04	FY05	FY06
Non-Commercial Aircraft	1.00	1.00	1.00
Federally Documented Vessels	0.10	0.10	0.10
Floor Plan Financed Machinery and Equipment	0.10	0.10	0.10
In-Transit Warehoused Goods	10.80	10.80	10.80
Motor Vehicles with a Salvage Title held by Insurance Companies	0.05	0.05	0.05
Specially Identified Classes of Intangible Properties at a 1.5 cent rate	25.20	25.20	25.20
Bank Deposits	114.50	117.00	119.60
Exemption of Stock from Intangible Property Tax	180.40	180.40	180.40
Retirement Plans Taxed at Reduced Rate	51.80	53.90	56.00
Special Rates on Cooperatives and Production Credit Assoc.	5.00	4.50	4.40
Certain Classes of Intangible Property at one-tenth cent rate	65.30	65.30	65.30
Exemption for Credit Union Accounts and Shares	9.70	9.70	9.70
Reduced Rate on Broker's Accounts Receivable	0.57	0.57	0.57
Reduced Rate on Domestic Life Insurance Reserves and Capital	0.90	0.90	0.90
Total Property Tax Expenditures	**941.11**	**972.41**	**1,005.81**
Sales and Use Taxes			
Food Items	414.60	427.00	439.80
Baked Goods	0.00	4.10	4.10
Non-Profit Educational, Charitable and Religious Institutions	140.50	144.70	149.00
Labor and Services Used in Property Sold	171.10	176.20	181.50
Residential Utilities	134.40	138.40	142.60
Prescription Medicine, Prosthetics, Physical Aids	244.00	251.30	258.80
Machinery for New and Expanded Industry	67.50	68.80	70.20
Coal Used in the Manufacture of Electricity	55.00	57.10	59.20
Energy and Energy Producing Fuels	55.50	56.20	56.90
Retailers' Compensation for Collecting Sales Tax	11.20	18.30	18.60
Enterprise Zones	38.00	14.00	10.00
State, Cities, Counties, Special Districts Exemption	85.80	88.40	91.00
Textbook Exemption	4.20	4.30	4.50
Recycling Machinery and Equipment	3.50	3.60	3.70
Pollution Control Facilities	13.50	13.90	14.30
Tombstones and Grave Markers	2.80	3.00	3.10
Lodgings of Thirty Days or More	2.30	2.30	2.40
Garage and Yard Sales	2.20	2.20	2.30
Semi-Trailers and Trailers	11.20	11.70	12.10
Vessels and Maritime Supplies	4.20	4.20	4.30
Sales by School-Sponsored Clubs and Organizations	5.90	5.90	6.00
Interstate Cargo and Passenger Aircraft, Parts & Supplies	36.20	37.40	38.80
Sales by Higher Education Clubs and Organizations	1.20	1.20	1.30
Sales to Motion Picture Companies	0.10	0.10	0.10
Admissions and Purchases at Historic Sites	3.00	3.10	3.20
Sales to Credit Unions	1.20	1.20	1.20
Coin Operated Bulk Vending Machines	2.10	2.10	2.20
Non Returnable and Returnable Containers	1.20	1.20	1.20
Occasional Sales	120.00	120.00	120.00
Locomotives and Rolling Stock	1.50	1.50	1.50
Blood or Human Tissue	0.90	0.90	0.90
School Tax Portion of Residential Telephone Bill	4.00	4.10	4.30
Raw Materials and Industrial Supplies	453.20	466.80	480.80
Federal Tax Portion of Sale of Tangible Personal Property	4.10	4.30	4.50
Sales to Common Carriers Under a Bill of Lading	0.00	0.00	0.00
Lease or Rental of Films by Commercial Theaters	1.10	1.10	1.20
Tourism Attraction Project Credit/Refund	4.50	4.80	5.10
Alcohol Production Facilities	0.00	0.00	0.00
Fluidized Bed Energy Production Facility Exemption	0.00	0.00	0.00
Catalog and Newspaper Inserts Shipped Outside Kentucky	3.00	3.00	3.00

	FY04	FY05	FY06
Exemption for Sales by 4-H Clubs	0.10	0.10	0.10
Jet Fuel Tax is Capped at $1 million per Carrier	19.30	20.00	20.70
Repair parts for Large Trucks	1.50	4.00	4.10
Various Farm Products and Supplies	87.10	89.70	92.40
Horses Purchased for Breeding	12.30	12.50	12.60
Various Farm Machinery and Facilities	12.90	13.30	13.70
Fuel Used for Farm Purposes	7.10	7.30	7.50
Water Used for Most Farm Purposes	0.05	0.05	0.05
Water Used for Equine Purposes	0.05	0.05	0.05
Aquaculture Supplies and Products	0.10	0.11	0.11
Baling Twine and Wire	0.03	0.03	0.03
Horses Less Than Two Years of Age	17.20	17.80	18.60
Farm Chemicals	7.30	7.50	7.70
Total Sales and Use Tax Expenditures	**2,269.73**	**2,320.84**	**2,381.34**
Sales Tax			
Excluded Services:			
Personal Services	*59.30*	*63.00*	*67.00*
Business Services	*168.60*	*179.10*	*190.30*
Health Services	*421.30*	*447.60*	*475.50*
Legal Services	*74.50*	*79.20*	*84.10*
Educational Services	*5.00*	*5.30*	*5.60*
Social Services	*13.60*	*14.50*	*15.40*
Engineering, Accounting, Research, Management	*99.80*	*106.00*	*112.60*
Automotive and Miscellaneous Repair Services	*110.80*	*117.70*	*125.00*
Amusement and Recreational Services	*13.40*	*14.30*	*15.10*
Other Services	*5.10*	*5.40*	*5.70*
Total Sales Tax Excluded Services	***971.40***	***1,032.10***	***1,096.30***
Special Fuels Taxes			
Non-Highway Use Exemption	27.00	28.00	29.00
Railroad Companies	12.20	12.50	12.70
Agricultural Use Exemption	3.50	3.60	3.70
Dealer's Monthly Reporting Allowance	2.30	2.30	2.30
Residential Heating	1.40	1.40	1.40
Bus, Taxicab and Certain Senior Citizen's Program Refunds	0.31	0.32	0.32
State and Local Government Use	0.20	0.20	0.20
Religious, Charitable, Educational Use	0.20	0.20	0.20
Watercraft Use Exemption	0.03	0.03	0.03
U.S. Government Exemption	2.00	2.00	2.00
Total Special Fuels Tax Expenditures	**49.14**	**50.55**	**51.85**
Earmarked Funds			
Thoroughbred Development Fund - Pari-mutuel Tax	8.20	8.30	8.30
Equine Industry Program Trust/Revolving Fund - Pari-mutuel Tax	0.53	0.53	0.53
Higher Education Equine Trust/Revolving Fund - Pari-mutuel Tax	0.55	0.55	0.55
Standardbred Development Fund - Pari-mutuel Tax	0.43	0.43	0.43
Teen Tobacco Enforcement Program - Cigarette Tax	0.53	0.54	0.54
Kentucky Transportation Center - Motor Fuels Tax	0.19	0.19	0.19
Tobacco Research Trust Fund - Cigarette Tax	3.30	3.40	3.50
Agricultural Diversification and Development Fund - Cigarette Tax	0.00	0.00	0.00
Equine Drug Research - Pari-mutuel Tax	0.60	0.60	0.60
Kentucky Aviation Economic Development Fund - Sales Tax	5.60	5.70	5.80
Tax Increment Financing - Various Taxes	1.00	2.50	2.75
Total Earmarked Funds	**20.93**	**22.74**	**23.19**
TOTAL IDENTIFIED TAX EXPENDITURES ***(Not Including Sales Tax Excluded Services)***	**5,832.67**	**6,032.00**	**6,249.68**

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 $75.9 million in FY03, which represents 1.12 percent of total General Fund revenue.

Current Rate Structure

The consumption tax is levied at a rate of $1.92 per gallon on distilled spirits, and 50 cents per 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 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

Fiscal Year	Tax Expenditures
2004	$835,000
2005	$845,000
2006	$845,000

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.

FY2004 .... $200,000
FY2005 .... $210,000
FY2006 .... $210,000

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.

FY2004 .... $35,000
FY2005 .... $35,000
FY2006 .... $35,000

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.

FY2004 .... $600,000
FY2005 .... $600,000
FY2006 .... $600,000

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 FY03, cigarette tax collections of $16.4 million were 0.24 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.

Note: For Fiscal Year 2004 only, compensation to wholesalers is reduced to one half of the statutory discount.

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

Fiscal Year	Tax Expenditures
2004	$3.2 million
2005	$4.3 million
2006	$4.3 million

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.

FY2004 .... $0.9 million*
FY2005 .... $2.0 million
FY2006 .... $2.0 million

*Note: Reduced to one-half for FY04 by the FY03-FY04 Appropriations Act, HB 269

2. U.S. Government Purchases

Regulation 103 KAR 41:130, effective 1975

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

FY2004 .... $2.3 million
FY2005 .... $2.3 million
FY2006 .... $2.3 million

COAL SEVERANCE AND PROCESSING TAX *FY2004-2006*

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 Department for Local Government administers the local refund program.

During FY03, the coal tax produced $141.7 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.

Table 3. Total Coal Severance and Processing Tax Expenditures

Fiscal Year	Tax Expenditures
2004	$9.1 million
2005	$9.1 million
2006	$9.1 million

Tax Expenditures

1. Transportation Expense

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

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

FY2004 .... $9.0 million
FY2005 .... $9.0 million
FY2006 .... $9.0 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.

FY2004 .... $-0-
FY2005 .... $-0-
FY2006 .... $-0-

3. Thin Seam Tax Credit

Kentucky Revised Statute 143.021, effective 2000

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

FY2004	$100,000
FY2005	$100,000
FY2006	$100,000

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 $1,000 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 1990 Session of the General Assembly, are graduated between 4 and 8.25 percent of taxable income.

Corporate license tax receipts for FY03 were $152.6 million and accounted for 2.2 percent of total General Fund tax receipts. Corporate income tax receipts for FY03 were $278.0 million and accounted for 4.1 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. It should be noted that limited liability entities (LLPs, LLCs, LPs, etc.) are not corporations, and are not subject to corporate license tax. Limited liability entities are allowed to elect income tax treatment, so only those who actively elect to be taxed as a corporation will pay corporation income tax to Kentucky.

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

Table 4. Corporation Income Tax Rates

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

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:

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

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

Taxable Unit Every corporation 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 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.

Table 5. Total Corporation Income and License Tax Expenditures

Fiscal Year	Tax Expenditures
2004	$183.3 million
2005	$190.0 million
2006	$197.2 million

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 taxable income in profitable years.

FY2004 .... $40.0 million
FY2005 .... $41.0 million
FY2006 .... $42.5 million

2. Exemption of Dividend Income

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

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

FY2004 .... $27.7 million
FY2005 .... $28.2 million
FY2006 .... $29.1 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.

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

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.

FY2004 .... $5.2 million
FY2005 .... $5.2 million
FY2006 .... $5.2 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.

FY2004 .... $5.2 million
FY2005 .... $5.2 million
FY2006 .... $5.3 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.

FY2004	$100,000
FY2005	$100,000
FY2006	$100,000

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.

FY2004	$-0-
FY2005	$-0-
FY2006	$-0-

8. Exemption for Credit Unions

Kentucky Revised Statute 290.115, effective 1954

Credit unions are exempt from corporation income tax.

FY2004	$5.1 million
FY2005	$5.1 million
FY2006	$5.2 million

9. Coal Conversion Credit

Kentucky Revised Statute 141.041, effective 1984

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

FY2004 ....$200,000
FY2005 ....$200,000
FY2006 ....$200,000

10. Double Weighted Sales Factor

Kentucky Revised Statute 141.120(8), effective 1985

Double weighting of the sales factor for multistate corporations.

FY2004 ....$32.0 million
FY2005 ....$33.0 million
FY2006 ....$34.0 million

11. Recycling Credit

Kentucky Revised Statute 141.390, effective 1991

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

FY2004 ....$1.2 million
FY2005 ....$1.4 million
FY2006 ....$1.4 million

12. Enterprise Zone Credit

Kentucky Revised Statute 154.45-090, effective 1992

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

Enterprise Zones are scheduled to expire 20 years after initial designation as a zone. The first zones approved (Jefferson County and Fulton County) will expire on December 31, 2003, with additional zones expiring thereafter.

FY2004 .... $150,000
FY2005 .... $ 50,000
FY2006 .... $ 50,000

13. (KREDA) Economic Development Credit

Kentucky Revised Statute 141.347, effective 1988

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

FY2004 .... $12.0 million
FY2005 .... $12.8 million
FY2006 .... $13.4 million

14. (KIDA) Economic Development Credit

Kentucky Revised Statute 141.400, effective 1992

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

FY2004 .... $11.5 million
FY2005 .... $12.1 million
FY2006 .... $12.6 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.

FY2004 .... $1.2 million
FY2005 .... $1.3 million
FY2006 .... $1.5 million

16. (KJDA) Economic Development Credit

Kentucky Revised Statute 141.407, effective 1992

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

FY2004 .... $8.3 million
FY2005 .... $8.5 million
FY2006 .... $8.9 million

17. Kentucky Investment Fund Tax Credit

Kentucky Revised Statute 154.20, effective 1998

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

FY2004 .... $0.8 million
FY2005 .... $1.5 million
FY2006 .... $1.7 million

18. Skills Training Investment Tax Credit

Kentucky Revised Statute 154 - 12.2088, effective 1998

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

FY2004 .... $2.0 million
FY2005 .... $2.0 million
FY2006 .... $2.1 million

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.

FY2004 .... $-0-
FY2005 .... $-0-
FY2006 .... $-0-

20. (KEOZ) Economic Development Credit

Kentucky Revised Statute 154.23, effective 2000

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

FY2004 .... $-0-
FY2005 .... $-0-
FY2006 .... $-0-

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.

FY2004 .... $29.9 million
FY2005 .... $31.3 million
FY2006 .... $32.7 million

22. Coal Incentive Credit

Kentucky Revised Statutes 141.0405, effective 2000

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

FY2004………………………..$0.6 million
FY2005………………………..$0.9 million
FY2006………………………..$1.1 million

Background

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

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 FY03, gasoline tax collections totaled $333.9 million. This accounted for 29.7 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 or exemptions 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.

Tax Expenditures Enacted during Fiscal Years 2002 – 2003

The following change was enacted by the 2002 General Assembly, and became effective July 15, 2002:

Agricultural Exemption from Gasoline Tax – Approved agricultural users are permitted to purchase gasoline tax-free at the time of purchase. Previously the statute required payment of the tax, and applying for a refund at year end. *HB 43*

Table 6. Total Gasoline Tax Expenditures

Fiscal Year	Tax Expenditures
2004	$9.0 million
2005	$9.0 million
2006	$9.2 million

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.

FY2004 ....$7.5 million
FY2005 ....$7.5 million
FY2006 ....$7.6 million

2. U.S. Government Exemption

Kentucky Revised Statute 138.240(2), effective 1956

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

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

3. Agricultural Exemption

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

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

FY2004 ....$150,000
FY2005 ....$150,000
FY2006 ....$160,000

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.

FY2004 ....$215,000
FY2005 ....$225,000
FY2006 ....$230,000

5. Watercraft Refund

Kentucky Revised Statue 138.445, effective 1960

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

FY2004 ....$750,000
FY2005 ....$760,000
FY2006 ....$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.

FY2004 .... $300,000
FY2005 .... $305,000
FY2006 .... $310,000

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 $2,746 million in FY03, a growth of 1.6 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 federal code, except for changes in accounting provisions and methods. Any adoption of changes made in the federal code require ratification by the General Assembly. Many times the impacts of adopting changes in the federal code on Kentucky taxpayers and General Fund receipts can only be made after extensive studies of the changes. Kentucky's method of adoption helps prevent unanticipated and undesirable results from occurring.

Kentucky income tax law provides for 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

Taxable Income			Rate
First	-	$3,000	2%
$3,001	-	$4,000	3
$4,001	-	$5,000	4
$5,001	-	$8,000	5
Over	-	$8,000	6

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

Adjusted Gross Income			Credit Amount
$5,000	-	Or Less	100%
$5,001	-	$10,000	50
$10,001	-	$15,000	25
$15,001	-	$20,000	15
$20,001	-	$25,000	5
Over	-	$25,000	0

Tax Base

The individual income tax is levied on taxable income. Taxable income is computed by reducing gross income by trade or business expenses, and the standard deduction ($1,800 for 2002) or, at the option of the taxpayer, itemized deductions. Gross income is defined as gross income under the 2001 federal Internal Revenue Code with certain adjustments.

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

Taxable Unit

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

Tax Due

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

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

Tax Expenditures Enacted During Fiscal Years 2002 – 2003

The following tax expenditures were enacted by the 2002 General Assembly.

Adoption of the Internal Revenue Code - The Kentucky income tax reference to the IRC was updated to December 31, 2001, for tax years beginning on or after January 1, 2002. Tax expenditures that are affected by this update are listed separately below.

Table 9. Total Individual Income Tax Expenditures

Fiscal Year	Tax Expenditures
2004	$2,091.2 million
2005	$2,189.6 million
2006	$2,291.4 million

Tax Expenditures

1. Net Exclusion of Pension Contributions and Earnings

Internal Revenue Code Section 401 and 414, effective 1983

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

FY2004 .... $265.3 million
FY2005 .... $273.1 million
FY2006 .... $281.3 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.

FY2004 .... $75.9 million
FY2005 .... $77.3 million
FY2006 .... $78.7 million

3. Standard Deduction

Kentucky Revised Statutes 141.081, effective 1946, various amendments

A taxpayer who does not itemize deductions is permitted a deduction of a predetermined amount, referred to as the 'standard deduction'. The amount of the deduction has been amended several times; under current law it increases based on growth in inflation. For 2002, the standard deduction was $1,800 per taxpayer.

FY2004 .... $92.0 million
FY2005 .... $93.4 million
FY2006 .... $94.7 million

4. Deductibility of Home Mortgage Interest

Internal Revenue Code Section 163(a), effective 1954

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

FY2004 .... $132.8 million
FY2005 .... $135.1 million
FY2006 .... $138.2 million

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

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

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

FY2004 .... $37.4 million
FY2005 .... $38.3 million
FY2006 .... $39.3 million

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

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

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

FY2004 .... $260.1 million
FY2005 .... $278.3 million
FY2006 .... $297.8 million

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

Revenue Ruling 70-217, effective 1954

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

FY2004 .... $309.0 million
FY2005 .... $330.6 million
FY2006 .... $353.8 million

8. Deductibility of Property Tax on Owner-Occupied Homes

Internal Revenue Code Section 164(a), effective 1954

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

FY2004 .... $45.9 million
FY2005 .... $48.2 million
FY2006 .... $51.8 million

9. Deductibility of Charitable Contributions

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

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

FY2004 .... $78.8 million
FY2005 .... $80.1 million
FY2006 .... $82.2 million

10. Exclusion of Interest on Life Insurance Savings

Internal Revenue Code Section 101(a), effective 1978

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

FY2004 .... $55.0 million
FY2005 .... $56.1 million
FY2006 .... $57.4 million

11. Exclusion of Capital Gains at Death

Internal Revenue Code Section 1014, effective 1954

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

FY2004 ....$82.0 million
FY2005 ....$83.9 million
FY2006 ....$85.8 million

12. Deductibility of Individual Retirement Account Contributions

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

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

FY2004 ....$17.1 million
FY2005 ....$17.4 million
FY2006 ....$17.7 million

13. Deductibility of Keogh Plan Contributions

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

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

FY2004 ....$6.6 million
FY2005 ....$6.7 million
FY2006 ....$6.8 million

14. Exclusion of Federal and Military Retirement Income Received

Kentucky Revised Statute 141.021, effective 1990

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

FY2004 .... $54.8 million
FY2005 .... $58.6 million
FY2006 .... $62.7 million

15. 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.

FY2004 .... $4.5 million
FY2005 .... $4.6 million
FY2006 .... $4.8 million

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

FY2004 .... $620,000
FY2005 .... $625,000
FY2006 .... $630,000

16. Exclusion of Worker's Compensation Benefits

Internal Revenue Code Section 104(a), effective 1954

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

FY2004 .... $ 7.5 million
FY2005 .... $ 7.7 million
FY2006 .... $ 7.9 million

17. Exclusion of Veteran's Disability Benefits

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

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

FY2004 .... $6.1 million
FY2005 .... $6.1 million
FY2006 .... $6.2 million

18. Credit for Child and Dependent Care Expenses

Kentucky Revised Statute 141.067, effective 1990

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

FY2004 .... $5.8 million
FY2005 .... $5.9 million
FY2006 .... $5.9 million

19. Deductibility of Foreign Income Tax

Kentucky Revised Statute 141.010(11)(a), effective 1974

Foreign income tax is allowed as an itemized deduction.
Note: This deduction was suspended for returns filed during FY04.

FY2004 .... $0.0 million
FY2005 .... $3.3 million
FY2006 .... $3.3 million

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

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

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

FY2004 .... $4.8 million
FY2005 .... $4.8 million
FY2006 .... $4.9 million

21. Deductibility of Excess of Percentage Over Cost Depletion

Internal Revenue Code Section 613, effective 1981

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

FY2004 .... $1.1 million
FY2005 .... $1.1 million
FY2006 .... $1.1 million

22. Deductibility of Medical Expenses

Internal Revenue Code Section 213, effective 1990

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

FY2004 .... $22.8 million
FY2005 .... $24.0 million
FY2006 .... $25.1 million

23. Deductibility of Net Operating Losses

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

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

FY2004 ....$40.0 million
FY2005 ....$40.0 million
FY2006 ....$40.0 million

24. Exclusion of Employee Meals and Lodging on Employer Premises

Internal Revenue Code Section 119, effective 1978

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

FY2004 ....$1.5 million
FY2005 ....$1.5 million
FY2006 ....$1.6 million

25. Exclusion of Railroad and Supplemental Railroad Retirement System Benefits

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

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

FY2004 ....$ 9.9 million
FY2005 .... $10.3 million
FY2006 .... $10.6 million

26. Exclusion of State Employee Pension Benefits and Contributions

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

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

FY2004 .... $47.2 million
FY2005 .... $51.2 million
FY2006 .... $55.6 million

27. Exclusion of Private Pensions and Individual Retirement Accounts

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

An exemption is allowed for benefits received from private pensions and Individual Retirement Accounts including Roth IRAs. The exclusion was $35,000 for tax year 1998, and is increased for inflation each year. The exclusion for tax year 2004 is $40,200.

FY2004 .... $133.1 million
FY2005 .... $145.0 million
FY2006 .... $158.1 million

28. Exclusion of Scholarship and Fellowship Income

Internal Revenue Code Section 117, effective 1954

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

FY2004 .... $3.2 million
FY2005 .... $3.5 million
FY2006 .... $3.8 million

29. Exclusion of Public Assistance Benefits

Internal Revenue Code Section 61, et. al.

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

FY2004 ....$1.9 million
FY2005 ....$1.9 million
FY2006 ....$1.9 million

30. Credit for Hiring Unemployed

Kentucky Revised Statute 141.065, effective 1982

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

FY2004 ....$10,000
FY2005 ....$10,000
FY2006 ....$10,000

31. Exclusion of Special Benefits for Disabled Coal Miners

Internal Revenue Code Section 104 and 192, effective 1981

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

FY2004 .... $3.7 million
FY2005 .... $3.7 million
FY2006 .... $3.6 million

32. Exclusion of GI Bill Benefits

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

GI bill benefits are excluded from gross income.

FY2004 .... $300,000
FY2005 .... $300,000
FY2006 .... $300,000

33. Deductibility of Expenses of Certain Capital Outlays

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

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

FY2004	$13.4 million
FY2005	$13.6 million
FY2006	$13.8 million

34. 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.

FY2004	$47.5 million
FY2005	$47.5 million
FY2006	$47.5 million

35. 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.

FY2004	$23.8 million
FY2005	$24.8 million
FY2006	$25.9 million

36. 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.

FY2004 .... $10.1 million
FY2005 .... $10.8 million
FY2006 .... $11.5 million

37. 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.

FY2004 .... $550,000
FY2005 .... $550,000
FY2006 .... $550,000

38. 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.

FY2004 .... $1.0 million
FY2005 .... $1.1 million
FY2006 .... $1.1 million

39. 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.

FY2004 .... $57.0 million
FY2005 .... $63.5 million
FY2006 .... $68.0 million

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

Internal Revenue Code Sections 61 and 138

Medicare benefits received for hospital insurance are not taxed.

FY2004 .... $49.8 million
FY2005 .... $51.0 million
FY2006 .... $52.6 million

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

FY2004 .... $27.5 million
FY2005 .... $28.2 million
FY2006 .... $29.0 million

41. Deductibility of Moving Expenses

Internal Revenue Code Section 217, effective 1964

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

FY2004 .... $5.0 million
FY2005 .... $5.1 million
FY2006 .... $5.1 million

42. 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).

FY2004 .... $27.5 million
FY2005 .... $29.0 million
FY2006 .... $30.6 million

43. 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.

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

44. 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.

FY2004 .... $4.6 million
FY2005 .... $4.7 million
FY2006 .... $4.8 million

45. Health Insurance Premiums

Kentucky Revised Statute 141.010(10), effective 1999

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

FY2004 .... $8.8 million
FY2005 .... $9.2 million
FY2006 .... $9.6 million

46. Interest on Educational Loans

Internal Revenue Code Section 62(a), effective 1997

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

FY2004 .... $1.5 million
FY2005 .... $1.6 million
FY2006 .... $1.7 million

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.

FY2004 .... $75,000
FY2005 .... $75,000
FY2006 .... $75,000

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.

FY2004 .... $5.0 million
FY2005 .... $5.0 million
FY2006 .... $5.0 million

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.

FY2004 .... $110,000
FY2005 .... $120,000
FY2006 .... $130,000

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.

FY2004 .... $750,000
FY2005 .... $600,000
FY2006 .... $450,000

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.

FY2004 .... $1.0 million
FY2005 .... $1.0 million
FY2006 .... $1.0 million

Background

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

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

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

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

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

During FY03, the inheritance and estate taxes produced $95.9 million in General Fund revenues. This was a 15.0 percent increase from the prior year and accounted for 1.4 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. Effective with the fiscal year ending on June 30, 2002, the amount of the tax credit allowed on the federal return is reduced by 25 percent each year until the credit is removed in Fiscal Year 2005.

Taxable Unit

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

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

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

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

Current 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 10. Total Inheritance And Estate Tax Expenditures

Fiscal Year	Tax Expenditures
2004	$153.7 million
2005	$160.4 million
2006	$171.1 million

Tax Expenditures

1. Class A Beneficiaries

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

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

FY2004 ....$68.2 million
FY2005 ....$71.5 million
FY2006 ....$75.0 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.

FY2004 ....$5.3 million
FY2005 ....$3.8 million
FY2006 ....$2.8 million

3. Discount for Early Payment of Tax

Kentucky Revised Statute 140.210(1), effective 1924

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

FY2004 .... $1.2 million
FY2005 .... $0.8 million
FY2006 .... $0.6 million

4. Class B Beneficiaries

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

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

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

5. Class C Beneficiaries

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

Class C beneficiaries are granted a $500 exemption.

FY2004 .... $50,000
FY2005 .... $50,000
FY2006 .... $50,000

6. Life Insurance Proceeds

Kentucky Revised Statute 140.030(2), effective 1944

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

FY2004 .... $25.0 million
FY2005 .... $25.0 million
FY2006 .... $25.0 million

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.

FY2004 .... $600,000
FY2005 .... $600,000
FY2006 .... $600,000

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

Kentucky Revised Statute 140.020(3), effective 1978

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

FY2004 .... $250,000
FY2005 .... $250,000
FY2006 .... $250,000

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.

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

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.

FY2004 .... $50,000
FY2005 .... $50,000
FY2006 .... $50,000

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.

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

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.

FY2004 .... $28.8 million
FY2005 .... $20.3 million
FY2006 .... $13.5 million

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

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

Kentucky Revised Statute 140.015(2), effective 1980

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

FY2004	$50,000
FY2005	$50,000
FY2006	$50,000

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.

FY2004	$10,000
FY2005	$10,000
FY2006	$10,000

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 <u>if</u> 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.

FY2004	$23.9 million
FY2005	$37.7 million
FY2006	$52.9 million

LIQUEFIED PETROLEUM GAS TAX

Background

The term "liquefied petroleum gas" includes any material which is composed predominantly of any of the following hydrocarbons, or mixtures of them, whether in the liquid or gaseous states: 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 FY03, the liquefied petroleum gas collections were $207,000 which accounts for 0.018 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

Fiscal Year	Tax Expenditures
2004	$1,000
2005	$1,000
2006	$1,000

Tax Expenditures

1. Dealer's Monthly Reporting Allowance

Kentucky Revised Statute 234.320(1), effective 1972

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

FY2004 .... $1,000
FY2005 .... $1,000
FY2006 .... $1,000

2. Approved Carburetion Systems

Kentucky Revised Statute 234.321(1), effective 1972

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

FY2004 .... $-0-
FY2005 .... $-0-
FY2006 .... $-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 FY03, motor vehicle usage tax collections were $432.9 million, a 0.8 percent increase from the previous year. These receipts constituted 38.5 percent of total Road Fund tax receipts.

Current Rate Structure

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

Tax Base

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

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

Tax Expenditures Enacted During Fiscal Years 2002 – 2003

The following change was enacted by the 2003 General Assembly, and became effective October 1, 2003:

Exemption of Trucks over 44,000 lbs from the Motor Vehicle Use Tax – Effective October 1, 2003, trucks registered with a gross weight of 44,001 pounds and greater are not subject to the Motor Vehicle Use Tax. *HB 293*

Table 12. Total Motor Vehicle Usage Tax Expenditures

Fiscal Year	Tax Expenditures
2004	$94.7 million
2005	$95.4 million
2006	$97.3 million

Tax Expenditures

1. Trade-In Allowance on Used Vehicles

Kentucky Revised Statute 138.450(4), effective 1976

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

FY2004 .... $54.1 million
FY2005 .... $55.5 million
FY2006 .... $57.0 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.

FY2004 .... $14.5 million
FY2005 .... $14.9 million
FY2006 .... $15.2 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.

FY2004 .... $7.5 million
FY2005 .... $7.7 million
FY2006 .... $7.9 million

4. Enterprise Zone Exemption

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

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

Enterprise Zones are scheduled to expire 20 years after initial designation as a zone. The first zones approved (Jefferson County and Fulton County) will expire on December 31, 2003, with additional zones expiring thereafter.

FY2004 .... $3.8 million
FY2005 .... $1.3 million
FY2006 .... $1.1 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.

FY2004 .... $3.5 million
FY2005 .... $3.6 million
FY2006 .... $3.7 million

6. Repossessed Exemption

Kentucky Revised Statute 138.470(13), effective 1972

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

FY2004 .... $700,000
FY2005 .... $710,000
FY2006 .... $720,000

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.

FY2004 .... $1.6 million
FY2005 .... $1.7 million
FY2006 .... $1.7 million

8. Educational & Charitable Organizations

Kentucky Revised Statute 138.470(2), effective 1968

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

FY2004 .... $800,000
FY2005 .... $810,000
FY2006 .... $820,000

9. Enterprise Zone Exemption – U Drive-It Tax

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

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

FY2004 .... $2.4 million
FY2005 .... $1.8 million
FY2006 .... $1.6 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.

FY2004 .... $-0-
FY2005 .... $-0-
FY2006 .... $-0-

11. Change in Business Structure

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

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

FY2004 .... $250,000
FY2005 .... $250,000
FY2006 .... $250,000

12. Transfers Between a Limited Liability Company and its Members

Kentucky Revised Statute 138.470,(11), effective 1998

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

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

13. Transfers Between a Subsidiary and a Parent Corporation

Kentucky Revised Statute 138.470(10), effective 1970

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

FY2004 .... $150,000
FY2005 .... $150,000
FY2006 .... $150,000

14. Partnership Interests

Kentucky Revised Statute 138.470(12), effective 1970

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

FY2004 .... $-0-
FY2005 .... $-0-
FY2006 .... $-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.

FY2004 .... $4.2 million
FY2005 .... $4.2 million
FY2006 .... $4.2 million

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.

FY2004 ....$60,000
FY2005 ....$60,000
FY2006 ....$60,000

17. Large Truck Exclusion

Kentucky Revised Statute 138.470, effective October 1, 2003.

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

FY2004……………………..$ 1.0 million
FY2005……………………..$ 2.6 million
FY2006……………………..$ 2.8 million

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, severed in Kentucky, including natural gas and natural gas liquids. Coal and oil were specifically excluded due to taxation under other statutes. The legislation imposed no minimum rate of tax per unit as is the case with the coal severance tax.

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

KRS 42.450(2) and 42.470(2) require that one-half of the taxes collected on the sale of minerals, other than coal, be distributed among the mineral producing counties. In FY03 the tax of $27.3 million represented 0.4 percent of total General Fund tax receipts.

Current Rate Structure

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

Tax Base

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

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

Taxable Unit

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

Tax Due

The tax must normally be reported and remitted on a monthly basis. The 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

Fiscal Year	Tax Expenditures
2004	$6.8 million
2005	$6.9 million
2006	$7.0 million

Tax Expenditures

1. Transportation Expense

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

Expenses incurred in transporting minerals are excluded from gross value.

FY2004 .... $4.1 million
FY2005 .... $4.2 million
FY2006 .... $4.3 million

2. Limestone Sold in Interstate Commerce

Kentucky Revised Statute 143A.035, effective 1984

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

FY2004 .... $1.8 million
FY2005 .... $1.8 million
FY2006 .... $1.8 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.

FY2004 .... $200,000
FY2005 .... $200,000
FY2006 .... $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.

FY2004 .... $450,000
FY2005 .... $450,000
FY2006 .... $450,000

5. Limit on Tax from Clay

Kentucky Revised Statute 143A.037, effective 1991

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

FY2004 .... $150,000
FY2005 .... $150,000
FY2006 .... $150,000

6. Clay Used in Landfill Construction

Kentucky Revised Statute 143A.037, effective 1991

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

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

7. Inactive Crude Oil and Natural Gas Wells

Kentucky Revised Statute 143A, effective 1998

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

FY2004 ....$-0-
FY2005 ....$-0-
FY2006 ....$-0-

Background

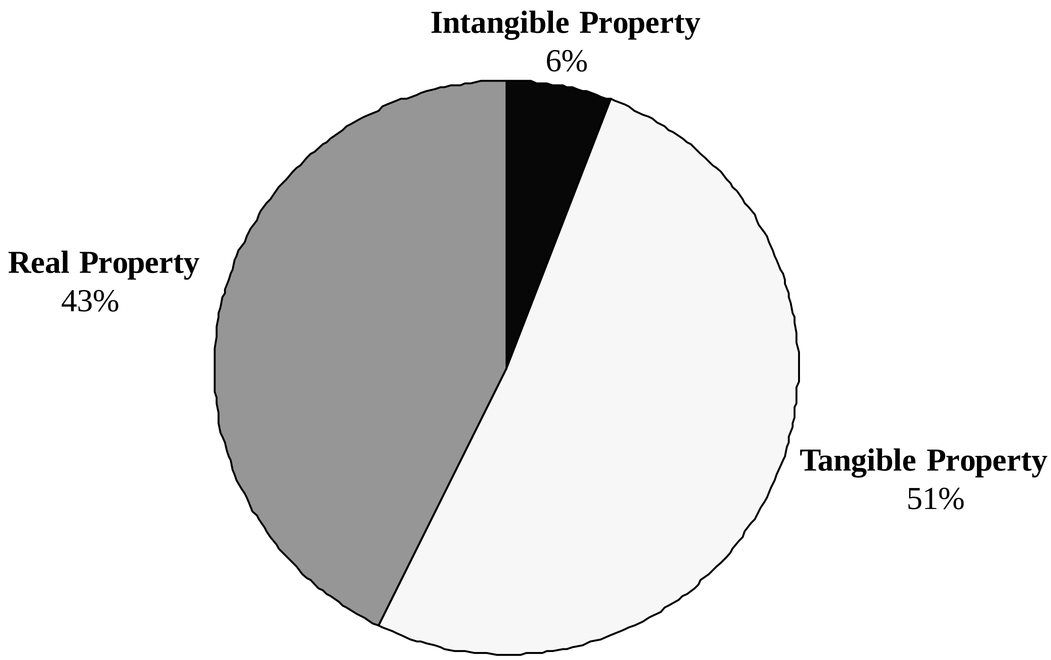
Kentucky has had a tax on property since becoming a state on June 1, 1792. The original method of taxation began with a set levy for each item of tangible property owned in the state. It was not until 1814 that the standard for establishing the tax liability was changed to the ad valorem, or fair value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

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

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 FY03 total property tax collections of $434.8 million accounted for 6.4 percent of total General Fund tax receipts. The chart on the following page shows the allocation between real, tangible and intangible property tax receipts.

Figure 3. Allocation of Property Tax Receipts for FY03



Total: $434.8 million 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 2003, the rate was set at 13.3 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 2003 and 2004 is $28,000.

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.

Table 14. Total Property Tax Expenditures

Fiscal Year	Tax Expenditures
2004	$ 941.1 million
2005	$ 972.4 million
2006	$ 1,005.8 million

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

Real Property Tax Expenditures

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

1. State Real Property Tax Yearly Revenue Ceiling

Kentucky Revised Statute 132.020(7), effective 1979

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

FY2004 ....$291.6 million
FY2005 ....$311.6 million
FY2006 ....$333.0 million

2. Alcohol Production Facilities

Kentucky Revised Statute 132.020(1), effective 1980

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

FY2004 ....$-0-
FY2005 ....$-0-
FY2006 ....$-0-

3. Leasehold Interests in Buildings Financed with Industrial Revenue Bonds

Kentucky Revised Statute 132.020(1), effective 1978

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

FY2004 .... $2.5 million
FY2005 .... $2.8 million
FY2006 .... $3.0 million

4. Homestead Exemption

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

A taxpayer 65 years of age or older or totally disabled is allowed an exemption against the assessed value of a single-unit residence. In 2003 and 2004 this exemption is $28,000.

FY2004 .... $12.6 million
FY2005 .... $13.3 million
FY2006 .... $14.1 million

5. Agricultural and Horticultural Land Assessment Protection

Kentucky Revised Statute 132.450, effective 1999

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

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

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

6. Intrastate Railroads and Railway Companies

Kentucky Revised Statute 132.020(10), effective 1990

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

FY2004 .... $15,000
FY2005 .... $15,000
FY2006 .... $15,000

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.

FY2004 .... $54.8 million
FY2005 .... $57.6 million
FY2006 .... $60.5 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.

FY2004 .... $2.8 million
FY2005 .... $2.8 million
FY2006 .... $2.8 million

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

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

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

FY2004 .... $57.2 million
FY2005 .... $60.4 million
FY2006 .... $63.7 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.

FY2004 .... $22.5 million
FY2005 .... $22.5 million
FY2006 .... $22.5 million

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.

FY2004 .... $260,000
FY2005 .... $260,000
FY2006 .... $260,000

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.

FY2004 ....$24.4 million
FY2005 ....$24.4 million
FY2006 ....$24.4 million

13. Historic Vehicles

Kentucky Revised Statute 132.020(1), effective 1984

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

FY2004 ....$90,000
FY2005 ....$90,000
FY2006 ....$90,000

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.

FY2004 ....$325,000
FY2005 ....$325,000
FY2006 ....$325,000

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, 2002 was 23.49 cents per $100.

FY2004 ....$3.3 million
FY2005 ....$3.5 million
FY2006 ....$3.7 million

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, 2002 was 23.5 cents per $100.

FY2004 .... $3.2 million
FY2005 .... $3.2 million
FY2006 .... $3.2 million

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.

FY2004 .... $1.0 million
FY2005 .... $1.0 million
FY2006 .... $1.0 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.

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

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.

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

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 are exempt from property tax at the state level.

FY2004 .... $10.8 million
FY2005 .... $10.8 million
FY2006 .... $10.8 million

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.

FY2004 .... $50,000
FY2005 .... $50,000
FY2006 .... $50,000

Intangible Property Tax Expenditures

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

22. Certain Classes of Intangible Properties at a 1.5 Cent Rate

Kentucky Revised Statute 132.020(2), effective 1968

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

FY2004 .... $25.2 million
FY2005 .... $25.2 million
FY2006 .... $25.2 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.

FY2004 .... $114.5 million
FY2005 .... $117.0 million
FY2006 .... $119.6 million

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

FY2004 .... $180.4 million
FY2005 .... $180.4 million
FY2006 .... $180.4 million

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.

FY2004 ....$51.8 million
FY2005 ....$53.9 million
FY2006 ....$56.0 million

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.

FY2004 ....$5.0 million
FY2005 ....$4.5 million
FY2006 ....$4.4 million

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

Kentucky Revised Statute 132.215(2), effective 1972

These items are taxed at a reduced rate of 1/10 of a cent per $100.
Note: This includes certain bank holdings that were previously not reported.

FY2004 ....$65.3 million
FY2005 ....$65.3 million
FY2006 ....$65.3 million

28. Credit Union Accounts and Shares

Kentucky Revised Statute 290.635, effective 1984

Deposits and shares are totally exempt from tax.

FY2004 .... $9.7 million
FY2005 .... $9.7 million
FY2006 .... $9.7 million

29. Broker's Accounts Receivable

Kentucky Revised Statute 132.050, effective 1948

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

FY2004 .... $570,000
FY2005 .... $570,000
FY2006 .... $570,000

30. Reserves and Capital of Domestic Life Insurance Companies

Kentucky Revised Statute 136.320(3), effective 1990

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

FY2004 .... $900,000
FY2005 .... $900,000
FY2006 .... $900,000

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 FY03 totaled $2,364.2 million, which was a growth of 2.8 percent over the prior year. This tax represented 34.9 percent of total General Fund tax receipts in FY03.

Current Rate Structure

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

Tax Base

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

The tax base for the use tax is the purchase price of tangible personal property purchased for storage, use, or other consumption in Kentucky. The use tax is a "back stop" for sales tax and generally applies to property purchased outside the state for storage, use, or consumption within the state. The purchaser's 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 2002-2003

The following changes were enacted by the 2002 General Assembly:

Expanded Application of Tourism Tax Credits – This change expands the availability of tourism tax credits to include large lodging renovations or construction, and removes the sunset date, which was June 30, 2002. *HB 372*

The following changes were enacted by the 2003 General Assembly:

Streamlined Sales Tax Project – Kentucky's sales tax laws were aligned with those of a significant number of other states, so these states can pursue sales tax collection from out-of-state vendors. Several of Kentucky's definitions of taxable items required amending. These provisions take effect July 1, 2004.
HB 293

Exemption of repair parts for large trucks – Repair parts for trucks and their towed units over 44,001 pounds that are used exclusively in interstate commerce are exempt from the sales tax, for purchases on or after January 1, 2004. *HB 293*

Table 15. Total Sales And Use Tax Expenditures

Fiscal Year	Tax Expenditures
2004	$2,269.7 million
2005	$2,320.8 million
2006	$2,381.3 million

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, revised 1986

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

FY2004 .... $414.6 million
FY2005 .... $427.0 million
FY2006 .... $439.8 million

Baked goods prepared by the seller and sold without eating utensils are exempt from sales tax. This exemption becomes effective July 1, 2004.

FY2004 .... $-0-
FY2005 .... $4.1 million
FY2006 .... $4.1 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.

FY2004 .... $140.5 million
FY2005 .... $144.7 million
FY2006 .... $149.0 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.

FY2004	$171.1 million
FY2005	$176.2 million
FY2006	$181.5 million

4. Residential Utilities

Kentucky Revised Statute 139.470(8), effective 1979

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

FY2004	$134.4 million
FY2005	$138.4 million
FY2006	$142.6 million

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.

FY2004	$244.0 million
FY2005	$251.3 million
FY2006	$258.8 million

6. Machinery for New and Expanded Industry and Certain Industrial Machinery

Kentucky Revised Statute 139.170 and 139.480(10), effective 1960

Machinery for new and expanded industry that is used directly in manufacturing or processing and is incorporated for the first time into plant facilities in this state, and does not replace machinery in such plant, is exempt.

Kentucky Revised Statute 139.487, effective 1982

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

FY2004	$67.5 million
FY2005	$68.8 million
FY2006	$70.2 million

7. Coal Used in the Manufacture of Electricity

Kentucky Revised Statute 139.480(2), effective 1960

Coal used in the manufacturing of electricity is exempt.

FY2004	$55.0 million
FY2005	$57.1 million
FY2006	$59.2 million

8. Energy and Energy Producing Fuels

Kentucky Revised Statute 139.480(3), effective 1960

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

FY2004	$55.5 million
FY2005	$56.2 million
FY2006	$56.9 million

9. Retailers' Compensation for Collecting and Remitting the Tax

Kentucky Revised Statute 139.570, effective 1960

As reimbursement for the cost of collecting and remitting tax, the 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.

FY2004 ....$11.2 million*
FY2005 ....$18.3 million
FY2006 ....$18.6 million

Note: FY04 compensation is reduced by FY03-FY04 Budget Bill, HB 269.

10. Enterprise Zones

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

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

Enterprise Zones are scheduled to expire 20 years after initial designation as a zone. The first zones approved (Jefferson County and Fulton County) will expire on December 31, 2003, with additional zones expiring thereafter.

FY2004 ....$38.0 million
FY2005 ....$14.0 million
FY2006 ....$10.0 million

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.

FY2004 ....$85.8 million
FY2005 ....$88.4 million
FY2006… ....$91.0 million

12. Textbooks

Kentucky Revised Statute 139.480(17), effective 1978

Textbooks, related workbooks, and other course material purchased for use in a course of study conducted by an institution qualifies as a non-profit educational institution are exempt.

FY2004 .... $4.2 million
FY2005 .... $4.3 million
FY2006 .... $4.5 million

13. Recycling Machinery and Equipment

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

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

FY2004 .... $3.5 million
FY2005 .... $3.6 million
FY2006 .... $3.7 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.

FY2004 .... $13.5 million
FY2005 .... $13.9 million
FY2006 .... $14.3 million

15. Tombstones and Other Grave Markers

Kentucky Revised Statute 139.480(13), effective 1976

Tombstones and other grave markers are exempt.

FY2004 .... $2.8 million
FY2005 .... $3.0 million
FY2006 .... $3.1 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.

FY2004 .... $2.3 million
FY2005 .... $2.3 million
FY2006 .... $2.4 million

17. Garage or Yard Sales

Kentucky Revised Statute 139.496, effective 1976

Sales and use tax does not apply to the first $1,000 of sales made in any calendar year by an individual or nonprofit organization not engaged in the business of selling.

FY2004 .... $2.2 million
FY2005 .... $2.2 million
FY2006 .... $2.3 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.

FY2004 .... $11.2 million
FY2005 .... $11.7 million
FY2006 .... $12.1 million

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.

FY2004 .... $4.2 million
FY2005 .... $4.2 million
FY2006 .... $4.3 million

20. Sales by Elementary and Secondary Nonprofit, School-Sponsored Clubs and Organizations

Kentucky Revised Statute 139.497, effective 1984

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

FY2004 .... $5.9 million
FY2005 .... $5.9 million
FY2006 .... $6.0 million

21. Interstate Cargo and Passenger Aircraft, Parts and Supplies

Kentucky Revised Statute 139.480(19), effective 1982

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

FY2004 .... $36.2 million
FY2005 .... $37.4 million
FY2006 .... $38.8 million

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

Kentucky Revised Statute 139.495(4), effective 1980

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

FY2004 .... $1.2 million
FY2005 .... $1.2 million
FY2006 .... $1.3 million

23. Sales to Motion Picture Companies

Kentucky Revised Statute 139.538-.5386, effective 1986

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

FY2004 .... $100,000
FY2005 .... $100,000
FY2006 .... $100,000

24. Admissions to and Purchases by Historical Sites

Kentucky Revised Statute 139.482, effective 1976

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

FY2004 ....$3.0 million
FY2005 ....$3.1 million
FY2006 ....$3.2 million

25. Credit Unions

Kentucky Revised Statute 290.365, effective 1984

Sales to credit unions organized under Kentucky law are exempt.

FY2004 ....$1.2 million
FY2005 ....$1.2 million
FY2006 ....$1.2 million

26. Coin-Operating Bulk Vending Machines

Kentucky Revised Statute 139.470(6), effective 1966, revised 1998

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

FY2004 ....$2.1 million
FY2005 ....$2.1 million
FY2006 ....$2.2 million

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.

FY2004 .... $1.2 million
FY2005 .... $1.2 million
FY2006 .... $1.2 million

28. Occasional Sales

Kentucky Revised Statute 139.070, 139.470(4), effective 1960

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

FY2004 .... $120.0 million
FY2005 .... $120.0 million
FY2006 .... $120.0 million

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.

FY2004 .... $1.5 million
FY2005 .... $1.5 million
FY2006 .... $1.5 million

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.

FY2004 .... $900,000
FY2005 .... $900,000
FY2006 .... $910,000

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.

FY2004 .... $4.0 million
FY2005 .... $4.1 million
FY2006 .... $4.3 million

32. Raw Materials and Industrial Supplies

Kentucky Revised Statute 139.470(11), effective 1990

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

FY2004 .... $453.2 million
FY2005 .... $466.8 million
FY2006 .... $480.8 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.

FY2004 .... $4.1 million
FY2005 .... $4.3 million
FY2006 .... $4.5 million

34. Sales to Common Carriers Under a Bill of Lading

Kentucky Revised Statute 139.470(5), effective 1960

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

FY2004 .... $-0-
FY2005 .... $-0-
FY2006 .... $-0-

35. Lease or Rental of Films by Commercial Theaters

Kentucky Revised Statute 139.484, effective 1990

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

FY2004 .... $1.1 million
FY2005 .... $1.1 million
FY2006 .... $1.2 million

36. Tourism Attraction Project Credit/Refund

Kentucky Revised Statute 139.536, effective 1996 – Kentucky Revised Statute 154, effective 1998, amended 2001

A credit is allowed against the sales tax generated by or arising from a tourism attraction project. The amount of the credit is calculated and refunded on an annual basis.

FY2004 .... $4.5 million
FY2005 .... $4.8 million
FY2006 .... $5.1 million

37. Alcohol Production Facilities

Kentucky Revised Statute 139.480(18), effective 1980

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

FY2004 .... $-0-
FY2005 .... $-0-
FY2006 .... $-0-

38. Property Certified as a Fluidized Bed Energy Production Facility

Kentucky Revised Statute 139.480(20), effective 1986

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

FY2004 .... $-0-
FY2005 .... $-0-
FY2006 .... $-0-

39. Catalogs and Newspaper Inserts Shipped Outside Kentucky

Kentucky Revised Statute 139.470, effective 1988

Catalogs and newspaper inserts purchased for storage, use or other consumption outside this state and delivered by the seller's own vehicle, postal service, common carrier or contract carrier to a location outside this state are exempt.

FY2004 ....$3.0 million
FY2005 ....$3.0 million
FY2006 ....$3.0 million

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.

FY2004 ....$100,000
FY2005 ....$100,000
FY2006 ....$100,000

41. Jet Fuel

Kentucky Revised Statute 144.132, effective July 1, 2000

Certified air carriers are allowed a credit after payment of the first $1.0 million in sales and use tax on the purchase of aircraft fuel including jet fuel.

FY2004 ....$19.3 million
FY2005 ....$20.0 million
FY2006 ....$20.7 million

42. Repair Parts for Large Trucks

Kentucky Revised Statute 139.480, effective January 1, 2004

Repair parts for those trucks and their towed units over 44,001 pounds that are used exclusively in interstate commerce are exempt from sales tax for purchases on or after January 1, 2004.

FY2004 ....$1.5 million
FY2005 ....$4.0 million
FY2006 ....$4.1 million

Sales Tax Exemptions for Farmers

The following tax expenditures pertain to the farming industry.

43. Livestock, Poultry, Ratite Birds, Embryos and Semen, Alpacas, Llamas, Buffalo, Farm Work Stock and Feed, Seeds and Fertilizers

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

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

FY2004 ....$87.1 million
FY2005 ....$89.7 million
FY2006 ....$92.4 million

44. 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.

FY2004 .... $12.3 million
FY2005 .... $12.5 million
FY2006 .... $12.6 million

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

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

On-farm facilities used exclusively for grain or soybean storing, drying, processing or handling, including all construction, renovation, or repair materials, parts, and equipment, are exempt. *Kentucky Revised Statute 139.480(14), effective 1978*

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

FY2004 .... $12.9 million
FY2005 .... $13.3 million
FY2006 .... $13.7 million

46. Fuel Used for Farm Purposes

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

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

FY2004 .... $7.1 million
FY2005 .... $7.3 million
FY2006 .... $7.5 million

47. 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.

FY2004 .... $50,000
FY2005 .... $50,000
FY2006 .... $50,000

48. Equine Water

Kentucky Revised Statute 139.470, effective 1998

Water used in the equine-raising business is exempt.

FY2004 .... $50,000
FY2005 .... $50,000
FY2006 .... $50,000

49. 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.

FY2004 .... $100,000
FY2005 .... $105,000
FY2006 .... $110,000

50. Twine and Wire

Kentucky Revised Statute 139.480, effective 1998

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

FY2004 .... $30,000
FY2005 .... $30,000
FY2006 .... $30,000

51. 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.

FY2004 .... $17.2 million
FY2005 .... $17.8 million
FY2006 .... $18.6 million

52. Farm Chemicals

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

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

FY2004 ....$7.3 million
FY2005 ....$7.5 million
FY2006 ....$7.7 million

Table 16. Subtotal for Farming Tax Expenditures

Fiscal Year	Amount
2004	$144.1 million
2005	$148.3 million
2006	$152.7 million

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.

FY2004 ....$59.3 million
FY2005 ....$63.0 million
FY2006 ....$67.0 million

(b) Business services.

FY2004 .... $168.6 million
FY2005 .... $179.1 million
FY2006 .... $190.3 million

(c) Health services.

FY2004 .... $421.3 million
FY2005 .... $447.6 million
FY2006 .... $475.5 million

(d) Legal services.

FY2004 .... $74.5 million
FY2005 .... $79.2 million
FY2006 .... $84.1 million

(e) Educational services.

FY2004 .... $5.0 million
FY2005 .... $5.3 million
FY2006 .... $5.6 million

(f) Social services.

FY2004 .... $13.6 million
FY2005 .... $14.5 million
FY2006 .... $15.4 million

(g) Engineering, accounting, research, management.

FY2004 .... $ 99.8 million
FY2005 .... $ 106.0 million
FY2006 .... $ 112.6 million

(h) Automotive and miscellaneous repair services.

FY2004 .... $110.8 million
FY2005 .... $117.7 million
FY2006 .... $125.0 million

(i) Amusement and recreational services.
(Taxable amusement and recreational services such as video tape rentals and commercial sports events are not included in this estimate.)

FY2004 ....$13.4 million
FY2005 ....$14.3 million
FY2006 ....$15.1 million

(j) Other Services.

FY2004 ....$5.1 million
FY2005 ....$5.4 million
FY2006 ....$5.7 million

Table 17. Total for Excluded Services

Fiscal Year	Amount
2004	$ 971.4 million
2005	$ 1,032.1 million
2006	$ 1,096.3 million

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 FY03, the special fuels tax collections were $104.5 million, which was 9.3 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.

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

Fiscal Year	Tax Expenditures
2004	$49.1 million
2005	$50.6 million
2006	$52.0 million

Tax Expenditures

1. Non-highway Use

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

Special fuels used exclusively for non-highway use by qualified purchasers are exempt sales.

FY2004 .... $27.0 million
FY2005 .... $28.0 million
FY2006 .... $29.0 million

2. Railroad Companies

Kentucky Revised Statute 138.240(2)(f), effective 1988

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

FY2004 .... $12.2 million
FY2005 .... $12.5 million
FY2006 .... $12.7 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.

FY2004 .... $3.5 million
FY2005 .... $3.6 million
FY2006 .... $3.7 million

4. Dealer's Monthly Reporting Allowance

Kentucky revised Statute 138.270(1)(b), effective 1958

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

FY2004 .... $2.3 million
FY2005 .... $2.3 million
FY2006 .... $2.3 million

5. Residential Heating

Kentucky Revised Statute 138.358(1), effective 1988

An exemption is allowed for special fuels used exclusively for heating personal residences.

FY2004 .... $1.4 million
FY2005 .... $1.4 million
FY2006 .... $1.4 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.

FY2004 .... $310,000
FY2005 .... $315,000
FY2006 .... $320,000

7. State and Local Government Use

Kentucky Revised Statute 138.358(3), effective 1988

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

FY2004 .... $200,000
FY2005 .... $200,000
FY2006 .... $200,000

8. Religious, Charitable or Educational Use

Kentucky Revised Statute 138.358(3), effective 1988

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

FY2004 .... $200,000
FY2005 .... $200,000
FY2006 .... $200,000

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.

FY2004 .... $30,000
FY2005 .... $30,000
FY2006 .... $30,000

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.

FY2004 .... $2.0 million
FY2005 .... $2.0 million
FY2006 .... $2.0 million

EARMARKED FUNDS

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

Earmarked funds are included for informational purposes in this report because they do have an impact on the amount of usable funds collected by the General Fund and the Road Fund.

Table 19. Total Earmarked Funds

Fiscal Year	Amount
2004	$20.9 million
2005	$22.7 million
2006	$23.2 million

Earmarked Funds

1. Thoroughbred Development Fund - Pari-Mutuel Tax

Kentucky Revised Statute 138.510, effective 1990

Three-quarters of one percent (0.75%) of all pari-mutuel wagering at thoroughbred horse tracks under the jurisdiction of the Kentucky 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.

FY2004 .... $8.2 million
FY2005 .... $8.3 million
FY2006 .... $8.3 million

2. Equine Industry Program Trust and Revolving Fund - Pari-Mutuel Tax

Kentucky Revised Statute 138.510(3), effective 1990

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

FY2004 ....$525,000
FY2005 ....$525,000
FY2006 ....$525,000

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.

FY2004 ....$550,000
FY2005 ....$550,000
FY2006 ....$550,000

4. Standardbred Development Fund - Pari-Mutuel Tax

Kentucky Revised Statute 230.265(3), effective 1990

One percent of all pari-mutuel wagering at harness host tracks under the jurisdiction of the Kentucky 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.

FY2004 ....$430,000
FY2005 ....$430,000
FY2006 ....$430,000

5. Tobacco Enforcement Program - Cigarette Tax

Kentucky Revised Statute 438.335 and 438.337, effective 1996

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

FY2004 ....$530,000
FY2005 ....$535,000
FY2006 ....$540,000

6. Kentucky Transportation Center - Motor Fuels Tax

Kentucky Revised Statute 177.320(4), effective 1986

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

FY2004 ....$190,000
FY2005 ....$190,000
FY2006 ....$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.

FY2004 ....$3.3 million
FY2005 ....$3.4 million
FY2006 ....$3.5 million

8. Agricultural Diversification and Development Fund - Cigarette Tax

Kentucky Revised Statute 248.652 , effective 1998

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

FY2004 ....$-0-
FY2005 ....$-0-
FY2006 ....$-0-

9. Equine Drug Research - Pari-Mutuel Tax

Kentucky Revised Statute 230.265)3), effective 1982

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

FY2004 ....$600,000
FY2005 ....$600,000
FY2006 ....$600,000

10. Kentucky Aviation Economic Development Fund - Sales Tax

Kentucky Revised Statute 183.525, effective July 1, 2000

All sales and use tax collected on the sale of aircraft fuel is deposited in this fund.

FY2004 ....$5.6 million
FY2005 ....$5.7 million
FY2006 ....$5.8 million

11. Tax Increment Financing - Various Taxes

Kentucky Revised Statute 65.495, effective July 14, 2000 and
Kentucky Revised Statute 65.703, effective June 21, 2001

A locality may create a development area and, with state approval, receive payment of part of the increase in tax revenues within the development area to help offset the cost of development. Potentially all taxes could be involved, although it is expected that sales, property and income taxes would be most utilized because of the dollar volume.

FY2004 ....$1.0 million
FY2005 ....$2.5 million
FY2006 ....$2.8 million