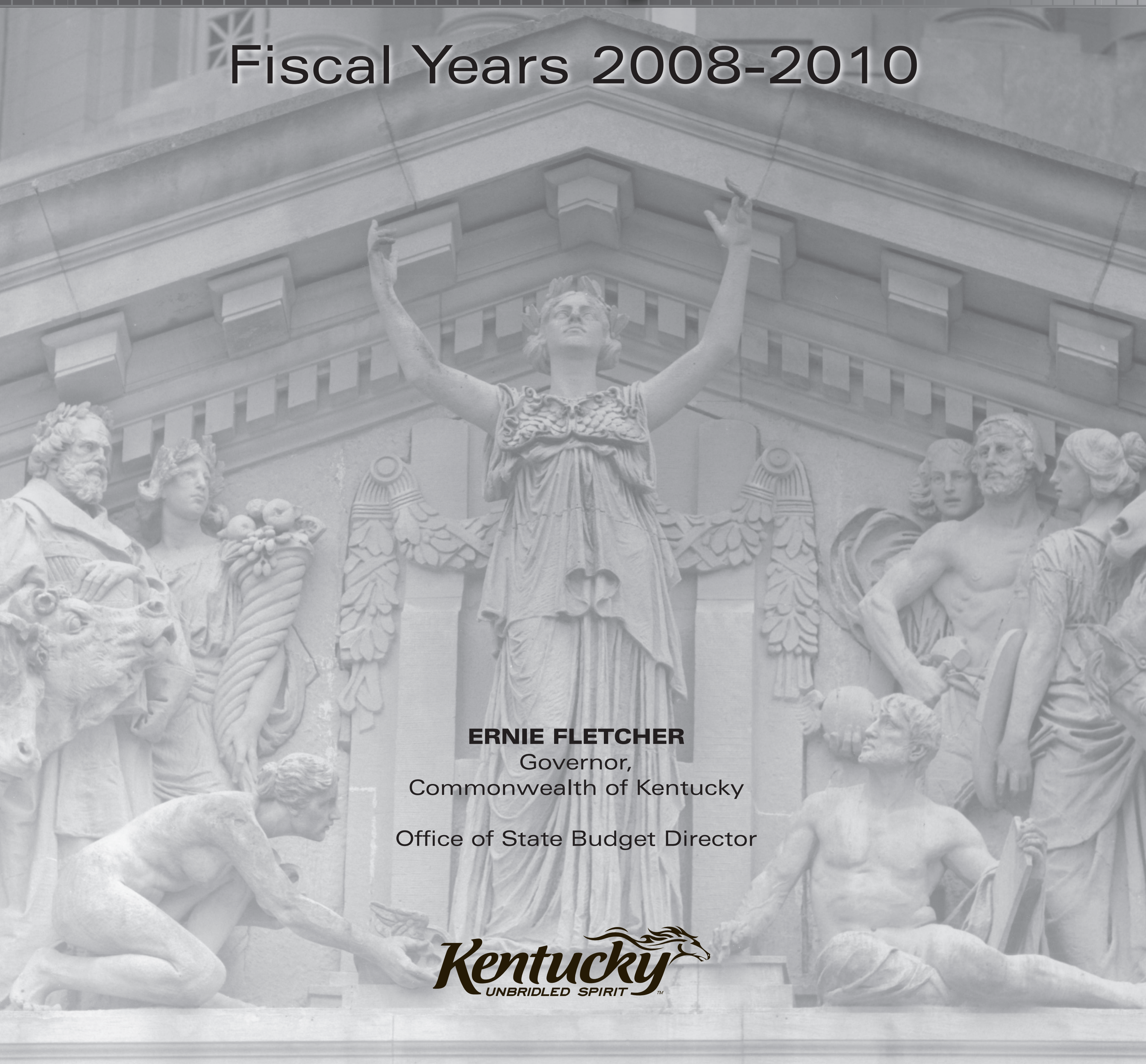
COMMONWEALTH OF KENTUCKY

Tax Expenditure Analysis

Fiscal Years 2008-2010



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Executive Summary

The purpose of a Tax Expenditure Analysis is to quantify and catalog specific tax reductions that have been granted in statute. An item is determined to be 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 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 a statutory preference is enacted. There is no process to review or periodically re-evaluate tax expenditures once they are passed and placed in statute except by this Tax Expenditure Analysis.

This report itemizes tax expenditures using multiple displays and assists in a biennial review of the expenditures. The report briefly explains each tax containing tax expenditures and quantifies the amount of potential tax revenue that is foregone because of the statutory implementation of these expenditures.

Tax expenditures function in different ways to accomplish the intended goals. For example, a sales tax exemption almost always results in some product being sold without the sales tax or transaction tax being assessed and collected. The lack of this collection 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.

The following list outlines each major tax type containing tax expenditures, 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.

Summary of Tax Expenditures for the Major Taxes

- ***Alcoholic Beverage Taxes*** – Various taxes are 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 FY07, alcoholic beverage taxes generated $102.2 million in Kentucky. Tax expenditures within these tax types are estimated at $865,000 for FY08.

- ***Bank Franchise Tax*** – Assessed on financial institutions engaging in business in Kentucky, this tax was enacted during the 1996 Regular Session of the General Assembly. For FY 07, this tax generated $63.9 million. While there are two tax credits available to financial institutions, to date, no credits have been taken.

- ***Coal Severance and Processing Tax*** – Assessed on the severance (removal) and processing of coal, this tax was first utilized in 1972. The tax is assessed at the rate of 4.5 percent of the gross value of the coal, with a minimum of fifty cents per ton. The tax is assessed against the entity severing or processing the coal. For FY07, this tax generated $222.0 million. Tax expenditures for this tax type are estimated at $24.3 million for FY08.

- ***Corporation Income Tax*** – Income tax was first assessed in 1936, on the net income attributable to Kentucky. Current rates of tax range from 4 percent to 6 percent of net income for tax years beginning on or after January 1, 2007. For FY07, the corporation income tax generated $988.1 million. Tax expenditures for these taxes are estimated at $312.7 million for FY08.

- ***Gasoline Tax*** – First levied in 1920, this tax is assessed on gallons of gasoline sold in Kentucky. The floor of the gasoline rate is 17.1 cents per gallon; if the wholesale price rises above $1.342, the tax rate will rise. For FY07, this tax generated $397.6 million. Tax expenditures for this tax are estimated at $11.6 million for FY08.

- ***Individual Income Tax*** – First imposed in 1936, this tax has been the most productive revenue source in Kentucky. Beginning in 2005, a restructuring of the graduated rates occurred to apply a rate of 5.8 percent to net income over $8,000 but less than $75,000; the top 6 percent rate applies to net income over $75,000. Additionally, pass-through entities were taxed at the entity level for 2005 and 2006, further reducing individual income tax receipts. For 2007 and the following years, this aspect was reversed and Kentucky once again conforms to the Federal pass-through treatment. For FY07, this tax generated $3.0 billion. Tax expenditures for this tax are estimated at $2.6 billion for FY08.

- ***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 FY07, this tax generated $43.6 million. Tax expenditures for this tax are estimated at $75.0 million for FY08.

- ***Insurance Premiums Taxes*** - First adopted in 1942, this tax is assessed on the receipts of premiums collected by insurance companies in the Commonwealth. The rate of taxation varies according to type of insurer, with different rates for life insurers, insurers other than life, and captive insurers (licensed insurers owned by a business entity and offering insurance only to their owners). Tax expenditures for these taxes are estimated to total $16.5 million in FY08.

- ***Limited Liability Entity Tax*** – Enacted during the 2006 Extraordinary Session of the General Assembly, this tax applies to all entities which provide limited liability to their owners and is assessed for the privilege of doing business in Kentucky. This new tax applies to taxable periods beginning on or after January 1, 2007, therefore, limited receipts were realized during FY 07. Tax expenditures for this are estimated to total $132.4 million in FY08.

- ***Liquefied Petroleum Gas Tax*** – Implemented in 1960 as a "companion" to the gasoline tax, this tax is assessed on gallons sold. The floor of the tax rate is 17.1 cents per gallon; if the wholesale price rises above $1.342, the tax rate will also rise. For FY07, this tax generated $0.2 million; tax expenditures for this tax are estimate at $3,000 for FY08.

- ***Motor Vehicle Usage Tax*** – First assessed in 1936, the current tax rate is 6 percent of the retail price of motor vehicles. Many people think of this tax as a "sales" tax, but the tax is assessed for the privilege of using a motor vehicle upon the public highways of the Commonwealth. As such, the proceeds are deposited in the Road Fund. For FY07, this tax generated $411.3 million; tax expenditures are estimated at $92.9 million for FY08.

- ***Natural Resources Severance and Processing Tax*** – First assessed in 1980, taxes are levied against the gross value of all minerals severed or processed in Kentucky, excluding coal and oil. For FY07, these taxes generated $47.2 million; tax expenditures are estimated at $6.5 million for FY08.

- ***Property Taxes*** – Kentucky has levied a property tax since becoming a Commonwealth on June 1, 1792. Property is assessed at its fair market value; rates vary depending upon the type of property. For FY07, property taxes generated $492.5 million; tax expenditures are estimated at $307.1 million for FY08.

- ***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 percent of the sales price. For FY07, this tax generated $2.8 billion; tax expenditures are estimated at $2.3 billion for FY08.

- ***Special Fuels Tax*** – This tax includes fuels other than gasoline that are used in motor vehicles. The floor of the special fuels rate is 14.1 cents per gallon; if the wholesale price rises above $1.342, the tax rate will also rise. For FY07, this tax generated $141.4 million; tax expenditures for this tax are estimated at $67.7 million for FY08.

- ***Tobacco Taxes*** – The cigarette tax is a tax on each pack of cigarettes and was first assessed in 1936. The per-pack rate currently totals thirty cents and is composed of the original excise tax of three cents and a surtax of twenty-seven cents. The other tobacco products tax includes taxes on loose tobacco, cigars, snuff, and other miscellaneous tobacco products. The unit value tax differs depending on the product. All tobacco taxes are paid by the wholesaler. For FY07, tobacco taxes generated $177.4 million. The tax expenditures associated with these taxes are estimated at $1.3 million for FY08.

- ***Earmarked Funds*** – These items are included for informational purposes only. They 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 $40.3 million for FY08.

This is the second edition of the report within which a view of tax expenditures by program has been included. Many of the expenditures could be placed in multiple categories. This depiction considers the primary purpose or use of the expenditure and accordingly places the expenditure within that category. The following list outlines the major program categories, subcategories and an estimated of the amount of potential tax revenue not collected because of the tax expenditures related to the purpose.

Summary of Tax Expenditures by Program ($ millions)

	FY 08	FY 09	FY 10
Agriculture	**239.479**	**248.197**	**258.218**
Agricultural Development	207.920	215.636	224.654
Equine Industry Support	31.559	32.561	33.564
Business	**1,582.417**	**1,673.772**	**1,728.481**
Banking Support	7.140	7.580	7.900
Economic Development	105.950	109.050	111.650
Energy Development and Coal Industry Support	376.971	413.846	429.828
Existing Business Support	822.651	859.692	885.622
Job Development	147.635	155.635	161.835
Natural Resources	10.580	10.810	11.010
Transportation Industry Support	111.490	117.159	120.636
Human Resources	**3,117.949**	**3,282.729**	**3,484.512**
Education Support	31.000	32.700	36.200
Family Support	372.300	383.800	396.700
Health Care Support	907.289	989.139	1,075.792
Housing Development	501.300	531.100	563.100
Income Maintenance	689.160	709.490	725.220
Retirement Support	616.900	636.500	687.500
Government	**381.740**	**392.737**	**408.109**
Federal Government Support	10.800	10.900	10.900
Intergovernmental Transfers	12.000	12.600	13.200
Military Support	32.220	33.390	34.650
State and Local Government Support	326.720	335.847	349.359
Social Services	**646.184**	**650.744**	**676.290**
Charitable Organization Support	559.061	584.649	610.114
Community Development	47.891	26.563	26.644
Environmental Conservation and Historic Preservation	39.232	39.532	39.532

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. House Bill 380 enacted by the 2006 General Assembly defines the term “tax expenditure” to mean an exemption, exclusion or deduction from the base of a tax, a credit against the tax, a deferral of a tax, or a preferential tax rate.

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, other necessary information is not reflected on tax returns or the data is not captured. For these tax expenditures, 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.

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

- "Minimal" if its value is expected to be below $1 million; or
- "Substantial" if its value is expected to be above $1 million.

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.

This report catalogs or aggregates the various tax expenditures by tax type, to provide a more concise listing for quicker reference and comparison. Also included is a catalog of tax expeditures organized by programmatic area, to allow the reader to observe how various social goals are advanced through tax expenditure.

How to Read This Report

This report also contains the traditional method of identifying each expenditure by statutes, 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. Each identified tax type includes the following sections:

- ***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.

The summary tables are provided within the report as a reference to quickly find amounts associated with a particular expenditure. In addition to reflecting tax expenditures by tax type, the summary tables also depict the expenditures by purpose or use of the tax expenditures.

This report continues to quantify the exemption of certain services from sales tax even though these exemptions are not considered a tax expenditure. A list of specific services and the estimated costs can be found on pages 160-162 of this report.

Some taxes are 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 171-175.

The Office of State Budget Director welcomes your comments and any questions you may have about this report. We wish to extend our appreciation to Marian Davis and John May who were Commissioners for the Department of Revenue during the research stage of this publication, and to the many members from their staff who participated in the data collection process of this project. Without their assistance, this publication would not have been possible:

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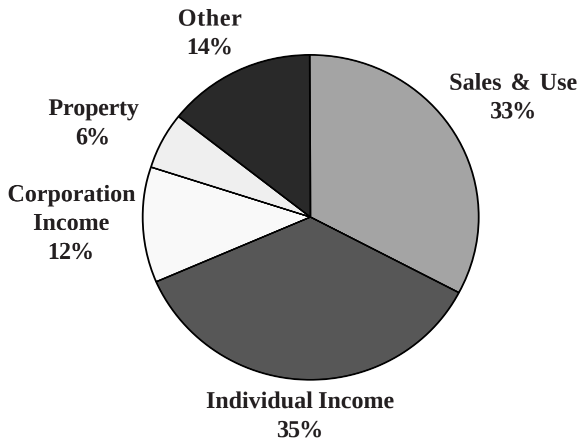
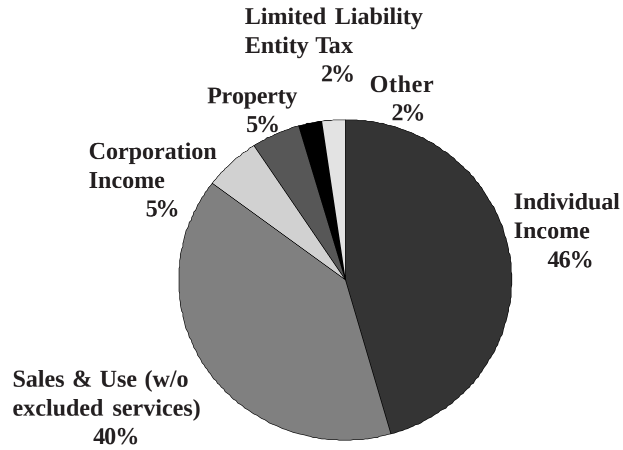
Figure 1. General Fund Overview

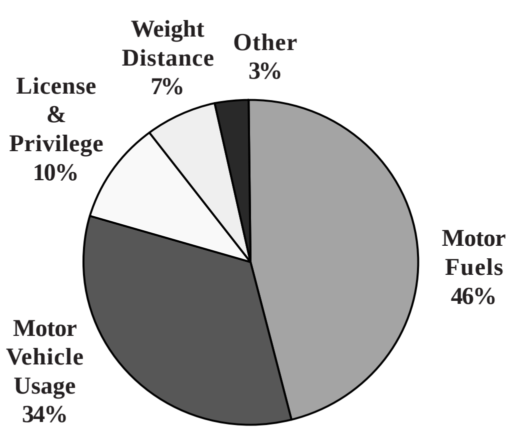


Actual FY2007 Tax Receipts

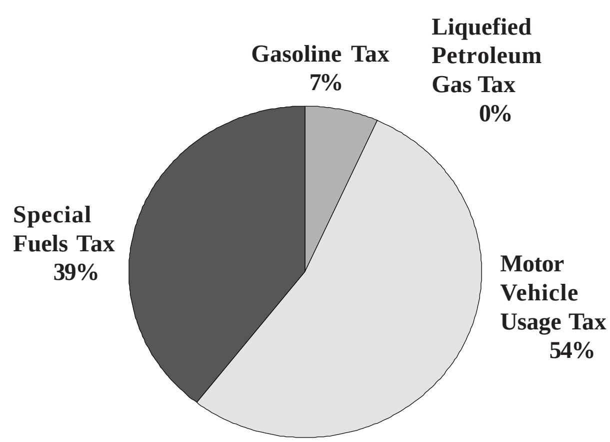


Estimated FY2008 Tax Expenditures

Figure 2. Road Fund Overview



Actual FY2007 Tax Receipts



Estimated FY2008 Tax Expenditures

Kentucky's Tax Expenditure Summit

The Kentucky General Assembly, as it has for the past dozen years, directed in the biennial budget bill (HB 380, 2006 Regular Session) that the Office of State Budget Director (OSBD) prepare a Tax Expenditure Analysis. Although the reports themselves have evolved over the years, since the inception of these there has never been a systematic review of the report or of the concepts and particular items included in the report.

The concept of tax expenditures has been controversial not only due to various views of government and taxation in general, but also in deciding which items to include and which to leave out. Critics of tax expenditure analysis argue that the term is loaded with implications regarding the government's powers of taxation, and that activities or items not taxed should not be treated as "expenditures". Even supporters of the concept have difficulty agreeing on what constitutes the legitimate tax base.

The OSBD does not claim to be an authority on this despite having prepared these reports for over 10 years. In practice, OSBD has largely followed the lead of the analyst primarily responsible for the report, and as personnel has changed, the views taken toward tax expenditures have varied over the years. As a result, before preparing the current issue of the Tax Expenditure Analysis, it was decided that a review was needed to assure that the principles guiding the preparation of the report would be based upon a wide range of views from within state government as well as input from taxpayers, the business community, and other interested groups.

To conduct the review, OSBD hosted the first conference on tax expenditures prior to undertaking an update of its analysis. The process of the review included these steps:

1. Hold conference with recognized authorities making presentations to help define the concept and share experiences.

2. Assemble knowledgeable participants to review existing Tax Expenditure publications and state laws to determine which items should be included in report.

3. Make decision based on consistent logic and rationale.

The review process was invaluable in helping OSBD update and revise this edition of the Tax Expenditure Analysis. As a result, significant changes were made to the content of the report, leading some items that had heretofore been considered tax expenditures to no longer bear that designation. More surprising, the process identified many tax expenditures that had not been documented in earlier analyses. OSBD is grateful to the individuals acknowledged at the end of this chapter, but of course bears full responsibility for the decision to include or exclude particular provisions of Kentucky's tax code in this edition of the Analysis.

The Tax Expenditure Summit

On September 7, 2006, the Office of State Budget Director held the first-ever Tax Expenditure Summit. The day-long conference included speakers from two separate areas of federal government agencies, a University of Kentucky professor who is an acknowledged authority on the subject of tax expenditure, and a diverse mixture of users of the past publications. Conference participants:

- Heard how the concept of tax expenditures evolved over time;
- Learned what other states do in reporting tax expenditures;
- Took a detailed look at Kentucky's last publication;
- Decided whether a tax expenditure budget was appropriate for Kentucky; and
- Joined panelists in offering a critique of Kentucky's last publication.

Bradford L. Cowgill, State Budget Director at that time, welcomed the participants and thanked each participant for joining the OSBD in an effort to refine and improve the next edition — *Tax Expenditure Analysis: Fiscal Years 2008 – 2010*. Mr. Cowgill explained that the goal of the Summit was to get ideas and feedback from people who use the report so that an improved product could be delivered. A summary of presentations following the introduction is presented below.

The Tax Expenditure Concept

David Joulfaian,
Economist, U.S. Treasury Department

Mr. Joulfaian explained that the U.S. Treasury Department prepared the first list of Federal tax expenditures in 1967. The Congressional Budget Act of 1974 directed the executive branch to prepare a Tax Expenditure Budget annually. More recently, the Government Performance Results Act of 1993 required the annual evaluation of tax expenditures. For federal purposes, the term "tax expenditures" means those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability. The federal tax expenditure budget estimates do not account for behavioral effects, interaction effects among different provisions, and interaction among taxes.

When deciding how to identify tax expenditures, the first step is to determine a baseline or benchmark. Conceptually, tax expenditures could be viewed from a comprehensive approach or a modified approach. A comprehensive view might include the Haig-Simons principle which includes any net increase in an individual's power to consume. This approach would expand Kentucky's definition of the term tax expenditure by including all payments, including transfer payments. The modified approach would exclude the transfer payments and focus on the structural element of the tax system. For federal income tax purposes, these elements include the tax rate schedule, personal exemptions, martial status, accounting methods, and organizational form. Finally, despite the numerous changes throughout the years, the tax expenditure budget has remained a vital document for evaluation purposes. The spotlight will remain on the annual federal document because of the sharp expansion in tax expenditures in recent years.

The Need for Reexamination

Marylynn Sergent
Assistant Director, U.S. Government Accountability Office (GAO)

Ms. Sergent explained that from her perspective in GAO, a tax expenditure is a preferential provision in the tax code. This preferential treatment may substitute for a government spending program in that the government "spends" some of its revenue on subsidies by forgoing the taxation of some items. Over time, tax expenditures may not be efficient, effective, or equitable. Therefore, reexamination is needed. Information about the attributes can help policy makers as they adapt current policies in light of overarching trends and the fiscal outlook. Periodic reviews help to establish whether tax expenditures are relevant to the current needs. A cost-benefit analysis may be required to determine if a tax expenditure has achieved its objective. Additionally, coordinated reviews of tax expenditures with related spending programs could assess the relationships and interaction within the mission areas and identify which strategies are effective. With full information, policy makers can evaluate the results to reduce program overlap and fragmentation as well as to target scarce resources to the most effective or least costly methods for delivering government support.

The magnitude of federal tax expenditures is huge. Federal income tax expenditures reported by Treasury have doubled in number since 1974. The sum of federal tax expenditure revenue loss has tripled in real terms since that time. Federal tax expenditures exceeded discretionary spending for half of the last decade. Federal tax expenditures span most federal missions but their size varies by budget function. Growth in the total tax expenditures is attributable to federal tax expenditures for individual taxpayers with health care being the top federal tax expenditure in fiscal year 2005, amounting to approximately $118.4 billion. For the federal government, the nation's current and projected fiscal imbalance serves to reinforce the importance of engaging in an annual review and reassessment. Although revenue loss estimates are substantial, tax expenditure costs are not integrated in the annual federal budget presentation. Presenting tax expenditures alongside outlays would be a useful starting point in highlighting the relative magnitude of total expenditures across mission areas. Therefore, the GAO recommends greater accountability for federal tax expenditures and has published additional resources containing more information on this subject. These publications were included in the conference packet of handouts.

- *Government Performance and Accountability: Tax Expenditures Represent a Substantial Federal Commitment and Need to be Reexamined (GAO-05-690, September 23, 2005)*

- *Understanding the Tax Reform Debate: Background, Criteria, & Questions* (GAO-05-1099SP, September 2005)

- *Budget Process: Better Transparency, Controls, Triggers, and Default Mechanisms Would Help to Address Our Large and Growing Long-term Fiscal Challenge (GAO-06-761T, May 25, 2006)*

Prospects for Improvement

Dr. David Wildasin
Professor, Martin School of Public Policy and Administration,
University of Kentucky

Dr. Wildasin asked whether tax expenditure reporting can be improved. He explained that if we are going to try, there were two issues which must be addressed immediately. The first is a conceptual question: How can we define a norm and then how can we apply it? The second is a practical policy question: Are tax expenditure accounts useful and can they be made more useful? If policymakers want to close their eyes to tax expenditures, who can stop them? The practical impact of a tax expenditure report depends on conceptual clarity. However, the tax expenditure approach is conceptually unclear because it's hard to arrive at a satisfactory definition of what tax expenditures truly are.

To be useful, tax expenditure concepts need to be as clear as possible. Tax expenditures occur when the tax law deviates from the norm in order to promote some government policy. The subject is inevitably controversial because of the lack of consensus about what the tax system ought to be. Who defines the norm? If legislators were to define the norm, tax expenditures would be zero since they write the law and thereby the norm. If economists were to define the norm, should it be the norm presented by noted economists like George Schanz, R. M. Haig, Henry C. Simons, Irving Fisher, or John Maynard Keynes? The answer to this question matters greatly, since tax expenditures under one norm may not be tax expenditures under another norm. A more tentative approach might be to follow existing practice by trying to do it better and attempting to expose those "hidden" expenditures for recurring scrutiny. A tax expenditure budget could potentially be used for budgetary scrutiny; control the size of government; determine the total amount of expenditure for functional categories of the budget; and provide a mechanism for tax-specific reviews. Despite basic conceptual issues, tax expenditure reports are potentially highly useful since some issues warrant special attention at the state and local levels. The following chapters from the book entitled *"Tax Expenditures and Government Policy"* were provided in the conference packet of handouts:

- "Pathways to Tax Expenditures: A Survey of Conceptual Issues and Controversies," Neil Bruce.

- “Tax Expenditures: The Personal Standard,” David E. Wildasin.

Dr. Wildasin’s final challenge to the group was to think about how to make the tax expenditure report more relevant for policy making.

What Other States (and Countries) Do (or don’t do?)!”

Jennifer Hays
Analyst, Governor’s Office for Economic Analysis

From internet research of state websites, Ms. Hays located and reviewed twenty-one reports from the states. Most of these reports were prepared by Revenue agencies; however, four states’ reports were completed by either the budget, treasury or finance agency within the state (Kentucky, Oregon, Vermont, and Wisconsin). Of the twenty-one reports, nine introduce their reports as being prepared for either: (1) the governor; (2) the legislature; (3) the citizens; or (4) some combination of these three groups. Fourteen states identify a resolution or legislative enactment which required the production of the report. The reports contain many different purposes for their publication. In addition to the report produced by the United States federal government, the governments of Canada and the Commonwealth of Australia produce a report. Further, the International Monetary Fund produces an annual report for eight additional countries containing a section on tax expenditures for each (Austria, France, Ireland, Spain, Belgium, Germany, Netherlands, and United Kingdom).

Many of the reports have common characteristics. They are generally organized by tax type, contain a short description of the expenditure, usually report two or three years of estimated future expense, cite the statutory reference for each expenditure, and contain charts and graphs. Some unusual features found include distributions of the expenditure among the population, expanded text such as number of returns impacted, a comparison of the actual amount of expenditure in the past and the estimate for future, and summary tables which rank expenditures by cost or explain the purpose or use of the expenditure.

The chart which follows summarizes data presented in these reports.

	Prepared for:	Prepared by:	Statutory Reference:	Purpose:	Link to Budget:
Arizona	The Governor and the Legislature	Dept of Revenue, Office of Economic Research & Analysis	ARS Sec 42-1005	To provide a better understanding of the costs associated with the existing set of tax exemptions, exclusions, deductions and credits.	No
California		California Franchise Tax Board, Economics & Statistical Research Bureau			No
Connecticut		Connecticut General Assembly Office of Fiscal Analysis	Connecticut General Statutes Section 12-7b		No
Hawaii		Department of Taxation		To summarize the tax credits	
Iowa		Iowa Department of Revenue & Finance		Improve government accountability	No
Kansas	The Governor, the Kansas Legislature and the citizens of the state of Kansas	Department of Revenue		To allow for the making of informative analysis and decisions.	No
Kentucky	The Governor, the Legislature and the citizens of the Commonwealth	Office of State Budget Director	The Budget Bill - HB 380 (2006 Regular Session)		No
Maine			5 M.R.S.A 1664	To identify, estimate and forecast the fiscal impact of those provisions of the State tax structure which grant benefits analogous to those provided by direct State spending programs	Appendix to Budget
Massachusetts		Executive Office for Administration and Finance			No
Michigan		Department of Treasury, Office of Revenue and Tax Analysis	Public Act 72 of 1979		Appendix to Budget
Minnesota	Members of the Legislature	Departrment of Revenue	Section 270.067	To evaluate Minnesota's current state and local tax system and to make future tax policy decisions.	No
Montana		Department of Revenue	House Bill 387 (1987)	To provide information useful to the Governor and the Legislature for developing tax policy	No
Nebraska	Governor and to all members of the Legislature	Department of Revenue	Sections 77-379 through 77-385, R.R.S. 2003	To better determine those sectors of the economy which are receiving indirect subsidies as a result of tax expenditures	No
New York		Department of Taxation and Finance		To describe tax expenditures and provide revenue estimates for them	No
North Carolina		Department of Revenue, Tax Research Division	Sections 105-256 of the General Statutes of North Carolina	To allow legislative review of the impact to the State's economy and government revenues	No

	Prepared for:	Prepared by:	Statutory Reference:	Purpose:	Link to Budget:
North Dakota	Policy makers, students, business leaders, and anyone else interested in learning about North Dakota's tax laws, state comparisons, and how North Dakota ranks when compared to other states	North Dakota Tax Department		An Overview and Comparative Guide to North Dakota Taxes	No
Ohio	The 126th General Assembly	Department of Taxation	Ohio Revised Code Section 107.03 and 5703.48	To lend a better understanding of the current tax system and act as a resource for those making decisions about Ohio's tax policy	Appendix to Budget
Oregon	Citizens of Oregon	Department of Administrative Services and Department of Revenue	1995 Budget Accountability Act	A tool to understand how government supports the achievement of education, social, economic and environmental policies through the use of Oregon's tax structure	No
Vermont		Vermont Tax Department and Joint Fiscal Office	Act 75 of the 2005 General Assembly		No
West Virginia	Legislature	State Tax Department, Research Division	West Virginia Code Sections 11-10-5s	To analyze tax expenditures for most major state taxes. The Tax Commissioner has promulgated rules setting forth a procedure and timetable for the reports in 3-year cycles.	No
Wisconsin	Members of the 2005-2006 Legislature	Department of Administration and Department of Revenue	Section 16.425 of the Wisconsin Statutes	Facilitates a comprehensive review of tax exemption devices and their corresponding fiscal effects.	No
United States			Congressional Budget Act of 1974 (Public Law 93-344)		Appendix to Budget
Australia		Australia Treasury	Charter of Budget Honesty Act of 1998	To allow tax expenditures to receive a similar degree of scrutiny as direct expenditures, allow for a more comprehensive assessment of government activity, and contribute to the design of the tax system, by promoting and assisting public debate on all elements of the tax system.	No
Canada	Her Majesty the Queen	Canada Department of Finance			No

A Look Inside Kentucky's Tax Expenditure Analysis

Robert Cox
Deputy Executive Director, Governor's Office for Economic Analysis

House Bill 380, as enacted by the 2006 Regular Session of the Kentucky's General Assembly, mandates the publication and defines the term "tax expenditure":

> *By October 15, 2007, the Office of State Budget Director shall provide to each branch of government detailed estimates for the General Fund and Road Fund for the current and next two fiscal years of the revenue loss effected by tax expenditures.*

> *Tax expenditure means an exemption, exclusion, or deduction from the base of a tax, a credit against the tax, a deferral of a tax, or a preferential tax rate.*

Kentucky's report has been prepared every two years dating back to 1989. Since that time, the report has continued to evolve. The 2005 edition contains a "What's New" tab that explains recent law changes, a "Summary Tables" tab that contains the tax expenditures listed by program area and by tax type, and tax-specific tabs which contain detailed descriptions of each expenditure, including background information on the tax, a description of the tax base, the effective date of each expenditure, and an estimated cost. Mr. Cox then encouraged the participants to think about the following questions.

- For philosophical consistency, how do you decide what is a tax expenditure? Should you
    - Look at the original statute?
    - Try to determine the intent of the legislature?
    - Examine economic principles of taxation?
    - Look at how other governments treat it?

- When do the tax and the tax expenditure trade places, i.e., intangible property tax and the tax on bank deposits?

- If you couldn't tax it even if you wanted to, is it a tax expenditure, i.e., sales to the US Government or judicial decisions?

- Are earmarked funds tax expenditures?

- How can we overcome data issues? Some potentially large tax expenditures have not been directly measurable or the quality of the data has been a problem, i.e., net operating loss deductions or agricultural property.

Panel Discussion on Tax Expenditures
John Chilton, Kentucky Society of CPAs
Debra Gabbard, KY Transportation Cabinet
Larry Lynch, Kentucky Consensus Forecasting Group
Tony Sholar, Kentucky Farm Bureau
Mark Treesh, CPA, former Kentucky State Representative and tax administrator

Comments included the following:

- The Tax Expenditure Report should be used as a shadow budget. It should be included in the Governor's Budget document and address.

- Tax expenditures are a lot like firemen – you don't think about them until you need them.

- The publication is used by the legislature, but only looked at on the margin to determine the incremental value of a policy change.

- The publication could be improved by adding the rationale of the expenditure.

- The publication could be improved by adding some identifier as to why we have the expenditure, i.e., related to charities, retirement, interstate competition, or because the federal government has the same expenditure, it is popular with the public, and we need it for business.

- Business tax expenditures are generally available to certain industries – coal, movies, banking.

- Other areas of interest could include the geographic location of the tax expenditure and a cost/benefit analysis for the expenditure.

- Does the expenditure merely represent the outsourcing of administrative costs?

Following the afternoon break and networking session, four discussion groups moderated by staff of OSBD were established by tax types. Manoj Shanker led a discussion on Individual Income Tax; Jennifer Hays headed the Business Tax discussion; Gene Zaparanick-Brown guided a discussion on Property Taxes, and Bob Cox conducted the Sales and Excise Tax discussion.

Each group briefly discussed the earlier presentations applicable to its particular tax. However, the primary purpose of this initial meeting of the discussion groups was to ascertain interest in furthering discussions through the interim period. All groups agreed that additional discussion would be insightful. Documentation of the decisions made by the discussion groups follows.

Results from Discussion Groups

Following the Kentucky Tax Expenditure Summit, OSBD staff met several times in the next few weeks and distilled information gathered at the Summit in order to develop criteria or principles that would govern the inclusion and classification of tax expenditures. The consensus among staff is that the legal definition of a tax expenditure as listed in HB 380 is useful but not by itself adequate for determining whether a particular feature of Kentucky's tax code creates a tax expenditure. For further guidance to be used in this report and future reports, staff listed eight principles gleaned from material presented at the Summit and in subsequent discussions to identify tax expenditures. These principles are applied to clarify the statutory definition used in HB 380. The eight guiding principles are:

1. A tax expenditure does not include an exemption from tax when the entity must pay under an alternative method of taxation. For instance, exclusion of financial institutions from the corporation income tax is not a tax expenditure since that type of entity is covered by the bank franchise tax.

2. A tax expenditure does not include an exemption for entities, items, or transactions that are commonly and traditionally exempted from payment of taxes.

3. A tax expenditure does not include a credit or exclusion which prevents the taxation of the same base more than once. As an example, a "sale for resale" exemption in the sales tax is not considered a tax expenditure since in the absence of such an exemption an article could be subjected to the tax multiple times as it moves through the production cycle.

4. A tax expenditure is not created when Kentucky has no discretionary ability to tax. This rule generally applies to exemptions listed in the US or Kentucky Constitutions. As an exception, some specific features of property tax are found within the Kentucky Constitution. Applying this principle means, for instance, that reduced valuation of agricultural property for property tax purposes is not a tax expenditure since this is a provision of the Kentucky Constitution.

5. A tax expenditure does not include items defined outside the normal taxable base. As an example, the exclusion of most services from the sales tax is not considered a tax expenditure since the tax is broadly imposed on the sale of "tangible personal property", a term generally understood to exclude services.

6. A tax expenditure will be listed even if the value of the expenditure is zero. Provisions in the law creating a tax expenditure may not be utilized in a year or for several years, but should be recognized nevertheless since the possibility of utilization exists.

7. When the distribution of data among tax types is not readily available, the tax expenditure will be listed within one section of the publication with notes in other applicable sections. The development of tax increment financing and other economic development incentives may extend to several taxes.

8. A tax expenditure does not include progressive rate structures which apply equally to all taxpayers. This principle holds even if a rate of "zero" is set below a certain threshold, as for the limited liability entity tax.

Using these eight principles for guidance, OSBD organized discussion groups for a one-day meeting on November 30, 2006. These groups included representatives from within OSBD, the Department of Revenue, the Legislative Research Commission and others. (A listing of participants can be found in the acknowledgments on page 30.) The groups focused on four major groupings of taxes: (1) Individual Income Tax; (2) Business Taxes; (3) Property Tax; and (4) Sales and Excise Taxes.

The purpose of each discussion group was to catalogue the tax expenditures related to the specific tax type for the upcoming publication (*Tax Expenditures Analysis: Fiscal Years 2008 – 2010)*. The members of each group were asked to prepare for the discussion by reviewing the tax statutes and then bring to the discussion a list of tax expenditure additions or deletions needed. The starting point for the discussion would be the most recent edition of the Tax Expenditure Analysis. The decisions to be made were to add or delete tax expenditure items based on the guiding principles. Each group initially adopted guiding principles before beginning the evaluation and listing process.

The Property Tax discussion group acknowledged that their tax circumstance may be an exception to Principle Number 4 since most of Kentucky's property tax exclusions are constitutionally based, instead of being statutory exemptions.

The two discussion groups related to income tax (individual and business taxes) voiced the need to regroup expenditures so that the reader could more easily find a single expenditure. For past publications, new expenditures were generally added at the end of a section. This process meant that, several years later, the casual reader saw neither rhyme nor reason to the list of tax expenditures. The following charts outline the decisions made by the discussion groups.

Individual Income Tax Discussion Group

Individual Income Tax		
"Agent Orange" settlement income	KRS 141.010 (10) (h)	Include in Report
Exclusion of income for soldiers killed in line of duty	KRS 141.010 (10) (t)	Include in Report
Depreciation	KRS 141.0101	Do not include in Report
Health insurance credit	KRS 141.062	Include in Report
Tax credit for qualified farming operations	KRS 141.410	Include in Report
Artistic charitable contributions deduction for individuals	KRS 141.0201	Include in Report
Deduction of leasehold interest of property contributed as living quarters for homeless persons	KRS 141.0202	Include in Report
Designation of funds to political party	KRS 141.072	Include in Report
Credit for Kentucky Reinvestment Act	KRS 141.415	Include in Report
Credits allowed individuals for tax paid to other states	KRS 141.070	Do not include in Report
Extension of time to pay when deployed	KRS 141.175	Include in Report
Construction of research facilities	KRS 141.395	Include in Report
Employer GED incentive credit	KRS 151B.127	Include in Report
Voluntary environmental remediation	KRS 141.418	Include in Report
Biodiesel	KRS 141.423	Include in Report
Clean coal	KRS 141.428	Include in Report
Various unlisted federal adjustments	Various IRC Sections	Include in Report
Member, Shareholder, or Partner credit	KRS 141.420(3)(a)	Delete from Report

The Individual Income Tax discussion group recommended deleting the last item on the list since it no longer applies following enactment of HB 1 in the 2006 Extraordinary Session.

The group also discussed two items for possible inclusion in the analysis: depreciation and the credit for tax paid to another state. Neither has been included in past Tax Expenditure Analyses, but an argument was made that each might warrant inclusion. The group decided that the deduction for depreciation or depreciation different from the federal deduction should be reported only when Kentucky allows a deduction higher than the federal deduction. Any other difference is merely a difference in timing. The credit for tax paid to another state was not included since Principle #3 would argue against recognizing as a tax expenditure a feature that merely prevents “double taxation.

Business Taxes Discussion Group

Corporation Income Tax		
Tobacco settlement	KRS 141.010 (12)	Include in Report
Homeowners' association	KRS 141.010 (14)	Include in Report
Health insurance credit	KRS 141.062	Include in Report
Deduction of leasehold interest of property contributed as living quarters for homeless	KRS 141.0202	Include in Report
Credit for qualified farming operation	KRS 141.410	Include in Report
Credit for Kentucky Reinvestment Act	KRS 141.415	Include in Report
Employer GED incentive credit	KRS 151B.127	Include in Report
Exclusion of publicly traded partnerships	KRS141.010 (24)	Delete from Report
Double weighted sales factor	KRS 141.120(8)	Delete from Report
Tax increment financing	KRS Chapter 65	Include in Report
Construction of research facilities	KRS 141.395	Include in Report
Limited Liability Entity Tax		
Public service corporations	KRS 141.0401 (6) (i)	Do not include in Report
Open-end registered investment companies	KRS 141.0401 (6) (j)	Include in Report
Certified fluidized bed energy production facility	KRS 141.0401 (6) (k)	Include in Report
Alcohol production facility	KRS 141.0401 (6) (l)	Include in Report
Political organizations	KRS 141.0401 (6) (q)	Do not include in Report
Small business exemption	KRS 141.0401 (2) (b)	Do not include in Report
REIT,RIC,REMIC	KRS 141.0401 (6) (m), (n), (o)	Include in Report
Personal service corporations	KRS 141.0401 (6) (p)	Include in Report
Cooperatives	KRS 141.0401 (6) (q)	Include in Report
Publicly traded partnership	KRS 141.0401 (6) (r)	Include in Report
Tax increment financing	KRS Chapter 65	Include in Report

The Business Taxes discussion group used the following justifications for deleting some items:

Exclusion of publicly traded partnerships	No longer applies following the enactment of House Bill 1 (SS 2006)
Enterprise zones	Will be phasing out
Double weighted sales factor	Principle # 5. Is not a tax expenditure – Double weighting is no longer outside the norm of taxation

The exclusion of certain entities not covered by the corporation income tax, that had not been listed as creating a tax expenditure in earlier reports, were considered and decided not to be tax expenditures. Public service corporations, one such entity, is subjected to a public service property tax that is assessed differently from most property taxes, and the form of taxation under which these entities pay was considered more appropriate for regulated entities such as these. Under Principle #1 therefore their exclusion should not be considered a tax expenditure.

Political organizations recognized under Internal Revenue Code 501 are traditionally exempted from taxation, and their exclusion conforms with Principle #2.

The small business exemption allowed to the limited liability entity tax is considered not to be a tax expenditure since the tax is structured with a progressive rate, and the exemption is equivalent to a tax rate of "zero".

Property Tax Discussion Group

Property Taxes		
State real property tax yearly revenue ceiling	KRS 132.020(7)	Delete from Report
Bank deposits	KRS 132.030(1)	Delete from Report
Agricultural land assessment	KRS 132.450(a)	Include in Report
Tax increment financing	KRS Chapter 65	Include in Report
Real and personal property owned by exempt entities	KY Constitution Sec. 170	Do not include in report
Household goods used in the home	KY Constitution Sec. 170	Do not include in report
reassessment	KRS 132.452	Do not include in report
25 domestic fowl	KRS 132.190(1)	Include in report
Personal property in vending stands operated by the blind	KRS 132.193	Include in Report
Fraternal benefit societies	KY Constitution Sec. 170	Do not include in Report
Local government hold harmless - commercial watercraft	KRS 136.181	Do not include in report

The Property Tax discussion group used the following justifications for deleting items:

Yearly revenue ceiling	Does not fit within the definition of a tax expenditure – rate setting mechanism.
Bank deposits	Principle #2. The intangible tax has been abolished

Sales and Excise Taxes Discussion Group
Sales and Use Tax

Sales and Excise Taxes		
Vendor compensation	KRS 139.750	Include in Report
Lodging of 30 days or more	KRS 139.200 (2)(a)	Include in Report
Rate increase for school taxes added to residential telephone bills	KRS 139.470 (9)	Include in Report
Federal taxes imposed on sales of TPP	KRS 139.470 (20)	Include in Report
Raw materials and industrial supplies		Delete from Report
Lease or rental of films by commercial theaters	KRS 139.484	Delete from Report
Non-returnable and returnable containers	KRS 139.470 (2)	Delete from Report
Catalog and newspaper inserts shipped outside of KY	KRS 139.470 (13)	Delete from Report
Internet Tax Nondiscrimination Act		Delete from Report
Bad debts	KRS 139.350	Do not include in Report
Water fee paid to KY River Authority	KRS 139.470 (12)	Include in Report
Tobacco buydown	KRS 139.470 (17)	Do not include in Report
Food donated by retail food establishment to a charity	KRS 139.470 (33)	Do not include in Report
Switch access	KRS 139.195 (7)	Include in Report
Pay phones	KRS 139.195 (8)	Include in Report
Use tax credit for sales tax pd to another state	KRS 139.510	Do not include in Report
Coal-based zero emission power plant	KRS 139.537	Include in Report
County clerk fee for collection of use tax on TPP purchased out of state	KRS 139.778 (4)	Include in Report
Tax increment financing	KRS Chapter 65	Include in Report

The sales tax discussion group used the following justification for deleting items:

Raw materials and industrial supplies	Principle #3. The exemption results from the principle of a sale for resale and is not a tax expenditure
Lease or rental of films	Principle #3. The exemption results from the principle of a sale for resale and is not a tax expenditure
Non-returnable and returnable containers	Principle #3
Catalog and newspaper inserts	Principle #4. No discretion to tax
Internet Tax Nondiscrimination Act	Principle #4. No discretion to tax

Certain items exempted from taxation were considered and found not to constitute tax expenditures under any sales or excise tax. The bad debt exemption from the sales tax results from the principle as returned merchandise and is not normally taxed, so under Principle #2 would not be included as a tax expenditure. The tobacco buydown results from the principle as a discount and is not a tax expenditure. Usually this takes the form of a rebate from the manufacturer of tobacco products and the retailer for products purchased by the retailer. A recent law declaring food donated to a charity by a retail establishment to be tax exempt is not a tax expenditure. The statutory change did not create an exemption. It already existed within the definition of food. Switch access fees paid by telecommunications companies who lease the lines of other providers are not considered a tax expenditure under the principle of a sale for resale. Use tax credit for tax paid to another state prevents the item from being taxed twice and according to Principle #3 is not a tax expenditure.

Sales and Excise Taxes Discussion Group

Excise Taxes

Alcoholic Beverage Taxes	**Comment**
US Government Exemption	Delete from Report
Cigarette Taxes	**Comment**
Compensation allowed Wholesaler - Cigarette Surtax	Delete from Report
US Government Exemption	Delete from Report
Gasoline & Special Fuels Taxes	**Comment**
US Government Exemption	Delete from Report
Motor Vehicle Usage Tax	**Comment**
US Government Exemption	Delete from Report

US Government Exemption	No discretion to tax
Compensation – Cigarette Surtax	The provision has expired
Enterprise Zone Exemption	Modification is needed since the zones will soon be expiring

Readers of this report will note the changes in the appropriate sections. OSBD is grateful for the assistance provided by all the participants in the review of tax expenditures. However, OSBD is responsible for the content of the report, and any questions concerning individual tax expenditure items, the justification for inclusion or exclusion, or the estimated cost of the tax expenditure should be directed to this office.

The Office of State Budget Director wishes to acknowledge and thank the following individuals who participated in the discussion groups. Their insight and information were helpful in determining whether a particular feature constituted a tax expenditure.

Tim Bennett	Michael Grammer
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Jim Livers	Perry Nutt
Jim Oliver	Charlotte Quarles
John Scott	Tony Sholar
Ainsley Snyder	Pam Thomas
Elyse Weigel	

Summary Tables of Tax Expenditures

This chapter of the Tax Expenditure Analysis contains a condensed presentation of the Tax Expenditure items in table format. The first table is a recap of the tax expenditures by major tax type. It lists each statutory exemption, deduction, credit rate adjustment, or other tax reduction by major tax type.

The second table is a recap of the expenditures categorized by the primary purpose or use of the expenditure even though many of the expenditures could be placed in multiple categories.

It is important to 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 sales tax refund for energy efficient projects, recently enacted by the General Assembly, could apply to machinery purchased for new and expanded industry, which is already exempt from sales tax. To add the estimated amounts of those two categories together would overstate the expected value if the exemptions were repealed simultaneously. The table makes no attempt to adjust for this.

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

Tax Expenditures by Tax Type *($ millions)*

	FY08	FY09	FY10
Total Alcoholic Beverage Taxes Expenditures	**0.865**	**0.865**	**0.865**
Allowance for Collecting and Reporting	0.825	0.825	0.825
Reduced Rate for "Low Volume" Spirits	0.040	0.040	0.040
Total Bank Franchise Tax Expenditures	**0.000**	**0.000**	**0.000**
Kentucky Historic Preservation Credit	0.000	0.000	0.000
Kentucky Investment Fund Credit	0.000	0.000	0.000
Total Coal Severance and Processing Tax Expenditures	**24.300**	**24.700**	**24.800**
Coal Used to Burn Solid Waste	0.000	0.000	0.000
Thin Seam Tax Credit	0.600	0.600	0.600
Transportation Expense	23.700	24.100	24.200
Coal Purchased for Alternative Energy or Gasification Facility	0.000	0.000	0.000
Total Corporation Income and License Taxes Expenditures	**312.684**	**333.636**	**345.734**
Coal Royalties	minimal	minimal	minimal
Credit Unions	4.900	5.200	5.500
Dividend Income	180.300	185.700	191.300
Homeowner's Associations	0.048	0.050	0.052
Real Estate Investment Trust	substantial	substantial	substantial
Tobacco Settlement	minimal	minimal	minimal
Charitable Contributions	10.700	11.000	11.300
Excess of Percentage over Cost Depletion	3.900	3.900	3.900
Leasehold Interest of Property Contributed as Living Quarters for Homeless	0.000	0.000	0.000
Net Operating Loss Deduction	43.700	44.300	43.500
Deductibility of Patronage Dividends	15.400	14.500	14.200
Biodiesel and Renewable Diesel Tax Credit	1.500	5.000	10.000
Clean Coal Incentive Credit	0.000	0.000	0.000
Coal Conversion Credit	0.000	0.000	0.000
Coal Incentive Tax Credit	0.001	0.001	0.097
Construction of Research Facilities Credit	2.200	2.800	3.500
Employer GED Credit	0.000	0.000	0.000
Enterprise Zone Credit	0.050	0.000	0.000
Environmental Remediation Tax Credit	1.000	1.000	1.000
Environmental Stewardship Tax Credit	5.000	5.000	5.000
Kentucky Investment Fund Tax Credit	0.050	0.050	0.050
Kentucky Reinvestment Act Credit	minimal	minimal	minimal
KEOZ Economic Development Credit	0.000	0.000	0.000
KIDA Economic Development Credit	7.900	8.100	8.300
KIRA Economic Development Credit	7.000	7.200	7.400
KJDA Economic Development Credit	9.900	10.200	10.500
KREDA Economic Development Credit	15.000	15.500	16.000
Qualified Farming Operation Credit	0.000	0.000	0.000
Recycling Credit	4.000	4.000	4.000
Skills Training Investment Tax Credit	0.120	0.120	0.120
Unemployment Tax Credit	0.015	0.015	0.015
Ethanol and Cellulosic Ethanol Tax Credit	0.000	10.000	10.000
Total Gasoline Tax Expenditures	**11.558**	**12.481**	**12.933**
Agricultural Exemption	0.050	0.053	0.055
Aircraft Refund	0.478	0.519	0.536
Bus, Taxicab, and Certain Senior Citizen's Programs Refund	0.473	0.513	0.530
Dealer's Monthly Reporting Allowance	10.100	10.900	11.300
Watercraft Refund	0.457	0.496	0.512
Total Individual Income Tax Expenditures	**2,630.210**	**2,792.640**	**2,996.930**
Armed Forces Personnel Benefits and Allowances	11.400	11.800	12.300
Assistance for Adopted Foster Children and Foster Care Payments	2.800	3.000	3.200
Cancellation of Indebtedness	0.470	0.370	0.270
Capital Gains - Eminent Domain	minimal	minimal	minimal
Disabled Coal Miners	1.000	1.100	1.100
Employee Stock Ownership Plan Provisions	1.200	1.300	1.300

	FY08	FY09	FY10
Employer Contributions for Medical Insurance and Medical Care	538.400	603.600	674.000
Employer-provided Benefits of Premiums on Group Term Life, Accident and Disability Insurance	8.700	8.900	9.100
Employer-provided Child Care Exclusions	3.400	3.600	3.700
Employer-provided Education Assistance	2.200	2.300	2.400
Employer-provided Meals and Lodging	3.200	3.300	3.500
Federal and Military Retirement Income Received	55.000	57.600	60.500
Financial Institutions Structured as S Corporations	minimal	minimal	minimal
Gain on the Sale of a Personal Residence	127.700	134.100	140.800
Exclusion of G.I. Bill Benefits	0.920	0.990	1.050
Income Earned Abroad by US Citizens	12.000	12.600	13.200
Interest on Life Insurance Savings	65.400	74.700	83.000
Miscellaneous Fringe Benefits	12.300	13.100	13.900
Passive Loss Rules Exception	24.700	25.600	26.200
Pension Contributions and Earnings from Employer Plans	159.200	157.800	152.300
Precinct Workers	0.100	0.100	0.100
Public Assistance Benefits	1.600	1.700	1.700
Private Pensions and Individual Retirement Accounts	144.400	151.000	159.500
Railroad and Supplemental Railroad Retirement System Benefits	1.300	1.300	1.200
Scholarship and Fellowship Income	6.400	6.700	7.100
Social Security Benefits for Retired Workers, Disabled Workers, and Dependents and Survivors	147.200	149.100	176.700
State Employee Pension Benefits and Contributions	54.200	60.200	71.400
Tobacco Settlement Income	6.000	6.000	6.000
Veteran's Pension, Death and Disability Compensation	13.400	13.800	14.400
Worker's Compensation Benefits	19.200	19.500	19.700
Casualty and Theft Losses	0.990	1.020	1.050
Charitable Contributions	176.700	190.700	204.300
Excess of Percentage over Cost Depletion	0.330	0.360	0.360
Health Savings Account Deduction	6.500	8.500	9.300
Home Mortgage Interest	293.800	316.200	340.100
Individual Retirement Account Contributions	21.800	23.400	26.700
Interest on Educational Loans	2.700	2.700	2.800
Job Expenses and Other Miscellaneous Deductions	32.400	34.500	37.000
Keogh Plan Contributions	32.800	35.000	38.100
Medical Expenses	16.200	19.100	22.500
Net Operating Loss Deduction	substantial	substantial	substantial
Parsonage Allowances	1.800	1.900	2.000
Property Tax on Owner-Occupied Homes	41.500	41.400	41.300
Standard Deduction	101.700	103.700	105.800
State and Local Taxes Other than Home Property Taxes	91.600	91.300	93.800
U.S. Production Activities	8.000	8.200	10.900
Basis of Capital Gains on Gifts	2.500	2.600	4.200
Capital Gains at Death	117.900	120.700	124.700
Income Averaging for Farmers	3.100	3.100	3.300
Installment Sales	3.000	3.100	3.100
Interest on U.S. Savings Bonds	4.400	4.500	4.500
Personal and Dependent Tax Credits	87.000	88.000	89.000
Child and Dependent Care Credit	7.600	7.700	7.800
Credit for Hiring Unemployed	minimal	minimal	minimal
Expanded Low Income Tax Credit	64.600	65.900	67.200
Historic Preservation Tax Credit	3.000	3.000	3.000
Job Development Credit	74.300	79.700	80.800
Postsecondary Education Tuition Credit	9.000	10.000	12.500
Recycling and/or Composting Equipment Credit	1.200	1.200	1.200
Total Inheritance and Estate Tax Expenditures	**75.000**	**71.300**	**67.700**
Class A Beneficiaries	60.900	57.900	55.000
Transfers to Educational, Religious, Charitable, or Certain Governmental Organizations	12.900	12.300	11.700
Discount for Early Payment of Tax	1.200	1.100	1.000
Class B Beneficiaries	minimal	minimal	minimal
Class C Beneficiaries	minimal	minimal	minimal

	FY08	FY09	FY10
Life Insurance Proceeds	substantial	substantial	substantial
Assessment of Land at its Agricultural or Horticultural Value	minimal	minimal	minimal
Certificates of Deposit Exempt from the Contemplation of Death Rule	minimal	minimal	minimal
Annuities Under Qualified Retirement Plans	minimal	minimal	minimal
Individual Retirement Accounts	minimal	minimal	minimal
Recurring Tax Credits	minimal	minimal	minimal
Benefits Paid to a Beneficiary of Military Personnel Under Certain Retirement Plans	minimal	minimal	minimal
Benefits Paid by the Federal Government Due to Service in Time of War	minimal	minimal	minimal
Total Insurance Premiums Taxes Expenditures	**16.526**	**18.174**	**19.825**
Health Insurance For State Employees	15.060	16.665	18.270
Hospital, Medical, or Dental Service Companies Exempt from Premium Tax	1.466	1.509	1.555
Total Limited Liability Entity Tax Expenditures	**132.389**	**136.484**	**140.649**
Alcohol Production Facility	0.158	0.166	0.181
Certified Fluidized Bed Energy Production Facility	0.000	0.000	0.000
Cooperatives, Homeowners' Assoc., Political Organizations	1.120	1.200	1.250
Costs of Good Sold, Bulk Delivery Charges, and Indirect Labor	129.400	133.300	137.300
Open-End Registered Investment Companies	0.001	0.001	0.001
Personal Service Corporations	0.175	0.175	0.175
Publicly Traded Partnerships	1.112	1.179	1.250
Real Estate Investment Trust	0.255	0.295	0.324
Regulated Investment Company	0.150	0.150	0.150
Real Estate Mortgage Investment Conduit	0.018	0.018	0.018
Total Liquefied Petroleum Gas Tax Expenditures	**0.003**	**0.003**	**0.003**
Approved Carburetion Systems	0.001	0.001	0.001
Dealer's Monthly Reporting Allowance	0.002	0.002	0.002
Total Motor Vehicle Usage Tax Expenditures	**92.913**	**95.998**	**98.052**
Adapted Equipment for Physically Handicapped Persons	0.063	0.065	0.067
Change in Business Structure	0.260	0.270	0.270
Charter Bus Exemption	0.052	0.054	0.056
Commercial Motor Vehicle Exemption	minimal	minimal	minimal
Educational & Charitable Organizations	1.300	1.300	1.300
Enterprise Zone Exemption	0.100	0.000	0.000
Enterprise Zone Exemption - U Drive-It Tax	0.900	0.000	0.000
Immediate Family Member	16.900	17.600	18.000
Insurance Company Transfers	0.104	0.108	0.111
Large Truck Exclusion	27.000	28.300	28.900
Military Exemption	6.500	6.800	6.900
Partnership Interests	0.104	0.108	0.111
Repossessed Exemption	0.940	0.980	1.000
Trade-In Allowance on Used Vehicles	35.000	36.600	37.400
Transfers between a Limited Liability Company and its Members	0.630	0.650	0.670
Transfers between a Subsidiary and a Parent Corporation	0.160	0.163	0.167
Transfers by Will or Court Order	2.900	3.000	3.100
Total Natural Resources Severance and Processing Tax Expenditures	**6.450**	**6.650**	**6.850**
Ball Clay, Fluorspar, Lead, Zinc, Tar Sands, Barite, and Stone Used for Privately Maintained but Publicly Dedicated Roads	0.250	0.250	0.250
Clay Used in Landfill Construction	0.000	0.000	0.000
Inactive Crude Oil & Natural Gas Wells	0.100	0.100	0.100
Limestone Sold in Interstate Commerce	3.100	3.200	3.300
Limestone Sold or Used for Agricultural Purposes	minimal	minimal	minimal
Limit on Tax from Clay	minimal	minimal	minimal
Transportation Expense	3.000	3.100	3.200
Total Property Tax Expenditures	**307.118**	**318.418**	**331.318**
Real Property			
Agricultural and Horticultural Land Assessment Protection	0.100	0.100	0.100

	FY08	FY09	FY10
Agricultural Value of Real Property	31.100	32.700	35.100
Alcohol Production Facilities	0.000	0.000	0.000
Environmental Remediation Property	0.002	0.002	0.002
Homestead Exemption	13.600	13.800	14.700
Intrastate Railroads and Railway Companies	0.022	0.022	0.022
Leasehold Interest in Buildings Financed with Industrial Revenue Bonds	2.900	2.100	2.200
Property of Local Governments in Neighboring States	0.020	0.020	0.020
Real Property Owned by Exempt Entities	38.500	40.700	42.900
Tangible Property			
Agricultural Products	0.310	0.310	0.310
Aircraft	1.400	1.400	1.400
Business Inventories	71.500	75.000	78.800
Carlines	4.300	4.300	4.300
Federally Documented Vessels	0.460	0.460	0.460
Foreign Trade Zone	33.000	33.000	33.000
Historic Vehicles	0.129	0.129	0.129
In-Transit Goods	16.500	17.400	17.400
Intrastate Railroads and Railway Companies	0.175	0.175	0.175
Interstate Trucks, Tractors and Buses	3.600	3.900	3.900
Leasehold Interests	3.900	3.900	3.900
Machinery Used in Farming and Livestock & Domestic Fowl	22.500	22.500	22.500
Manufacturing Machinery; Pollution Control Equipment; and Radio, Television & Telephonic Equipment	63.100	66.500	70.000
Motor Vehicles with a Salvage Title	minimal	minimal	minimal
Property of Local Government in Neighboring States	0.000	0.000	0.000
Personal Property Used in Vending Stands Operated by the Blind	minimal	minimal	minimal
Total Sales and Use Tax Expenditures (w/o excluded services)	**2,288.722**	**2,362.097**	**2,432.876**
Food Items	430.000	442.900	451.800
Non-profit Educational, Charitable and Religious Institutions	316.100	325.600	335.400
Labor or Services Used in Property Sold	226.700	233.500	240.500
Residential Utilities	254.600	259.600	260.200
Prescription Medicine, Prosthetic Devices and Physical Aids	322.300	332.000	341.900
Machinery for New and Expanded Industry and Certain Industrial Machinery	63.300	64.800	65.700
Coal Used in the Manufacture of Electricity	70.200	71.200	70.700
Energy and Energy Producing Fuels	25.000	26.300	27.500
Retailers' Compensation for Collecting and Remitting the Tax	21.200	30.400	31.800
Enterprise Zones	0.400	0.000	0.000
State, Cities, Counties and Special Districts	222.000	232.000	242.700
Textbooks	3.500	3.800	4.200
Recycling Machinery and Equipment	1.300	1.300	1.300
Pollution Control Facilities	23.600	23.900	23.900
Tombstones and Other Grave Markers	3.800	3.900	4.000
Lodgings of Thirty Days or More	substantial	substantial	substantial
Garage or Yard Sales	2.000	2.000	2.000
Semi-Trailers and Trailers	minimal	minimal	minimal
Vessels and Maritime Supplies	3.400	3.400	3.400
Sales by Elementary and Secondary Nonprofit, School-Sponsored Clubs and Organizations	5.900	5.900	5.900
Interstate Cargo and Passenger Aircraft, Parts and Supplies	9.600	9.600	9.600
Sales by Nonprofit Higher Educational School-Sponsored Clubs and Organizations	1.300	1.300	1.300
Sales to Motion Picture Companies	minimal	minimal	minimal
Admissions to and Purchases by Historical Sites	substantial	substantial	substantial
Credit Unions	1.300	1.400	1.400
Coin-Operating Bulk Vending Machines	minimal	minimal	minimal
Occasional Sales	substantial	substantial	substantial
Locomotives and Rolling Stock	substantial	substantial	substantial
Procurement, Processing or Distribution of Blood or Human Tissue	7.300	7.700	8.200
Rate Increase for School Taxes added to Residential Telephone Bills	5.800	6.000	6.200
Federal Taxes Imposed on Sales of Tangible Personal Property	6.400	6.400	6.400
Sales to Common Carriers Under a Bill of Lading	0.000	0.000	0.000
Tourism Attraction Project Credit/Refund	7.400	8.400	9.400

	FY08	FY09	FY10
Alcohol Production Facilities	0.000	0.000	0.000
Property Certified as a Fluidized Bed Energy Production Facility	0.000	0.000	0.000
4-H Sales	minimal	minimal	minimal
Jet Fuel	36.000	38.000	40.000
Repair Parts for Large Trucks	1.700	1.800	1.800
Donated Goods	0.350	0.400	0.450
Kentucky Enterprise Initiative	45.000	25.000	25.000
Charter Bus Repair & Replacement Parts	0.100	0.110	0.120
County Fair Admissions	0.270	0.270	0.270
Water Withdrawal Fees Paid to Kentucky River Authority	0.083	0.083	0.083
Interstate Business Communications Services	minimal	minimal	minimal
Pay Phones	0.200	0.200	0.200
Construction Expenses for Near Zero Emission Power Plants	0.000	0.000	0.000
New and Replacement Machinery or Equipment for Energy Efficient Projects	0.000	3.700	3.700
Construction Expenses for Alternative Fuel or Gasification Facility	0.000	11.900	21.300
Subtotal for Farming Tax Expenditures	**170.619**	**177.334**	**184.553**
Livestock, Poultry, Ratite Birds, Embryos and Semen, Alpacas, Llamas, Buffalo, Farm Work Stock and Feed, Seeds and Fertilizers	71.600	74.600	77.700
Horses Purchased for Breeding	12.500	12.900	13.300
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	53.800	56.000	58.400
Fuel Used for Farm Purposes	7.900	8.200	8.600
Water Used for Farm Purposes	0.059	0.061	0.064
Equine Water	0.059	0.061	0.064
Aquaculture	0.166	0.176	0.187
Twine and Wire	0.035	0.036	0.038
Horses Less Than Two Years of Age	19.000	19.600	20.200
Farm Chemicals	5.500	5.700	6.000
Total for Excluded Services	**1,636.800**	**1,759.400**	**1,888.700**
Personal services	61.500	64.700	68.200
Total business services	273.900	297.000	322.600
Specialized design services	6.700	7.200	7.800
Computer system designs	69.000	74.800	81.200
Scientific R&D	7.800	8.500	9.200
Advertising	33.900	36.700	39.900
Other professional services	35.100	38.000	41.300
Health services	776.300	832.300	888.400
Legal services	100.600	109.100	118.500
Education services	19.600	21.000	22.400
Social services	8.500	9.000	9.400
Engineering, accounting, research, management	212.400	230.400	250.200
Automotive and miscellaneous repair services	106.000	111.600	117.600
Amusement and recreational services	3.000	3.300	3.500
Other services	6.000	6.300	6.700
Total Special Fuels Tax Expenditures	**67.731**	**73.433**	**75.775**
Agricultural Use	5.700	6.100	6.300
Bus, Taxicab and Certain Senior Citizen's Programs Refunds	0.428	0.465	0.480
Dealer's Monthly Reporting Allowance	3.600	3.900	4.000
Non-Highway Use	34.200	37.200	38.400
Railroad Companies	21.800	23.600	24.400
Religious, Charitable or Educational Use	0.441	0.479	0.494
Residential Heating	1.200	1.300	1.300
State and Local Government Use	0.317	0.344	0.356
Watercraft	0.045	0.045	0.045
Total Tobacco Taxes Expenditures	**1.300**	**1.300**	**1.300**
Compensation Allowed Wholesaler	1.300	1.300	1.300
Total Earmarked Funds	**40.270**	**70.475**	**72.419**
Thoroughbred Development Fund-Pari-mutuel Tax	6.800	6.800	6.800

	FY08	FY09	FY10
Equine Industry Program Trust and Revolving Fund – Pari-mutuel Tax	0.490	0.490	0.490
Higher Education Equine Trust and Revolving Fund – Pari-mutuel Tax	0.460	0.460	0.460
Standardbred Development Fund – Pari-mutuel Tax	0.180	0.180	0.180
Tobacco Enforcement Program – Tobacco Tax	0.590	0.590	0.590
Kentucky Transportation Center – Motor Fuels Tax	0.190	0.190	0.190
Tobacco Research Trust Fund – Cigarette Tax	2.700	2.700	2.700
Equine Drug Research – Pari-mutuel Tax	0.450	0.450	0.450
Kentucky Aviation Economic Development Fund – Sales Tax	5.600	5.700	5.800
Tax Increment Financing – Various Taxes	3.310	32.815	33.959
Kentucky Thoroughbred Breeders Incentive Fund	15.600	16.000	16.500
Kentucky Standardbred Breeders Incentive Fund	2.500	2.600	2.700
Kentucky Horse Breeders Incentive Fund	1.400	1.500	1.600
County Clerk Share for Collection of Nonresident Sales Tax	0.100	0.150	0.150

Tax Expenditures by Program *($ millions)*

Tax Type		FY08	FY09	FY10
	Agricultural Development	**207.920**	**215.636**	**224.654**
Gasoline Tax	Agricultural Exemption	0.050	0.053	0.055
Corporation Income	Qualified Farming Operation Credit	0.000	0.000	0.000
Individual Income	Tobacco Settlement	6.000	6.000	6.000
Corporation Income	Tobacco Settlement	minimal	minimal	minimal
Individual Income	Income Averaging for Farmers	3.100	3.100	3.300
Inheritance Tax	Assessment of Land at its Agricultural or Horticultural Value	minimal	minimal	minimal
Natural Resources	Limestone Sold or Used for Agricultural Purposes	minimal	minimal	minimal
Real Property Tax	Agricultural and Horticultural Land Assessment Protection	0.100	0.100	0.100
Real Property Tax	Agricultural Value of Real Property	31.100	32.700	35.100
Tangible Property Tax	Machinery Used in Farming and Livestock & Domestic Fowl	22.500	22.500	22.500
Tangible Property Tax	Agricultural Products	0.310	0.310	0.310
Sales Tax	Livestock, Poultry, Ratite Birds, Embryos and Semen, Alpacas, Llamas, Buffalo, Farm Work Stock and Feed, Seeds and Fertilizers	71.600	74.600	77.700
Sales Tax	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	53.800	56.000	58.400
Sales Tax	Fuel Used for Farm Purposes	7.900	8.200	8.600
Sales Tax	Water Used for Farm Purposes	0.059	0.061	0.064
Sales Tax	Aquaculture	0.166	0.176	0.187
Sales Tax	Twine and Wire	0.035	0.036	0.038
Sales Tax	Farm Chemicals	5.500	5.700	6.000
Special Fuels	Agricultural Use	5.700	6.100	6.300
	Banking Support	**7.140**	**7.580**	**7.900**
Corporation Income	Credit Unions	4.900	5.200	5.500
Corporation Income	Real Estate Investment Trust	substantial	substantial	substantial
Individual Income	Financial Institutions Structured as S Corporations	minimal	minimal	minimal
Motor Vehicle	Repossessed Exemption	0.940	0.980	1.000
Sales Tax	Credit Unions	1.300	1.400	1.400
	Charitable Organization Support	**559.061**	**584.649**	**610.114**
Corporation Income	Charitable Contributions	10.700	11.000	11.300
Corporation Income	Leasehold Interest of Property Contributed as Living Quarters for Homeless	0.000	0.000	0.000
Individual Income	Charitable Contributions	176.700	190.700	204.300
Individual Income	Parsonage Allowances	1.800	1.900	2.000
Inheritance Tax	Transfers to Educational, Religious, Charitable, or Certain Governmental Organizations	12.900	12.300	11.700
Inheritance Tax	Class C Beneficiaries	minimal	minimal	minimal
Motor Vehicle	Educational & Charitable Organizations	1.300	1.300	1.300
Real Property Tax	Real Property Owned by Exempt Entities	38.500	40.700	42.900
Sales Tax	Non-profit Educational, Charitable and Religious Institutions	316.100	325.600	335.400
Sales Tax	4-H Sales	minimal	minimal	minimal
Sales Tax	Donated Goods	0.350	0.400	0.450
Sales Tax	County Fair Admissions	0.270	0.270	0.270
Special Fuels	Religious, Charitable or Educational Use	0.441	0.479	0.494
	Community Development	**47.891**	**26.563**	**26.644**
Corporation Income	Enterprise Zone Credit	0.050	0.000	0.000
Corporation Income	KEOZ Economic Development Credit	0.000	0.000	0.000
Corporation Income	Homeowner's Associations	0.048	0.050	0.052
Individual Income	Capital Gains - Eminent Domain	minimal	minimal	minimal
Limited Liability Entity	Cooperatives, Homeowners' Assoc., Political Organizations	1.120	1.200	1.250
Limited Liability Entity	Real Estate Investment Trust	0.255	0.295	0.324
Limited Liability Entity	Real Estate Mortgage Investment Conduit	0.018	0.018	0.018
Motor Vehicle	Enterprise Zone Exemption	0.100	0.000	0.000
Motor Vehicle	Enterprise Zone Exemption - U Drive-It Tax	0.900	0.000	0.000
Sales Tax	Enterprise Zones	0.400	0.000	0.000
Sales Tax	Kentucky Enterprise Initiative	45.000	25.000	25.000
	Earmarked Funds	**40.270**	**70.475**	**72.419**
Earmarked Funds	Thoroughbred Development Fund-Pari-mutuel Tax	6.800	6.800	6.800
Earmarked Funds	Equine Industry Program Trust and Revolving Fund – Pari-mutuel Tax	0.490	0.490	0.490
Earmarked Funds	Higher Education Equine Trust and Revolving Fund – Pari-mutuel Tax	0.460	0.460	0.460
Earmarked Funds	Standardbred Development Fund – Pari-mutuel Tax	0.180	0.180	0.180
Earmarked Funds	Tobacco Enforcement Program – Tobacco Tax	0.590	0.590	0.590
Earmarked Funds	Kentucky Transportation Center – Motor Fuels Tax	0.190	0.190	0.190
Earmarked Funds	Tobacco Research Trust Fund – Cigarette Tax	2.700	2.700	2.700
Earmarked Funds	Equine Drug Research – Pari-mutuel Tax	0.450	0.450	0.450

Tax Type		FY08	FY09	FY10
Earmarked Funds	Kentucky Aviation Economic Development Fund – Sales Tax	5.600	5.700	5.800
Earmarked Funds	Tax Increment Financing – Various Taxes	3.310	32.815	33.959
Earmarked Funds	Kentucky Thoroughbred Breeders Incentive Fund	15.600	16.000	16.500
Earmarked Funds	Kentucky Standardbred Breeders Incentive Fund	2.500	2.600	2.700
Earmarked Funds	Kentucky Horse Breeders Incentive Fund	1.400	1.500	1.600
Earmarked Funds	County Clerk Share for Collection of Nonresident Sales Tax	0.100	0.150	0.150
	Economic Development	**105.950**	**109.050**	**111.650**
Corporation Income	Kentucky Investment Fund Tax Credit	0.050	0.050	0.050
Corporation Income	Construction of Research Facilities Credit	2.200	2.800	3.500
Tangible Property Tax	Foreign Trade Zone	33.000	33.000	33.000
Sales Tax	Tourism Attraction Project Credit/Refund	7.400	8.400	9.400
Sales Tax	Interstate Business Communications Services	minimal	minimal	minimal
Sales Tax	Machinery for New and Expanded Industry and Certain Industrial Machinery	63.300	64.800	65.700
Sales Tax	Sales to Motion Picture Companies	minimal	minimal	minimal
	Education Support	**31.000**	**32.700**	**36.200**
Corporation Income	Employer GED Credit	0.000	0.000	0.000
Individual Income	Employer-provided Education Assistance	2.200	2.300	2.400
Individual Income	Exclusion of Scholarship and Fellowship Income	6.400	6.700	7.100
Individual Income	Interest on Educational Loans	2.700	2.700	2.800
Individual Income	Postsecondary Education Tuition Tax Credit	9.000	10.000	12.500
Sales Tax	Sales by Nonprofit Higher Educational School-Sponsored Clubs and Organizations	1.300	1.300	1.300
Sales Tax	Textbooks	3.500	3.800	4.200
Sales Tax	Sales by Elementary and Secondary Nonprofit, School-Sponsored Clubs and Organizations	5.900	5.900	5.900
	Energy Development and Coal Industry Support	**376.971**	**413.846**	**429.828**
Corporation Income	Biodiesel and Renewable Diesel Tax Credit	1.500	5.000	10.000
Natural Resources	Inactive Crude Oil & Natural Gas Wells	0.100	0.100	0.100
Real Property Tax	Alcohol Production Facilities	0.000	0.000	0.000
Sales Tax	Energy and Energy Producing Fuels	25.000	26.300	27.500
Sales Tax	Alcohol Production Facilities	0.000	0.000	0.000
Sales Tax	Property Certified as a Fluidized Bed Energy Production Facility	0.000	0.000	0.000
Sales Tax	Residential Utilities	254.600	259.600	260.200
Coal Severance	Transportation Expense	23.700	24.100	24.200
Coal Severance	Thin Seam Tax Credit	0.600	0.600	0.600
Corporation Income	Coal Royalties	minimal	minimal	minimal
Corporation Income	Coal Conversion Credit	0.000	0.000	0.000
Corporation Income	Coal Incentive Tax Credit	0.001	0.001	0.097
Corporation Income	Ethanol and Cellulosic Ethanol Credit	0.000	10.000	10.000
Limited Liability Entity	Certified Fluidized Bed Energy Production Facility	0.000	0.000	0.000
Limited Liability Entity	Alcohol Production Facility	0.158	0.166	0.181
Limited Liability Entity	Publicly Traded Partnerships	1.112	1.179	1.250
Sales Tax	Coal Used in the Manufacture of Electricity	70.200	71.200	70.700
Sales Tax	New and Replacement Machinery and Equipment for Energy Efficient Projects	0.000	3.700	3.700
Sales Tax	Construction Expenses for Alternative Fuel or Gasification Facility	0.000	11.900	21.300
	Environmental Conservation and Historical Preservation	**39.232**	**39.532**	**39.532**
Coal Severance	Coal Used to Burn Solid Waste	0.000	0.000	0.000
Corporation Income	Recycling Credit	4.000	4.000	4.000
Corporation Income	Environmental Remediation Tax Credit	1.000	1.000	1.000
Corporation Income	Environmental Stewardship Tax Credit	5.000	5.000	5.000
Corporation Income	Clean Coal Incentive Credit	0.000	0.000	0.000
Individual Income	Recycling and/or Composting Equipment	1.200	1.200	1.200
Liquefied Petroleum	Approved Carburetion Systems	0.001	0.001	0.001
Real Property Tax	Environmental Remediation Property	0.002	0.002	0.002
Sales Tax	Recycling Machinery and Equipment	1.300	1.300	1.300
Sales Tax	Pollution Control Facilities	23.600	23.900	23.900
Sales Tax	Admissions to and Purchases by Historical Sites	substantial	substantial	substantial
Sales Tax	Construction Expenses for Near Zero Emission Power Plants	0.000	0.000	0.000
Individual Income	Historic Preservation Tax Credit	3.000	3.000	3.000
Tangible Property Tax	Historic Vehicles	0.129	0.129	0.129
	Equine Industry Support	**31.559**	**32.561**	**33.564**
Sales Tax	Horses Purchased for Breeding	12.500	12.900	13.300
Sales Tax	Equine Water	0.059	0.061	0.064
Sales Tax	Horses Less Than Two Years of Age	19.000	19.600	20.200

Tax Type		FY08	FY09	FY10
	Excluded Services	**1,636.800**	**1,759.400**	**1,888.700**
Sales Tax	Personal services	61.500	64.700	68.200
Sales Tax	Business services	273.900	297.000	322.600
Sales Tax	Health services	776.300	832.300	888.400
Sales Tax	Legal services	100.600	109.100	118.500
Sales Tax	Education services	19.600	21.000	22.400
Sales Tax	Social services	8.500	9.000	9.400
Sales Tax	Engineering, accounting, research, management	212.400	230.400	250.200
Sales Tax	Automotive and miscellaneous repair services	106.000	111.600	117.600
Sales Tax	Amusement and recreational services	3.000	3.300	3.500
Sales Tax	Other services	6.000	6.300	6.700
Sales Tax	Advertising	33.900	36.700	39.900
Sales Tax	Other Professional Services	35.100	38.000	41.300
	Existing Business Support	**822.651**	**859.692**	**885.622**
Alcoholic Beverage	Reduced Rate for "Low Volume" Spirits	0.040	0.040	0.040
Corporation Income	Net Operating Loss Deduction	43.700	44.300	43.500
Corporation Income	Dividend Income	180.300	185.700	191.300
Corporation Income	Deductibility of Patronage Dividends	15.400	14.500	14.200
Individual Income	Net Operating Loss Deduction	substantial	substantial	substantial
Individual Income	Installment Sales	3.000	3.100	3.100
Limited Liability Entity	Costs of Good Sold, Bulk Delivery Charges, and Indirect Labor	129.400	133.300	137.300
Limited Liability Entity	Open-End Registered Investment Companies	0.001	0.001	0.001
Limited Liability Entity	Personal Service Corporations	0.175	0.175	0.175
Limited Liability Entity	Regulated Investment Company	0.150	0.150	0.150
Motor Vehicle	Change in Business Structure	0.260	0.270	0.270
Motor Vehicle	Transfers between a Limited Liability Company and its Members	0.630	0.650	0.670
Motor Vehicle	Transfers between a Subsidiary and a Parent Corporation	0.160	0.163	0.167
Motor Vehicle	Partnership Interests	0.104	0.108	0.111
Motor Vehicle	Insurance Company Transfers	0.104	0.108	0.111
Tangible Property Tax	Business Inventories	71.500	75.000	78.800
Tangible Property Tax	In-Transit Goods	16.500	17.400	17.400
Tangible Property Tax	Motor Vehicles with a Salvage Title	minimal	minimal	minimal
Sales Tax	Labor or Services Used in Property Sold	226.700	233.500	240.500
Sales Tax	Coin-Operating Bulk Vending Machines	minimal	minimal	minimal
Alcoholic Beverage	Allowance for Collecting and Reporting	0.825	0.825	0.825
Tobacco Tax	Compensation Allowed Wholesaler	1.300	1.300	1.300
Gasoline Tax	Dealer's Monthly Reporting Allowance	10.100	10.900	11.300
Sales Tax	Occasional Sales	substantial	substantial	substantial
Sales Tax	Pay Phones	0.200	0.200	0.200
Liquefied Petroleum	Dealer's Monthly Reporting Allowance	0.002	0.002	0.002
Sales Tax	Retailers' Compensation for Collecting and Remitting the Tax	21.200	30.400	31.800
Tangible Property Tax	Manufacturing Machinery; Pollution Control Equipment; and Radio, Television & Telephonic Equipment	63.100	66.500	70.000
Special Fuels	Dealer's Monthly Reporting Allowance	3.600	3.900	4.000
Special Fuels	Non-Highway Use	34.200	37.200	38.400
	Family Support	**372.300**	**383.800**	**396.700**
Individual Income	Assistance for Adopted Foster Children and Foster Care Payments	2.800	3.000	3.200
Individual Income	Employer-provided Child Care Exclusions	3.400	3.600	3.700
Individual Income	Personal and Dependent Tax Credits	87.000	88.000	89.000
Individual Income	Interest on Life Insurance Savings	65.400	74.700	83.000
Individual Income	Capital Gains at Death	117.900	120.700	124.700
Individual Income	Child and Dependent Care Expenses	7.600	7.700	7.800
Inheritance Tax	Class A Beneficiaries	60.900	57.900	55.000
Inheritance Tax	Class B Beneficiaries	minimal	minimal	minimal
Inheritance Tax	Life Insurance Proceeds	substantial	substantial	substantial
Inheritance Tax	Certificates of Deposit Exempt from the Contemplation of Death Rule	minimal	minimal	minimal
Inheritance Tax	Recurring Tax Credits	minimal	minimal	minimal
Inheritance Tax	Discount for Early Payment of Tax	1.200	1.100	1.000
Individual Income	Basis of Capital Gains on Gifts	2.500	2.600	4.200
Motor Vehicle	Immediate Family Member	16.900	17.600	18.000
Motor Vehicle	Transfers by Will or Court Order	2.900	3.000	3.100
Sales Tax	Tombstones and Other Grave Markers	3.800	3.900	4.000
	Federal Government Support	**10.800**	**10.900**	**10.900**
Sales Tax	Federal Taxes Imposed on Sales of Tangible Personal Property	6.400	6.400	6.400
Individual Income	Interest on U.S. Savings Bonds	4.400	4.500	4.500

Tax Type		FY08	FY09	FY10
	Health Care Support	**907.289**	**989.139**	**1,075.792**
Motor Vehicle	Adapted Equipment for Physically Handicapped Persons	0.063	0.065	0.067
Sales Tax	Prescription Medicine, Prosthetic Devices and Physical Aids	322.300	332.000	341.900
Sales Tax	Procurement, Processing or Distribution of Blood or Human Tissue	7.300	7.700	8.200
Individual Income	Exclusion of Employer Contributions for Medical Insurance Premiums and Care	538.400	603.600	674.000
Individual Income	Health Savings Accounts	6.500	8.500	9.300
Individual Income	Deductibility of Medical Expenses	16.200	19.100	22.500
Insurance Premiums	Health Insurance For State Employees	15.060	16.665	18.270
Insurance Premiums	Hospital, Medical, or Dental Service Companies	1.466	1.509	1.555
	Housing Development	**501.300**	**531.100**	**563.100**
Individual Income	Passive Loss Rules Exception	24.700	25.600	26.200
Individual Income	Deductibility of Home Mortgage Interest	293.800	316.200	340.100
Individual Income	Deductibility of Property Tax on Owner-Occupied Homes	41.500	41.400	41.300
Individual Income	Gain on the Sale of a Personal Residence	127.700	134.100	140.800
Real Property Tax	Homestead Exemption	13.600	13.800	14.700
Sales Tax	Lodgings of Thirty Days or More	substantial	substantial	substantial
	Income Maintenance	**689.160**	**709.490**	**725.220**
Individual Income	Cancellation of Indebtedness	0.470	0.370	0.270
Individual Income	Job Expenses and Other Miscellaneous Deductions	32.400	34.500	37.000
Individual Income	Standard Deduction	101.700	103.700	105.800
Individual Income	Exclusion of Worker's Compensation Benefits	19.200	19.500	19.700
Individual Income	Exclusion of Public Assistance Benefits	1.600	1.700	1.700
Individual Income	Expanded Low Income Tax Credit	64.600	65.900	67.200
Individual Income	Deductibility of Casualty and Theft Losses	0.990	1.020	1.050
Motor Vehicle	Trade-In Allowance on Used Vehicles	35.000	36.600	37.400
Sales Tax	Food Items	430.000	442.900	451.800
Sales Tax	Garage or Yard Sales	2.000	2.000	2.000
Special Fuels	Residential Heating	1.200	1.300	1.300
	Intergovernmental Transfers	**12.000**	**12.600**	**13.200**
Individual Income	Exclusion of Income Earned Abroad by US Citizens	12.000	12.600	13.200
	Job Development	**147.635**	**155.635**	**161.835**
Corporation Income	Unemployment Tax Credit	0.015	0.015	0.015
Corporation Income	KREDA Economic Development Credit	15.000	15.500	16.000
Corporation Income	KIDA Economic Development Credit	7.900	8.100	8.300
Corporation Income	KIRA Economic Development Credit	7.000	7.200	7.400
Corporation Income	KJDA Economic Development Credit	9.900	10.200	10.500
Corporation Income	Skills Training Investment Tax Credit	0.120	0.120	0.120
Individual Income	Employee Stock Ownership Plan Provisions	1.200	1.300	1.300
Individual Income	U.S. Production Activities	8.000	8.200	10.900
Individual Income	Exclusion of Employee Benefits Premiums on Group Term Life Insurance, Accident and Disability Insurance	8.700	8.900	9.100
Individual Income	Exclusion of Employee Meals and Lodging on Employer Premises	3.200	3.300	3.500
Individual Income	Credit for Hiring Unemployed	minimal	minimal	minimal
Individual Income	Exclusion of Miscellaneous Fringe Benefits	12.300	13.100	13.900
Individual Income	Job Development Credit	74.300	79.700	80.800
	Military Support	**32.220**	**33.390**	**34.650**
Individual Income	Armed Forces Personnel Benefits and Allowances	11.400	11.800	12.300
Individual Income	Exclusion of GI Bill Benefits	0.920	0.990	1.050
Individual Income	Exclusion of Veteran's Disability Benefits	13.400	13.800	14.400
Inheritance Tax	Benefits Paid to a Beneficiary of Military Personnel Under Certain Retirement Plans	minimal	minimal	minimal
Inheritance Tax	Benefits Paid by the Federal Government Due to Service in Time of War	minimal	minimal	minimal
Motor Vehicle	Military Exemption	6.500	6.800	6.900
	Natural Resource	**10.580**	**10.810**	**11.010**
Individual Income	Deductibility of Excess of Percentage Over Cost Depletion	0.330	0.360	0.360
Natural Resources	Transportation Expense	3.000	3.100	3.200
Natural Resources	Limestone Sold in Interstate Commerce	3.100	3.200	3.300
Natural Resources	Ball Clay, Fluorspar, Lead, Zinc, Tar Sands, Barite, and Stone Used for Privately Maintained but Publicly Dedicated Roads	0.250	0.250	0.250
Natural Resources	Limit on Tax from Clay	minimal	minimal	minimal
Corporation Income	Excess of Percentage over Cost Depletion	3.900	3.900	3.900

Tax Type		FY08	FY09	FY10
Natural Resources	Clay Used in Landfill Construction	0.000	0.000	0.000
	Retirement Support	**616.900**	**636.500**	**687.500**
Individual Income	Net Exclusion of Pension Contributions and Earnings	159.200	157.800	152.300
Individual Income	Exclusion of Social Security Benefits: OASI for Retirees Disability Insurance Survivors' Benefits	147.200	149.100	176.700
Individual Income	Deductibility of Individual Retirement Account Contributions	21.800	23.400	26.700
Individual Income	Deductibility of Keogh Plan Contributions	32.800	35.000	38.100
Individual Income	Exclusion of Federal and Military Retirement Income Received	55.000	57.600	60.500
Individual Income	Exclusion of Railroad and Supplemental Railroad Retirement System Benefits	1.300	1.300	1.200
Individual Income	Exclusion of State Employee Pension Benefits and Contributions	54.200	60.200	71.400
Individual Income	Exclusion of Private Pensions and Individual Retirement Accounts	144.400	151.000	159.500
Individual Income	Exclusion of Special Benefits for Disabled Coal Miners	1.000	1.100	1.100
Inheritance Tax	Annuities Under Qualified Retirement Plans	minimal	minimal	minimal
Inheritance Tax	Individual Retirement Accounts	minimal	minimal	minimal
	State and Local Government Support	**326.720**	**335.847**	**349.359**
Individual Income	Deductibility of State and Local Taxes Other Than Home Property Taxes	91.600	91.300	93.800
Individual Income	Precinct Workers	0.100	0.100	0.100
Individual Income	Capital Gains - Eminent Domain	minimal	minimal	minimal
Real Property Tax	Leasehold Interest in Buildings Financed with Industrial Revenue Bonds	2.900	2.100	2.200
Real Property Tax	Property of Local Governments in Neighboring States	0.020	0.020	0.020
Tangible Property Tax	Leasehold Interests	3.900	3.900	3.900
Tangible Property Tax	Property of Local Government in Neighboring States	0.000	0.000	0.000
Sales Tax	State, Cities, Counties and Special Districts	222.000	232.000	242.700
Sales Tax	Rate Increase for School Taxes added to Residential Telephone Bills	5.800	6.000	6.200
Sales Tax	Water Withdrawal Fees Paid to Kentucky River Authority	0.083	0.083	0.083
	Personal Property in Vending Stands Operated by the Blind	minimal	minimal	minimal
Special Fuels	State and Local Government Use	0.317	0.344	0.356
	Transportation Industry Support	**111.490**	**117.159**	**120.636**
Gasoline Tax	Aircraft Refund	0.478	0.519	0.536
Gasoline Tax	Watercraft Refund	0.457	0.496	0.512
Gasoline Tax	Bus, Taxicab, and Certain Senior Citizen's Program Refund	0.473	0.513	0.530
Motor Vehicle	Commercial Motor Vehicle Exemption	minimal	minimal	minimal
Motor Vehicle	Large Truck Exclusion	27.000	28.300	28.900
Motor Vehicle	Charter Bus Exemption	0.052	0.054	0.056
Real Property Tax	Intrastate Railroads and Railway Companies	0.022	0.022	0.022
Tangible Property Tax	Intrastate Railroads and Railway Companies	0.175	0.175	0.175
Tangible Property Tax	Interstate Trucks, Tractors, Semi-Trailers and Buses	3.600	3.900	3.900
Tangible Property Tax	Carlines	4.300	4.300	4.300
Tangible Property Tax	Aircraft	1.400	1.400	1.400
Tangible Property Tax	Federally Documented Vessels	0.460	0.460	0.460
Sales Tax	Sales to Common Carriers Under a Bill of Lading	0.000	0.000	0.000
Sales Tax	Semi-Trailers and Trailers	minimal	minimal	minimal
Sales Tax	Vessels and Maritime Supplies	3.400	3.400	3.400
Sales Tax	Interstate Cargo and Passenger Aircraft, Parts and Supplies	9.600	9.600	9.600
Sales Tax	Locomotives and Rolling Stock	substantial	substantial	substantial
Sales Tax	Jet Fuel	36.000	38.000	40.000
Sales Tax	Repair Parts for Large Trucks	1.700	1.800	1.800
Sales Tax	Charter Bus Repair & Replacement Parts	0.100	0.110	0.120
Special Fuels	Railroad Companies	21.800	23.600	24.400
Special Fuels	Bus, Taxicab and Certain Senior Citizen's Programs Refunds	0.428	0.465	0.480
Special Fuels	Watercraft	0.045	0.045	0.045

Alcoholic Beverage Taxes

Background

Alcoholic beverage excise taxes on distilled spirits, beer, and wine became effective in 1936 at the following rates: distilled spirits - $1.04 a gallon; beer - $1.50 a barrel; and wine - $0.25 a gallon.

In 1940, the excise tax rate for distilled spirits was raised to $1.20 and in 1948, it was raised to $1.28. In 1970, the rate was raised to $1.92 a gallon where it remains today. In 1986, the tax rate was lowered to $0.25 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 contents of such containers.

In 1954, the rate on wine excise was raised to $0.50 a gallon, and the rate on beer excise was increased to $2.50 a barrel ($0.083/gallon). Effective August 1, 1992, the liability for the excise tax on beer was shifted from the brewer to the distributor or retailer.

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". The 2005 General Assembly raised the wholesale sales tax to 11 percent effective June 1, 2005.

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.

Current Rate Structure

Total alcoholic beverage taxes were $102.2 million in FY07, which represents 1.02 percent of the total General Fund revenue.

Distilled Spirits Excise Tax	$1.92 a gallon
Beer Excise Tax	$2.50 a barrel
Wine Excise Tax	$0.50 a gallon
Wholesale Sales Tax	11% of gross receipts
Distilled Spirits Case Sales Tax	$0.05 per case

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 Department of Revenue on or before the twentieth day of the month following the month in which the transactions occurred.

Exemptions

- Wine manufactured, sold, given away or distributed and used solely for sacramental purposes.
- Distilled spirits and wine purchased by holders of special licenses provided for in KRS 243.320 and 243.330 and used as non-beverage alcohol, e.g. medicinal alcohol, antiseptic alcohol, flavoring extracts, syrups, etc.
- Holders of railroad or commercial airline system licenses exempt from excise tax.
- Sales to federal agencies and instrumentalities.
- Sales for shipment outside Kentucky for sales through retail outlets and consumption outside Kentucky.

Table 1. Total Alcoholic Beverage Tax Expenditures

FY 2008	FY 2009	FY 2010
$0.87 million	$0.87 million	$0.87 million

Tax Expenditures

1. 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.

FY 2008	FY 2009	FY 2010
$825,000	$825,000	$825,000

2. Low Volume Distilled Spirits Taxed at Reduced Rate

Kentucky Revised Statute 243.720(1)(b), 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.

FY 2008	FY 2009	FY 2010
$40,000	$40,000	$40,000

Background

KRS 136.500 through 136.575 was enacted during the 1996 Session of the Kentucky General Assembly and was titled the Bank Franchise and Local Deposit Tax Act. Within the same act, the General Assembly repealed KRS 136.270, commonly called the bank shares tax. The new statutory scheme for the bank franchise tax became effective July 15, 1996.

In the early part of 1996, the statutory structure of KRS 136.270 was being challenged in the courts and receipts were rapidly diminishing because of the litigation. The ongoing court proceedings were a result of discontent within the banking community with the method by which the Department of Revenue arrived at fair market values. Sometimes, banks were surprised by large and unexpected property tax assessments. Bank officials felt that there had to be a better way to calculate the liability, one that was more stable and did not fluctuate with economic trends. The new tax was enacted and implemented as a partnership between the Department of Revenue, the Kentucky Bankers Association, and the banking community. With the enactment, the court cases were settled, receipts were stabilized, and the banking community welcomed a reliable and steady tax environment.

Current Rate Structure

The bank franchise tax is assessed at the rate of 1.1 percent of net capital averaged over five years with a minimum of $300 per year.

Tax Base

Every financial institution regularly engaged in business in Kentucky is required to pay an annual state franchise tax measured by its net capital as apportioned, if applicable. A financial institution is presumed to be regularly engaging in business in Kentucky if during any taxable year it obtains or solicits business with 20 or more persons within Kentucky, or if receipts attributable to sources in Kentucky equal or exceed $100,000.

The bank franchise tax is in lieu of all city, county and local taxes, except the real estate transfer tax levied in KRS Chapter 142, real property and tangible personal property taxes levied in KRS Chapter 132, the local franchise tax levied in KRS 136.575, and taxes upon users of utility services. Every financial institution regularly engaged in business in Kentucky is subject to all state taxes except the corporation income tax and the limited liability entity tax levied in KRS Chapter 141.

Tax Due

Returns and payment of the tax are due on the fifteenth day of March reflecting the tax computation for the preceding calendar year. An automatic extension of up to ninety days for the filing of returns will be granted upon receipt of a written request.

Table 2. Total Bank Franchise Tax Expenditures

FY 2008	FY 2009	FY 2010
$0	$0	$0

Tax Expenditures

1. Kentucky Historic Preservation Credit

Kentucky Revised Statute 171.397, effective for tax periods ending on or after 12/31/2005

The 2005 Kentucky General Assembly created the Kentucky Historic Preservation Credit. The credit applies to individual income tax, corporation income tax, limited liability entity tax, or the bank franchise tax. The credit may be an amount equal to 30 percent of the qualified rehabilitation expenses, in the case of owner-occupied residential property, and 20 percent of the qualified rehabilitation expenses, in the case of all other property. The maximum credit which may be claimed with regard to owner-occupied residential property is $60,000. The total amount of credit approved for a calendar year for all taxpayers is limited to the certified rehabilitation credit cap of $3 million.

FY 2008	FY 2009	FY 2010
$0	$0	$0

2. Kentucky Investment Fund Credit

Kentucky Revised Statute 154.20-255, effective July 15, 2002

The 2002 Kentucky General Assembly amended the Kentucky Investment Fund Act (KIFA) so that the KIFA tax credit may now be applied against the bank franchise tax. A financial institution that makes a cash contribution to an investment fund approved by the Kentucky Economic Development Finance Authority (KEDFA) is entitled to a nonrefundable credit equal to 40 percent of the investor's proportional ownership share of all qualified investment made by its investment fund and verified by the authority. To claim the credit, a copy of the notification from KEDFA reflecting the amount of credit granted and the year in which the credit may first be claimed must be attached to the return.

FY 2008	FY 2009	FY 2010
$0	$0	$0

Coal Severance and Processing Tax

Background

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

During FY07, the coal tax produced $222.0 million, which accounted for 2.6 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

FY 2008	FY 2009	FY 2010
$24.3 million	$24.7 million	$24.8 million

Tax Expenditures

1. Coal Used to Burn Solid Waste

Kentucky Revised Statute 143.023, effective1991

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.

FY 2008	FY 2009	FY 2010
$0	$0	$0

2. Thin Seam Tax Credit

Kentucky Revised Statute 143.021, effective2000

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.

FY 2008	FY 2009	FY 2010
$600,000	$600,000	$600,000

3. Transportation Expense

Kentucky Revised Statute 143.010(6), and (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.

FY 2008	FY 2009	FY 2010
$23.7 million	$24.1 million	$24.2 million

4. Coal Purchased for Alternative Energy or Gasification Facility

Kentucky Revised Statute 154.270, effective January 1, 2008

An approved company that purchases or severs coal used by an alternative fuel facility or a gasification facility may be eligible for an incentive equal to eighty percent of the severance taxes paid on the purchase or severance of coal that is specifically used as feedstock for the facility.

FY 2008	FY 2009	FY 2010
$0	$0	$0

Background

The corporation income tax was first levied in 1936. The rate was 4 percent of net income attributable to Kentucky after the deduction of federal income tax. In 1972 the deduction of federal income tax was repealed. Several rate changes have occurred, including increasing the top rate of the graduated scale to 7.25 percent and 8.25 percent in 1985 and 1990, respectively.

The 2005 General Assembly made significant changes to the corporation income statutes by:

- including limited liability entities within the definition of corporation;
- providing an alternative minimum calculation with two optional calculations;
- reducing the top rate of the graduated scale to seven percent (7%) for taxable years beginning on or after January 1, 2005 and prior to January 1, 2007 and six percent (6%) for taxable years beginning on or after January 1, 2007; and
- closing multiple loopholes in order to provide a broader base on which to assess the lower rates.

During the 2006 Special Session of the General Assembly, the inclusion of limited liability entities and the alternative minimum calculation were repealed. Effective for taxable periods beginning on or after January 1, 2007, only formally incorporated entities file the corporation income tax return. The treatment of pass-through income from limited liability pass-through entities conforms to the federal treatment. The alternative minimum calculation was eliminated and a new limited liability entity tax was enacted. This new tax is described in the tab marked “Limited Liability Entity Tax,” which follows later in this publication.

Corporate income, license, and limited liability entity tax receipts for FY07 were $988.1 million and accounted for 11.5 percent of total General Fund tax receipts.

Table 4. Corporation Income Tax Rates

Current Rate Structure

For taxable years beginning after December 31, 2006

First	-	$50,000	4.00%
$50,001	-	$100,000	5.00%
Over	-	$100,000	6.00%

Tax Base

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 taxable only in Kentucky, taxable net income is the same as "net income". For corporations taxable 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:

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

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

Every corporation doing business in this state must pay an annual tax. The term "doing business" is defined to include, but is not limited to:

- Being organized under the laws of this state;
- Having a commercial domicile in this state;
- Owning or leasing property in this state;
- Having one or more individuals performing services in this state;

- Deriving income from or attributable to sources within this state, including deriving income directly or indirectly from a trust doing business in this state; or
- Directing activities at Kentucky customers for the purpose of selling them goods or services.

The following corporations are specifically exempted from the corporation icome 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) Banks for cooperatives;
(d) Production credit associations;
(e) Insurance companies, including farmers' or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;
(f) Corporations or other entites exempt under Section 501 of the IRC;
(g) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit; and
(h) Corporations whose only owned or leased property located in this state is located at the premises of a printer with which it has contracted for printing, provided that (1) the property consists of the final printed product, or copy from which the printed product is produced; and (2) the corporation has no employee receiving compensation in this state as provided in KRS 141.120(8) (b).

Tax Due

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. However, to avoid penalty, the entire amount of tax due must be paid by the original due date of the return.

Table 5. Total Corporation Income and License Tax Expenditures

FY 2008	FY 2009	FY 2010
$312.7 million	$336.6 million	$345.7 million

Exemptions

1. Coal Royalties

Kentucky Revised Statute 141.010(12)(d), effective 1962

A corporation 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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

2. Credit Unions

Kentucky Revised Statute 290.115, effective 1954

Credit unions are exempt from corporation income tax.

FY 2008	FY 2009	FY 2010
$4.9 million	$5.2 million	$5.5 million

3. Dividend Income

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

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

FY 2008	FY 2009	FY 2010
$180.3 million	$185.7 million	$191.3 million

4. Homeowners' Associations

Kentucky Revised Statute 141.010(14)(c), effective 1998

Certain income of qualified homeowners' associations is considered exempt function income and is therefore not taxable for income tax purposes.

FY 2008	FY 2009	FY 2010
$48,000	$50,000	$52,000

5. Real Estate Investment Trust

Kentucky Revised Statute 141.010(14)(d), effective 1998

REIT's are allowed the dividend paid deduction for corporation income tax if the REIT is not a captive real estate investment trust as defined by KRS 141.010(29).

FY 2008	FY 2009	FY 2010
Substantial	Substantial	Substantial

Deductions from Income

6. Tobacco Settlement

Kentucky Revised Statute 141.010(12) (i), (j), (k), (l), and (n), effective various dates

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

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

7. 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.

FY 2008	FY 2009	FY 2010
$10.7 million	$11.0 million	$11.3 million

8. 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.

FY 2008	FY 2009	FY 2010
$3.9 million	$3.9 million	$3.9 million

9. Leasehold Interest of Property Contributed as Living Quarters for Homeless

Kentucky Revised Statute 141.0202, effective 1990

A deduction is allowed for the value of any leasehold interest of property contributed to a charitable organization if the leased property is to be used by the charitable organization to provide temporary living quarters for a homeless family.

FY 2008	FY 2009	FY 2010
$0	$0	$0

10. Net Operating Loss Deduction

Kentucky Revised Statute 141.010(13), effective 1980

In calculating Kentucky taxable income, a corporation may carry forward a net operating loss for twenty years, in order to reduce taxable income in profitable years. The net operating loss carry back deduction is not allowed for losses incurred in tax years beginning on or after January 1, 2005.

FY 2008	FY 2009	FY 2010
$43.7 million	$44.3 million	$43.5 million

11. 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.

FY 2008	FY 2009	FY 2010
$15.4 million	$14.5 million	$14.2 million

Tax Credits

12. Biodiesel and Renewable Diesel Tax Credit

Kentucky Revised Statute 141.423, effective 2005

A credit of up to $1 per gallon may be taken for producing or blending biodiesel and renewable diesel fuels. The total amount that may be taken is capped each fiscal year. The amounts shown below are equal to the capped total for each year.

FY 2008	FY 2009	FY 2010
$1.5 million	$5.0 million	$10.0 million

13. Clean Coal Incentive Credit

Kentucky Revised Statutes 141.428, effective 2007

A credit is available at a rate of $2 per ton of qualifying coal burned by an electricity generation facility investing more than $150 million and certified by the Natural Resources and Environmental Protection Cabinet as using clean coal equipment and technology and burning coal subject to Kentucky's severance tax.

FY 2008	FY 2009	FY 2010
$0	$0	$0

14. Coal Conversion Credit

Kentucky Revised Statutes 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.

FY 2008	FY 2009	FY 2010
$0	$0	$0

15. Coal Incentive Credit

Kentucky Revised Statute 141.0405, effective 2000

A credit is allowed to any electric power company or any entity that operates a coal-fired electric generation plant, is an alternative fuel facility or gasification facility. 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.

FY 2008	FY 2009	FY 2010
$1,000	$1,000	$97,000

16. Construction of Research Facilities Credit

Kentucky Revised Statute 141.395, effective July 15, 2002

Five percent of the qualifed costs of construction of research facilities is allowed as a nonrefundable credit against corporation income tax.

FY 2008	FY 2009	FY 2010
$2.2 million	$2.8 million	$3.5 million

17. Employer GED Credit

Kentucky Revised Statute 141.395, effective July 15, 2002

An employer who assists an individual to complete coursework leading to his or her high school equivalency diploma (GED) shall receive a state tax credit against the income tax equal to 50 percent of the student's hourly salary for time released by the employer to study for test, limited to a total of $1,250.

FY 2008	FY 2009	FY 2010
$0	$0	$0

18. 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 Hopkinsville enterprise zone is the only one of the original ten enterprise zones in Kentucky still in existence, and it is due to expire on December 21, 2007.

FY 2008	FY 2009	FY 2010
$50,000	$0	$0

19. Environmental Remediation Tax Credit

Kentucky Revised Statute 141.418, effective 2005

Taxpayers who agree to clean up or develop an existing abandoned brownfield area may qualify for a credit against corporation income taxes in a maximum amount of $150,000.

FY 2008	FY 2009	FY 2010
$1.0 million	$1.0 million	$1.0 million

20. Environmental Stewardship Tax Credit

Kentucky Revised Statute 154.48, effective 2007

A credit is available for a taxpayer undertaking an environmental stewardship project with a minimum investment of at least $5 million. The credit covers 100 percent of eligible skills upgrade training costs and up to 25 percent of eligible equipment costs. The Cabinet for Economic Development approves a project producing a new or improved manufactured product that has a lesser or reduced adverse effect on human health or the environment for a taxpayer meeting certain wage requirements.

FY 2008	FY 2009	FY 2010
$5.0 million	$5.0 million	$5.0 million

21. Kentucky Investment Fund Tax Credit

Kentucky Revised Statute 154.20-259, 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.

FY 2008	FY 2009	FY 2010
$50,000	$50,000	$50,000

22. Kentucky Reinvestment Act Credit

Kentucky Revised Statute 154.34, effective June 24, 2003

Large automotive manufacturers may receive a credit against costs incurred for reinvesting in existing facilities in Kentucky.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

23. (KEOZ) Economic Development Credit

Kentucky Revised Statute 141.401, 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.

FY 2008	FY 2009	FY 2010
$0	$0	$0

24. (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.

FY 2008	FY 2009	FY 2010
$7.9 million	$8.1 million	$8.3 million

25. (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.

FY 2008	FY 2009	FY 2010
$7.0 million	$7.2 million	$7.4 million

26. (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.

FY 2008	FY 2009	FY 2010
$9.9 million	$10.2 million	$10.5 million

27. (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.

FY 2008	FY 2009	FY 2010
$15.0 million	$15.5 million	$16.0 million

28. Qualified Farming Operation Credit

Kentucky Revised Statute effective 1988

A corporation engaged in farming in Kenucky that provides raw materials for food producing facilities in Kentucky, that purchases new buildings or equipment, or that incurs training expenses to support its participation in a networking project is entitled to a nonrefundable credit for those charges against the corporation income tax imposed on income arising from its participation in the networking project.

FY 2008	FY 2009	FY 2010
$0	$0	$0

29. 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 is allowed.

FY 2008	FY 2009	FY 2010
$4.0 million	$4.0 million	$4.0 million

30. 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.

FY 2008	FY 2009	FY 2010
$120,000	$120,000	$120,000

31. 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.

FY 2008	FY 2009	FY 2010
$15,000	$15,000	$15,000

32. Ethanol and Cellulosic Ethanol Tax Credit

Kentucky Revised Statute 141.422-425, effective January 1, 2008

A producer of ethanol or cellulosic ethanol is allowed a credit equal to $1 per gallon, capped at a total of $5 million in credits authorized for each type of product per year for all producers.

FY 2008	FY 2009	FY 2010
$0	$10.0 million	$10.0 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. In 2006, the minimum wholesale price was increased to $1.342, raising the minimum tax to 17.1 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 FY07, gasoline tax collections totaled $397.6 million. This accounted for 32.4 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 $1.342 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.

Table 6. Total Gasoline Tax Expenditures

FY 2008	FY 2009	FY 2010
$11.6 million	$12.5 million	$12.9 million

Tax Expenditures

1. 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.

FY 2008	FY 2009	FY 2010
$50,000	$53,000	$55,000

2. Aircraft Refund

Kentucky Revised Statute 138.341, effective 1942

One hundred 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.

FY 2008	FY 2009	FY 2010
$478,000	$519,000	$536,000

3. 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.

FY 2008	FY 2009	FY 2010
$473,000	$513,000	$530,000

4. 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.

FY 2008	FY 2009	FY 2010
$10.1 million	$10.9 million	$11.3 million

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.

FY 2008	FY 2009	FY 2010
$457,000	$496,000	$512,000

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 $3.0 billion in FY07, a growth of 4.2 percent over the prior year. This amount accounted for 35.5 percent of total General Fund receipts for the 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 currently references the Internal Revenue Code in effect on December 31, 2006.

Kentucky income tax law provides for 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.

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

Current Rate Structure

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
$8,001	-	$75,000	5.8
Over	-	$75,000	6

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 ($2,050 for 2007) or, at the option of the taxpayer, itemized deductions. Gross income is defined as gross income under the 2006 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.

Table 8. Total Individual Income Tax Expenditures

FY 2008	FY 2009	FY 2010
$2.630 billion	$2.793 billion	$2.997 billion

Tax Expenditures - Exclusions from Income

1. Armed Forces Personnel Benefits and Allowances

Internal Revenue Code Section 112, effective 1996, and
Internal Revenue Code Section 134, effective 1986

The housing and meals provided military personnel, either in cash or in kind, as well as certain amounts of pay related to combat service, are excluded from income subject to tax.

FY 2008	FY 2009	FY 2010
$11.4 million	$11.8 million	$12.3 million

2. Assistance for Adopted Foster Children and Foster Care Payments

Internal Revenue Code Section 131 and 137, effective 2002 and 1978, respectively

Taxpayers who adopt eligible children from the public foster care system can receive monthly payments for the children's significant and varied needs and a reimbursement of up to $2,000 for nonrecurring adoption expenses. These payments are excluded from gross income. This federal provision will sunset for taxable years beginning after December 31, 2010. Additionally, gross income does not include amounts received by a foster care provider.

FY 2008	FY 2009	FY 2010
$2.8 million	$3.0 million	$3.2 million

3. Cancellation of Indebtedness

Internal Revenue Code Section 108, effective 1980

Individuals are not required to report the cancellation of certain indebtedness as current income. If the canceled debt is not reported as current income, however, the basis of the underlying property must be reduced by the amount canceled.

FY 2008	FY 2009	FY 2010
$470,000	$370,000	$270,000

4. Capital Gains - Eminent Domain

Kentucky Revised Statute 141.010(10), effective 1998

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

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

5. Disabled Coal Miners

Internal Revenue Code Section 104 and 192, effective 1981

Although it is income to the recipient, disability payments to former coal miners out of the Black Lung Trust Fund are not subject to the income tax.

FY 2008	FY 2009	FY 2010
$1.0 million	$1.1 million	$1.1 million

6. Employee Stock Ownership Plan Provisions

Internal Revenue Code Section 421, effective 1981

Employer-paid contributions to ESOP's are deductible by the employer as part of employee compensation costs. They are not included in the employee's gross income for tax purposes, however, until they are paid out as benefits.

FY 2008	FY 2009	FY 2010
$1.2 million	$1.3 million	$1.3 million

7. Employer Contributions for Medical Insurance and Medical Care

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

Employer-paid health insurance premiums and other medical expenses (including long-term care) are deducted as a business expense by employers, but they are not included in employee gross income. The self-employed also may deduct up to 100 percent of their family health insurance premiums.

FY 2008	FY 2009	FY 2010
$538.4 million	$603.6 million	$674.0 million

8. Employer-Provided Benefits of Premiums on Group Term Life, Accident and Disability Insurance

Internal Revenue Code Section 79(a) and 106, effective 1955

Employer payment of employee group term life insurance premiums for coverage up to $50,000 per employee is excluded from an employee's gross income even though the employer's cost for the benefit is a deductible business expense.

FY 2008	FY 2009	FY 2010
$7.7 million	$7.8 million	$8.0 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.

FY 2008	FY 2009	FY 2010
$1.0 million	$1.1 million	$1.1 million

9. Employer-Provided Child Care Exclusion

Internal Revenue Code Section 129, effective 1981

Up to $5,000 of employer-provider child care is excluded from an employee's gross income even though the employer's costs for the child care are a deductible business expense.

FY 2008	FY 2009	FY 2010
$3.4 million	$3.6 million	$3.7 million

10. Employer-Provided Educational Assistance

Internal Revenue Code Section 127, effective 1986

Employer-provided educational assistance is excluded from an employee's gross income.

FY 2008	FY 2009	FY 2010
$2.2 million	$2.3 million	$2.4 million

11. Employer-Provided Meals and Lodging

Internal Revenue Code Section 119, effective 1978

Employer-provided meals and lodging are excluded from an employee's gross income even though the employer's costs for these items are a deductible business expense.

FY 2008	FY 2009	FY 2010
$3.2 million	$3.3 million	$3.5 million

12. 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.

FY 2008	FY 2009	FY 2010
$55.0 million	$57.6 million	$60.5 million

13. 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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

14. Gain on the Sale of a Personal Residence

Internal Revenue Code Section 121, effective 1997

A homeowner can exclude from tax up to $500,000 ($250,000 for singles) of the capital gains from the sale of a principal residence. The exclusion may not be used more than once every two years.

FY 2008	FY 2009	FY 2010
$127.7 million	$134.1 million	$140.8 million

15. Exclusion of GI Bill Benefits

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

GI bill benefits paid by the Veterans Administration are excluded from gross income.

FY 2008	FY 2009	FY 2010
$920,000	$990,000	$1.05 million

16. Income Earned Abroad by U.S. Citizens

Internal Revenue Code Section 911 and 912, effective 1985

U.S. citizens who lived abroad, worked in the private sector, and satisfied a foreign residency requirement may exclude up to $80,000 in foreign earned income from U.S. taxes. In addition, if these taxpayers receive an allowance for foreign housing from their employers, they may also exclude the value of that allowance. Federal civilian employees and Peace Corps members who work outside the continental United States are allowed to exclude from U.S. taxable income allowances they receive to compensate them for the relatively high costs associated with living overseas. The allowances supplement wage income and cover expenses like rent, education and the cost of travel to and from the United States.

FY 2008	FY 2009	FY 2010
$12.0 million	$12.6 million	$13.2 million

17. Interest on Life Insurance Savings

Internal Revenue Code Section 101(a), effective 1978

Favorable tax treatment is provided for investment income within qualified life insurance and annuity contracts. Investment income earned on qualified life insurance contracts held until death is permanently exempt from income tax. Investment income distributed prior to the death of the insured is tax-deferred, if not tax-exempt. Investment income earned on annuities is treated less favorably than income earned on life insurance contracts, but it benefits from tax deferral without annual contribution or income limits generally applicable to other tax-favored retirement income plans.

FY 2008	FY 2009	FY 2010
$65.4 million	$74.7 million	$83.0 million

18. 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.

FY 2008	FY 2009	FY 2010
$12.3 million	$13.1 million	$13.9 million

19. Passive Loss Rules Exception

Internal Revenue Code Section 469, effective 1993

In general, passive losses may not offset income from other sources. Losses up to $25,000 attributable to certain rental real estate activity, however, are exempt from this rule.

FY 2008	FY 2009	FY 2010
$24.7 million	$25.6 million	$26.2 million

20. Pension Contributions and Earnings from Employer Plans

Kentucky Revised Statute 141.010(10)(d), effective 1983

Employer contributions to pension plans are excluded from an employee's gross income even though the employer can deduct the contributions. In addition, the tax on the investment income earned by the pension plans is deferred until the money is withdrawn.

FY 2008	FY 2009	FY 2010
$159.2 million	$157.8 million	$152.3 million

21. 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.

FY 2008	FY 2009	FY 2010
$100,000	$100,000	$100,000

22. 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.

FY 2008	FY 2009	FY 2010
$1.6 million	$1.7 million	$1.7 million

23. Private Pensions and Individual Retirement Accounts

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

Up to $41,110 in benefits received by the taxpayer from private pensions, Individual Retirement Accounts (IRAs), and Roth IRAs is exempted from income.

FY 2008	FY 2009	FY 2010
$144.4 million	$151.0 million	$159.5 million

24. 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.

FY 2008	FY 2009	FY 2010
$1.3 million	$1.3 million	$1.2 million

25. Scholarship and Fellowship Income

Internal Revenue Code Section 117, effective 1954

Scholarships and fellowships are excluded from taxable income to the extent they pay for tuition and course-related expenses of the grantee. Similarly, tuition reductions for employees of educational institutions and their families are not included in taxable income.

FY 2008	FY 2009	FY 2010
$6.4 million	$6.7 million	$7.1 million

26. Social Security Benefits for Retired Workers, Disabled Workers, and Dependents and Survivors

Internal Revenue Code Section 86, effective 1954 and KRS 141.010(10)(e)

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.

FY 2008	FY 2009	FY 2010
$147.2 million	$149.1 million	$176.7 million

27. 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.

FY 2008	FY 2009	FY 2010
$54.2 million	$60.2 million	$71.4million

28. Tobacco Settlement Income

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.

FY 2008	FY 2009	FY 2010
$6.0 million	$6.0 million	$6.0 million

29. Veteran's Pension, Death and Disability Compensation

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

All compensation due to pension payments, death or disability paid by the Veterans Administration is excluded from taxable income.

FY 2008	FY 2009	FY 2010
$13.4 million	$13.8 million	$14.4 million

30. Worker's Compensation Benefits

Internal Revenue Code Section 104(a), effective 1954

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

FY 2008	FY 2009	FY 2010
$19.2 million	$19.5 million	$19.7 million

Tax Expenditures - Deductions

31. Casualty and Theft Losses

Internal Revenue Code Section 165, effective 1954

Any uninsured losses incurred by the taxpayer during the tax year as a result of a casualty or theft are deductible as an itemized deduction.

FY 2008	FY 2009	FY 2010
$990,000	$1.02 million	$1.05 million

32. 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.

FY 2008	FY 2009	FY 2010
$176.7 million	$190.7 million	$204.3 million

33. Excess of Percentage over Cost Depletion

Internal Revenue Code Section 613, effective 1981

When property is eligible to be expensed using either the cost or percentage depletion methods, 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.

FY 2008	FY 2009	FY 2010
$330,000	$360,000	$360,000

34. Health Savings Account Deduction

Internal Revenue Code Section 223, effective January 1, 2005

Employee contributions to a Health Savings Account are deductible within the same limitations provided for federal purposes.

FY 2008	FY 2009	FY 2010
$6.5 million	$8.5 million	$9.3 million

35. 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.

FY 2008	FY 2009	FY 2010
$293.8 million	$316.2 million	$340.1 million

36. Individual Retirement Account Contributions

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

Individual taxpayers can take advantage of several different IRAs: deductible IRAs, non-deductible IRAs, and Roth IRAs. The annual contributions limit applies to the total of a taxpayer's deductible, non-deductible, and Roth IRAs contributions. The IRA contribution limit is $5,000 in 2008 and is indexed thereafter. Taxpayers whose AGI is below $100,000 can claim a deduction for IRA contributions. The IRA deduction is phased out for taxpayers with AGI between $80,000 and $100,000. The tax on investment income earned by 401(k) plans, non-deductible IRAs, and deductible IRAs is deferred until the money is withdrawn.

FY 2008	FY 2009	FY 2010
$21.8 million	$23.4 million	$26.7 million

37. Interest on Educational Loans

Internal Revenue Code Section 62(a), effective 1997

Up to $2,500 of interest paid on qualifed educational loans is deductible.

FY 2008	FY 2009	FY 2010
$2.7 million	$2.7 million	$2.8 million

38. Job Expenses and Other Miscellaneous Deductions

Internal Revenue Code Section 62, effective various dates

Unreimbursed employee expenses and various other allowable expenses for individuals are deducted from adjusted gross income to the extent that the total expenses exceed 2 percent of adjusted gross income. Examples of these miscellaneous deductions are: moving expenses, alimony, Archer MSAs, interest on educational loans, higher education expenses and health savings accounts.

FY 2008	FY 2009	FY 2010
$32.4 million	$34.5 million	$37.0 million

39. Keogh Plan Contributions

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

Self-employed individuals can make deductible contributions to their own retirement (Keogh) plans equal to 25 percent of their income, up to an indexed maximum amount of income. Total plan contributions are limited to 25 percent of a firm's total wages. The tax on the investment income earned by Keogh plans is deferred until withdrawn.

FY 2008	FY 2009	FY 2010
$32.8 million	$35.0 million	$38.1 million

40. 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.

FY 2008	FY 2009	FY 2010
$16.2 million	$19.1 million	$22.5 million

41. Net Operating Loss Deduction

Kentucky Revised Statute 141.010(11), effective 1980

The Kentucky net operating loss deduction is permitted in computing adjusted gross income. Beginning in 2005, taxpayers are no longer allowed to carry back a net operating loss but may continue to carry forward any net operating losses.

FY 2008	FY 2009	FY 2010
Substantial	Substantial	Substantial

42. Parsonage Allowances

Internal Revenue Code Section 164(a), effective 1954

The value of a minister's housing allowance and the rental value of parsonages are not included in a minister's taxable income.

FY 2008	FY 2009	FY 2010
$1.8 million	$1.9 million	$2.0 million

43. Property Tax on Owner-Occupied Homes

Internal Revenue Code Section 107, effective 2002

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

FY 2008	FY 2009	FY 2010
$41.5 million	$41.4 million	$41.3 million

44. Standard Deduction

Kentucky Revised Statute 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 inflation. For 2007, the standard deduction was $2,050 per taxpayer.

FY 2008	FY 2009	FY 2010
$101.7 million	$103.7 million	$105.8 million

45. 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.

FY 2008	FY 2009	FY 2010
$91.6 million	$91.3 million	$93.8 million

46. U.S. Production Activities

Internal Revenue Code Section 199, effective 2004

This provision was introduced by the American Jobs Creation Act (AJCA) in 2004 and allows for a deduction equal to a portion of taxable income attributable to domestic production. For taxable periods beginning in 2007, the amount of the deduction is equal to 6 percent of taxable income attributable to domestic production. For taxable years beginning 2008, the amount of the deduction is 7 percent and for taxable years beginning after 2008, the amount of the deduction is 9 percent.

FY 2008	FY 2009	FY 2010
$8.0 million	$8.2 million	$10.9 million

47. Basis of Capital Gains on Gifts

Internal Revenue Code Section 1015, effective 1959

When a gift is made, the donor's basis in the transferred property (the cost that was incurred when the transferred property was first acquired) carries over to the donee. The carryover of the donor's basis allows a continued deferral of unrealized capital gains.

FY 2008	FY 2009	FY 2010
$2.5 million	$2.6 million	$4.2 million

48. Capital Gain on Property Transferred 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.

FY 2008	FY 2009	FY 2010
$117.9 million	$120.7 million	$124.7 million

49. Income Averaging for Farmers

Internal Revenue Code Section 1301, effective 1986 with various amendments

Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming and fishing.

FY 2008	FY 2009	FY 2010
$3.1 million	$3.1 million	$3.3 million

50. Installment Sales

Internal Revenue Code Section 453, effective 1986

Dealers in real and personal property cannot defer taxable income from installment sales until the recipet of the loan repayment. Non-dealers are required to pay interest on deferred taxes attributable to their total installment obligations in excess of $5 million. Only property with sales prices exceeding $150,000 ae includable in the total. The payment of a market rate of interest eliminates the benefit of the tax deferral. The tax exemption for non-dealers with total installment obligations of less than $5 million is, therefore, a tax expenditure.

FY 2008	FY 2009	FY 2010
$3.0 million	$3.1 million	$3.1 million

51. Interest on U.S. Savings Bonds

Internal Revenue Code Section 454, effective 1959

Taxpayers may defer paying tax on interest earned on U.S. savings bonds until the bonds are redeemed.

FY 2008	FY 2009	FY 2010
$4.4 million	$4.5 million	$4.5 million

Tax Expenditures - Credits

52. 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.

FY 2008	FY 2009	FY 2010
$87.0 million	$88.0 million	$89.0 million

53. Child and Dependent Care Credit

Kentucky Revised Statute 141.067, effective 1990

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

FY 2008	FY 2009	FY 2010
$7.6 million	$7.7 million	$7.8 million

54. Credit for Hiring Unemployed

Kentucky Revised Statute 141.065, effective 1982

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

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

55. Expanded Low Income Tax Credit

Kentucky Revised Statute 141.066, effective 1990

Kentucky residents are allowed a low income tax credit based on modified adjusted gross income (MGI) which is equal to federal adjusted gross income plus any interest income from other states' municipal bonds and pension income from a qualifying lump-sum distribution. Single individuals whose MGI and married couples whose combined MGI is at or below federal poverty level for their family size will receive a 100 percent tax credit. The amounts are indexed for inflation each year.

FY 2008	FY 2009	FY 2010
$64.6 million	$65.9 million	$67.2 million

56. Historic Preservation Tax Credit

Kentucky Revised Statute 171.397, effective for tax years beginning on or after January 1, 2005

A credit is allowed against individual income tax for a portion of the cost of restoring a qualifed residential structure listed on the National Registry of Historic Places. The credit is equal to 30 percent of the rehabilitation expenses, in the case of owner-occupied residential property, and 20 percent of the rehabilitation expenses, in the case of all other property. The toal credit available is capped at $3 million annually, with each individual owner-occupied property receiving no more than $60,000.

FY 2008	FY 2009	FY 2010
$3.0 million	$3.0 million	$3.0 million

57. Job Development Credit

Kentucky Revised Statute 154.22-070, 154.24-110, 154.26-100, 154.27, 158.28-110, effective 1992

A job development assessment fee of 6 percent, a job creation assessment fee of 5 percent, a job revitalization assessment fee of 6 percent, an industrial development fee of 3 percent, or an alternative energy development assessment fee of 4 percent may be collected from employees under several economic development plans. A portion of these fees may be claimed as credits on the employees' individual income tax returns.

FY 2008	FY 2009	FY 2010
$74.3 million	$79.7 million	$80.8 million

58. Postsecondary Education Tuition Credit

Kentucky Revised Statute 141.069, effective for tax years beginning on or after January 1, 2005

A credit equal to 25 percent of the amount of the federal Hope Scholarship and the lifetime learning credit is available. The credit applies only to undergraduate studies, phases out for higher incomes and applies to most higher education opportunties within Kentucky.

FY 2008	FY 2009	FY 2010
$9.0 million	$10.0 million	$12.5 million

59. Recycling and/or Composting Equipment Credit

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 post-consumer waste.

FY 2008	FY 2009	FY 2010
$1.2 million	$1.2 million	$1.2 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. Since the phase out of the credit for state death taxes for federal purposes is now complete, Kentucky receives zero receipts from the estate tax portion of the tax. However, if Congress fails to act further on this issue, the state death tax credit returns in 2011, for dates of death occurring after December 31, 2010.

The Kentucky inheritance tax was adopted in 1906, making it the second oldest General Fund tax. The estate tax was enacted in 1936. The tax has seen several significant changes through the years.

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.

During FY07, the inheritance tax produced $43.6 million in General Fund revenues. This was a 5.2 percent decrease from the prior year and accounted for 0.5 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.

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 percent to 16 percent for Class B beneficiaries, and 6 percent 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 9. Total Inheritance And Estate Tax Expenditures

FY 2008	FY 2009	FY 2010
$75.0 million	$71.3 million	$67.7 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.

FY 2008	FY 2009	FY 2010
$60.9 million	$57.9 million	$55.0 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.

FY 2008	FY 2009	FY 2010
$12.9 million	$12.3 million	$11.7 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.

FY 2008	FY 2009	FY 2010
$1.2 million	$1.1 million	$1.0 million

4. Class B Beneficiaries

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

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

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

5. Class C Beneficiaries

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

Class C beneficiaries are granted a $500 exemption.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

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.

FY 2008	FY 2009	FY 2010
Substantial	Substantial	Substantial

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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

9. Annuities Under Qualified Retirement Plans

Kentucky Revised Statute 140.063, effective 1974

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

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

10. Individual Retirement Accounts

Kentucky Revised Statute 140.063(3) and (4), effective 1982

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

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

12. 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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

13. 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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

Insurance Premiums Tax

Background

Insurance premiums taxes include several taxes levied on the receipts of insurance premiums collected by insurers in the Commonwealth. All life insurance companies, all stock and mutual insurance companies other than life, and captive insurers except fraternal assessment life insurance companies doing business in Kentucky must pay a tax on the gross premiums collected from policyholders. The rate of tax varies by type of insurance company: life insurance companies are assessed at a rate of $1.50 per $100 of premium receipts; stock and mutual insurance companies other than life are assessed $2 per $100 of receipts; and all stock insurers other than life, every mutual insurance company and Lloyd's insurer must pay 0.75 percent of premiums paid for fire insurance and for that portion allocable to fire insurance included in other coverage. A captive insurer (defined as an insurance company owned by one or more business entities that are licensed insurance producers and that only insure risks on policies placed through their owners) must pay a minimum of $5,000 and/or a tax calculated on a sliding scale as a percentage of receipts.

The first insurance premiums taxes were adopted in 1942, and have been modified several times since that time.

Current Rate Structure

Life insurance companies .... $1.50 per $100 of premium receipts
Stock insurance companies other than life .... $2.00 per $100 of premium receipts
Mutual insurance companies other than life ... 2% of premiums or other receipts

In addition, every stock insurer other than life, every mutual insurance company and Lloyd's insurer shall pay 0.75% of all amounts paid for fire insurance and that portion allocable to insurance against the hazard of fire included in other coverage.

Captive insurance: Direct premiums:
0.4% on the first $20 million
0.3% on the next $20 million
0.2% on the next $20 million
0.075% on each dollar thereafter

Reinsurance premiums:

0.225% on the first $20 million
0.150% on the next $20 million
0.050% on the next $20 million
0.025% on each dollar thereafter

The minimum tax payable to captive insurers is $5,000 regardless of calculated tax liability.

Tax Base

The tax is levied on premium receipts of insurance companies doing business in Kentucky. Premium receipts include single premiums, annuity premiums, premiums received for original insurance, premiums received for renewal, revival or reinstatement of the policies, annual and periodical premiums, dividends applied for premiums and additions, and all other premium payments received on policies that have been written in Kentucky, or elsewhere on business done in this state, less returned premiums. No deduction is made for dividends on life insurance or annuity policies, but dividends on accident and health insurance policies may be deducted. Premium receipts beginning in calendar year 2000 do not include annuity premiums or annuity dividends.

Tax Due

Any company whose tax was $5,000 or more in the previous year must file a declaration of estimated tax by June 1. The tax must be paid in three equal installments, on June 1, October 1, and March 1 of the following year.

Table 10. Total Insurance Premiums Tax Expenditures

FY 2008	FY 2009	FY 2010
$16.5 million	$18.2 million	$19.8 million

Tax Expenditures

1. Health Insurance for State Employees

Kentucky Revised Statute 136.330(3), effective July 13, 1984

The health insurance contract or contracts for state employees as authorized by KRS 18A.225 shall not be subject to the tax on premium receipts of life insurance companies.

FY 2008	FY 2009	FY 2010
$15.060 million	$16.665 million	$18.270 million

2. Hospital, Medical or Dental Service Companies Exempt From Premium Tax

Kentucky Revised Statute 136.395, effective June 18, 1964

Premiums paid to or received by a hospital service corporation, medical service plan corporation, dental service plan corporation, or a domestic mutual insurer against the risk or cost of medical and/or surgical care organized under KRS 304.24-010 to 304.24-440 and KRS 304.32-010 to 304.32-270 are exempt from the premium tax.

FY 2008	FY 2009	FY 2010
$1.466 million	$1.509 million	$1.555 million

Limited Liability Entity Tax

Background

On June 28, 2006, the Kentucky General Assembly enacted House Bill 1 during a Special Session convened for the purpose of small business tax relief. The bill was signed into law by Governor Fletcher the same day. Within the single piece of legislation were several modifications to the Tax Modernization measures enacted during the 2005 Regular Session. The creation of the limited liability entity tax (LLET) was one of those modifications.

Effective for taxable years beginning on or after January 1, 2007, the LLET is imposed on corporations and other entities which afford limited liability to their owners, including limited liability companies, limited liability partnerships, limited partnerships, and S corporations. The entities may choose between two computational options to calculate the amount of tax due, based on either Kentucky gross receipts or Kentucky gross profits. The lesser amount of tax resulting from the two options is the amount due.

Current Rate Structure

When computing the tax using the gross receipts method, the tax rate is nine and one-half cents per $100 of gross receipts. When computing the tax using the gross profits method, the tax rate is seventy-five cents per $100 of gross profits.

Tax Due

The taxable period for the LLET is the same taxable period used by the entity for income tax purposes. Entities which can reasonably expect their income tax liability plus their LLET liability to exceed $5,000 are required to make a declaration of estimate tax, due in three installments.

The tax return and payment of any remaining liability are due on the fifteenth day of the fourth month following the close of the taxable period, April 15 for calendar-year entities. An extension of time to file the return is available; however, to avoid penalty for late payment, all tax due must be submitted by the original due date.

Table 11. Total Limited Liability Entity Tax Expenditures

FY 2008	FY 2009	FY 2010
$132.4 million	$136.5 million	$140.6 million

Tax Expenditures

1. Alcohol Production Facility

Kentucky Revised Statute 141.0401(6)(l), effective January 1, 2007

The tax does not apply to an alcohol production facility as defined in KRS 247.910.

FY 2008	FY 2009	FY 2010
$158,300	$166,200	$181,200

2. Certified Fluidized Bed Energy Production Facility

Kentucky Revised Statute 141.0401(6)(k), effective January 1, 2007

The tax does not apply to a certified fluidized bed energy production facility as defined in KRS 211.390.

FY 2008	FY 2009	FY 2010
$0	$0	$0

3. Cooperatives, Homeowners' Associations, Political Organizations

Kentucky Revised Statute 141.0401(6)(q), effective January 1, 2007

The tax does not apply to cooperatives described in Sections 521 and 1381 of the Internal Revenue Code, including farmer's agricultural and other cooperatives organized or recognized under KRS Chapter 272, advertising cooperatives, purchasing cooperatives, homeowners associations, including those described in Section 528 of the Internal Revenue Code, political organizations as defined in Section 527 of the Internal Revenue Code, and rural electric and rural telephone cooperatives.

FY 2008	FY 2009	FY 2010
$1.1 million	$1.2 million	$1.3 million

4. Costs of Goods Sold, Bulk Delivery Charges, and Indirect Labor

Kentucky Revised Statute 141.0401(6)(d), effective January 1, 2007

When computing the LLET using the gross profits method, Kentucky gross receipts are reduced by the amount of costs of goods sold attributable to Kentucky gross receipts.

FY 2008	FY 2009	FY 2010
$129.4 million	$133.3 million	$137.3 million

5. Open-end Registered Investment Companies

Kentucky Revised Statute 141.0401(6)(j), effective January 1, 2007

The tax does not apply to an open-end registered investment company organized under the laws of this state and registered under the Investment Company Act of 1940.

FY 2008	FY 2009	FY 2010
$1,000	$1,000	$1,000

6. Personal Service Corporations

Kentucky Revised Statute 141.0401(6)(p), effective January 1, 2007

The tax does not apply to a personal service corporation as defined in Section 269A(b) (1) of the Internal Revenue Code.

FY 2008	FY 2009	FY 2010
$175,000	$175,000	$175,000

7. Publicly Traded Partnerships

Kentucky Revised Statute 141.0401(6)(r), effective January 1, 2007

The tax does not apply to a publicly traded partnership as defined by Section 7704(b) of the Internal Revenue Code that is treated as a partnership for federal tax purposes under Section 7704(c) of the Internal Revenue Code, or its publicly traded partnership affiliate.

FY 2008	FY 2009	FY 2010
$1.112 million	$1.179 million	$1.250 million

8. Real Estate Investment Trust

Kentucky Revised Statute 141.0401(6)(m), effective January 1, 2007

The tax does not apply to a real estate investment trust as defined in Section 856 of the Internal Revenue Code.

FY 2008	FY 2009	FY 2010
$254,850	$294,750	$324,200

9. Regulated Investment Company

Kentucky Revised Statute 141.0401(6)(n), effective January 1, 2007

The tax does not apply to a regulated investment company as defined in Section 851 of the Internal Revenue Code.

FY 2008	FY 2009	FY 2010
$150,000	$150,000	$150,000

10. Real Estate Mortgage Investment Conduit

Kentucky Revised Statute 141.0401(6)(0), effective January 1, 2007

The tax does not apply to a real estate mortgage investment conduit as defined in Section 860D of the Internal Revenue Code.

FY 2008	FY 2009	FY 2010
$17,500	$17,500	$17,500

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, and which are used to propel vehicles of any kind upon the public highways: propane, propylene, butane (normal butane and isobutane), and butylene.

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. 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 FY07, the liquefied petroleum gas collections were $161,100 which accounts for 0.013 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 $1.342 per gallon. Consequently, the tax rate can be no less than 12.1 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 Department of Revenue on or before the twenty-fifth day of the month immediately following the month it is collected.

Table 12. Total Liquefied Petroleum Gas Tax Expenditures

FY 2008	FY 2009	FY 2010
$3,000	$3,000	$3,000

Tax Expenditures

1. 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.

FY 2008	FY 2009	FY 2010
$1,000	$1,000	$1,000

2. 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.

FY 2008	FY 2009	FY 2010
$2,000	$2,000	$2,000

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.

Since 1936, the tax was paid to the county clerk when a vehicle is first registered in the owner's name. In 2005, the General Assembly changed the incidence of taxation to the time when the vehicle is titled instead of when it is registered. 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 FY07, motor vehicle usage tax collections were $411.3 million, an increase of 4 percent from the previous year. These receipts constituted 33.5 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 defined as 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 Department of Revenue. Effective January 1, 2007, the General Assembly established a valuation floor for used motor vehicles.

The value of a used motor vehicle is now based upon the affidavit of total consideration given, unless that value is less than 50 percent of its trade-in as listed in the automotive price reference manuals.

Persons holding a certificate to operate as a U-Drive-It lessee 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 titled. The clerk deposits the tax in a Department of Revenue bank account on a daily basis and makes reports to the Department of Revenue on a weekly basis.

Table 13. Total Motor Vehicle Usage Tax Expenditures

FY 2008	FY 2009	FY 2010
$92.9 million	$96.0 million	$98.1 million

Tax Expenditures

1. Adapted Equipment for Physically Handicapped Persons

Kentucky Revised Statute 139.450(12)(c), 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.

FY 2008	FY 2009	FY 2010
$63,000	$65,000	$67,000

2. 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.

FY 2008	FY 2009	FY 2010
$260,000	$270,000	$270,000

3. Charter Bus Exemption

Kentucky Revised Statute 138.470(15), effective July 1, 2005

Motor carriers operating under a charter bus certificate issued by the Transportation Cabinet under KRS Chapter 281 are not subject to the Motor Vehicle Usage Tax.

FY 2008	FY 2009	FY 2010
$52,000	$54,000	$56,000

4. Commercial Motor Vehicle Exemption

Kentucky Revised Statute 138.450(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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

5. Educational and 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.

FY 2008	FY 2009	FY 2010
$1.3 million	$1.3 million	$1.3 million

6. 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 Hopkinsville enterprise zone is the only one of the original ten enterprise zones in Kentucky still in existence, and it is due to expire on December 21, 2007.

FY 2008	FY 2009	FY 2010
$100,000	$0	$0

7. 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.

FY 2008	FY 2009	FY 2010
$900,000	$0	$0

8. Immediate Family Member

Kentucky Revised Statute 138.470(6), 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.

FY 2008	FY 2009	FY 2010
$16.9 million	$17.6 million	$18.0 million

9. 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.

FY 2008	FY 2009	FY 2010
$104,000	$108,000	$111,000

10. Large Truck Exclusion

Kentucky Revised Statute 138.470, (16) and (17), 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.

FY 2008	FY 2009	FY 2010
$27.0 million	$28.3 million	$28.9 million

11. 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.

FY 2008	FY 2009	FY 2010
$6.50 million	$6.8 million	$6.9 million

12. 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.

FY 2008	FY 2009	FY 2010
$104,000	$108,000	$111,000

13. 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.

FY 2008	FY 2009	FY 2010
$940,000	$980,000	$1.0 million

14. 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 value included in the notarized affidavit attesting to total consideration given, or in the absence of a notarized affidavit, the value listed in the reference manual. The allowance is deducted in computing the retail price of the vehicle sold.

FY 2008	FY 2009	FY 2010
$35.0 million	$36.6 million	$37.4 million

15. 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.

FY 2008	FY 2009	FY 2010
$630,000	$650,000	$670,000

16. 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.

FY 2008	FY 2009	FY 2010
$160,000	$163,000	$167,000

17. 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.

FY 2008	FY 2009	FY 2010
$2.9 million	$3.0 million	$3.1 million

Natural Resources Severance & 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 FY07 the total taxes of $47.2 million represented 0.6 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 14. Total Natural Resources Severance and Processing Tax Expenditures

FY 2008	FY 2009	FY 2010
$6.5 million	$6.7 million	$6.9 million

Tax Expenditures

1. 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.

FY 2008	FY 2009	FY 2010
$250,000	$250,000	$250,000

2. 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.

FY 2008	FY 2009	FY 2010
$0	$0	$0

3. Inactive Crude Oil and Natural Gas Wells

Kentucky Revised Statute 143A.033, 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.

FY 2008	FY 2009	FY 2010
$100,000	$100,000	$100,000

4. 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.

FY 2008	FY 2009	FY 2010
$3.1 million	$3.2 million	$3.3 million

5. 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 for exemption from sales and use tax under KRS 139.480.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

6. Limit on Tax from Clay

Kentucky Revised Statute 143A.037, effective 1991

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

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

7. Transportation Expense

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

Expenses incurred in transporting minerals are excluded from gross value.

FY 2008	FY 2009	FY 2010
$3.0 million	$3.1 million	$3.2 million

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.

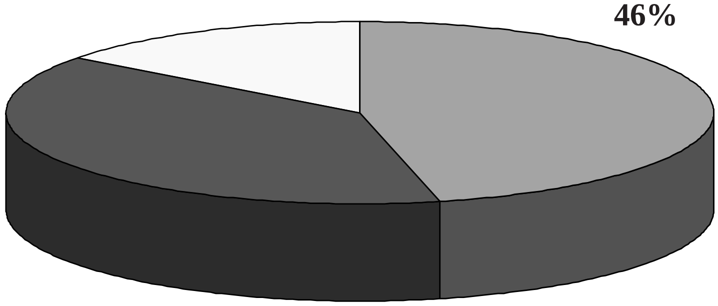
In 1793, the property tax represented over 86 percent of all state government receipts. That percentage has declined dramatically over the past 200 plus years. Much of the recent decline can be attributed to legislation passed during the 1979 Special Session of the General Assembly. House Bill 44, enacted 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. House Bill 272, passed by the 2005 General Assembly, altered the rate setting mechanism by excluding new property when the 4 percent growth limit is calculated. In contrast to earlier reports, this analysis does not consider the rate ceiling established by House Bill 44 to be a tax expenditure, as explained on page 27.

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 FY07 total property tax collections of $492.5 million accounted for 5.7 percent of total General Fund tax receipts. The chart on the following page shows the allocation between real, tangible and other property tax receipts.

The state tax rate for real property must be adjusted annually to

Figure 3. Allocation of Property Tax Receipts for FY07



Current Rate Structure

comply with the provisions of House Bill 44. For 2007, the rate was set at 12.4 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 may 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. Legislation enacted in 2005 repealed the intangible property tax effective January 1, 2006. Therefore, the tax expenditures for intangibles are $0 for FY07 and beyond and have been removed from this edition.

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 2007 and 2008 is $31,400.

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 personal property may be listed either with the PVA or the Department of Revenue and must be listed by May 15.

Tax Due

When the Department of Revenue 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 15. Total Property Tax Expenditures

FY 2008	FY 2009	FY 2010
$307.1 million	$318.4 million	$331.3 million

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

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

1. 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.

FY 2008	FY 2009	FY 2010
$100,000	$100,000	$100,000

2. Agriculture Value of Real Property

Kentucky Revised Statute 132.450, effective 1942

A special procedure is provided for assessing real property at its agricultural or horticultural value.

FY 2008	FY 2009	FY 2010
$31.1 million	$32.7 million	$35.1 million

3. 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.

FY 2008	FY 2009	FY 2010
$0	$0	$0

4. Environmental Remediation Property

Kentucky Revised Statute 132.020(1), effective 2005

The owner of all qualifying voluntary environmental remediation property pays tax at the rate of one and one-half cents upon each one hundred dollars of value for this property.

FY 2008	FY 2009	FY 2010
$2,000	$2,000	$2,000

5. 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 2005 and 2006 this exemption is $29,400.

FY 2008	FY 2009	FY 2010
$13.6 million	$13.8 million	$14.7 million

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.

FY 2008	FY 2009	FY 2010
$22,000	$22,000	$22,000

7. 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.

FY 2008	FY 2009	FY 2010
$2.9 million	$2.1 million	$2.2 million

8. Property of Local Governments in Neighboring States

Kentucky Revised Statute 132.192, effective 2005

All real property owned by another state or a political subdivision of another state that is used exclusively for public purposes is exempt from taxation if a comparable exemption is provided in that state or political subdivison for property owned by the Commonwealth or its political subdivisions.

FY 2008	FY 2009	FY 2010
$20,000	$20,000	$20,000

9. Real Property Owned by Exempt Entities

Section 170 of the Kentucky Constitution , effective 1891

Real property owned and occupied by institutions of religion, institutions of purely public charity, and institutions of education is exempted from taxation by the Kentucky Constitution.

FY 2008	FY 2009	FY 2010
$38.5 million	$40.7 million	$42.9 million

Tangible Property Tax Expenditures

(The normal tangible rate is 45 cents per $100 of value)

10. Agricultural Products

Kentucky Revised Statute 132.020(1), effective 1950

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

FY 2008	FY 2009	FY 2010
$310,000	$310,000	$310,000

11. 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.

FY 2008	FY 2009	FY 2010
$1.4 million	$1.4 million	$1.4 million

12. Business Inventories

Kentucky Revised Statute 132.020(9), effective 1990

Business inventories are taxed at a reduced rate of 5 cents per $100. This category includes machinery and equipment held in inventory in the regular course of business for sale or lease and originating under a floor plan financing arrangement.

FY 2008	FY 2009	FY 2010
$71.5 million	$75.0 million	$78.8 million

13. 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, 2005 was 23.5 cents per $100.

FY 2008	FY 2009	FY 2010
$4.3 million	$4.3 million	$4.3 million

14. 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.

FY 2008	FY 2009	FY 2010
$460,000	$460,000	$460,000

15. 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.

FY 2008	FY 2009	FY 2010
$33.0 million	$33.0 million	$33.0 million

16. Historic Vehicles

Kentucky Revised Statute 132.020(1), effective 1984

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

FY 2008	FY 2009	FY 2010
$129,000	$129,000	$129,000

17. In-Transit Goods

Kentucky Revised Statute 132.097, 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.

FY 2008	FY 2009	FY 2010
$16.5 million	$17.4 million	$17.4 million

18. 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.

FY 2008	FY 2009	FY 2010
$175,000	$175,000	$175,000

19. Interstate Trucks, Tractors and Buses

Kentucky Revised Statute 132.760, 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, 2007 was 24.62 cents per $100.

FY 2008	FY 2009	FY 2010
$3.6 million	$3.9 million	$3.9 million

20. Leasehold Interests

Kentucky Revised Statute 132.195, 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.

FY 2008	FY 2009	FY 2010
$3.9 million	$3.9 million	$3.9 million

21. Machinery Used in Farming and Livestock and Domestic Fowl

Kentucky Revised Statute 132.020(1)(f)(g), effective 1917

Machinery used in farming and the value of all livestock and 25 domestic fowl is taxed at a reduced rate of 1/10 of a cent per $100.

FY 2008	FY 2009	FY 2010
$22.5 million	$22.5 million	$22.5 million

22. 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.

FY 2008	FY 2009	FY 2010
$63.1 million	$66.5 million	$70.0 million

23. 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.

FY 2008	FY 2009	FY 2010
Miminal	Miminal	Miminal

24. Property of Local Governments in Neighboring States

Kentucky Revised Statute 132.192, effective 2005

All personal property owned by another state or a political subdivision of another state that is used exclusively for public purposes is exempt from taxation if a comparable exemption is provided in that state or political subdivision for property owned by the Commonwealth or its political subdivisions.

FY 2008	FY 2009	FY 2010
$0	$0	$0

25. Personal Property Used in Vending Stands Operated by the Blind

Kentucky Revised Statute 132.193(1), effective 1998

Personal property used in vending stands leased and operated by blind persons under the auspices of the Office for the Blind is exempt from taxation.

FY 2008	FY 2009	FY 2010
Minimal	Mininal	Minimal

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 FY07 totaled $2,817.7 million, which was a growth of 2.5 percent over the prior year. This tax represented 33 percent of total General Fund tax receipts in FY07.

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.

Tax Unit

The sales tax is imposed on gross receipts from the retail sale, lease, or rental price 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 Department of Revenue notifies taxpayers required to file on this alternate basis of their obligation.

Recent Legislation

The following changes have been enacted by the General Assembly since the last edition of this report:

Construction Expenses for Near Zero Emission Power Plants - (Effective January 1, 2007) Tangible personal property used to construct, repair, renovate or upgrade a coal-based near-zero emission power plant is exempt from sales tax, including repair and replacement parts.

New and Replacement Machinery or Equipment for Energy Efficient Projects - (Effective January 1, 2008) A manufacturer who purchases machinery or equipment that reduces energy consumption at its facility by 15 percent or more is eligible for a refund of the sales tax on the purchase.

Construction Expenses for Alternative Fuel or Gasification Facility - (Effective January 1, 2008) Sales taxes paid on tangible personal property used in the process of constructing an alternative fuel or gasification facility may be refunded at the end of the calendar year.

Table 16. Total Sales And Use Tax Expenditures

FY 2008	FY 2009	FY 2010
$2.289 billion	$2.362 billion	$2.433 billion

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 139.480(22), 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 and the exemption for baked goods which became effective July 1, 2004.

FY 2008	FY 2009	FY 2010
$430.0 million	$442.9 million	$451.8 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.

FY 2008	FY 2009	FY 2010
$316.1 million	$325.7 million	$335.4 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.

FY 2008	FY 2009	FY 2010
$226.7 million	$233.5 million	$240.5 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.

FY 2008	FY 2009	FY 2010
$254.6 million	$259.6 million	$260.2 million

5. Prescription Medicine, Prosthetic Devices 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.

FY 2008	FY 2009	FY 2010
$322.3 million	$332.0 million	$341.9 million

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

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

Kentucky Revised Statute 139.487, effective 1982

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. 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.

FY 2008	FY 2009	FY 2010
$63.3 million	$64.8 million	$65.7 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.

FY 2008	FY 2009	FY 2010
$70.2 million	$71.2 million	$70.7 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.

FY 2008	FY 2009	FY 2010
$25.0 million	$26.3 million	$27.5 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.

NOTE: The 2006 General Assembly capped the compensation allowed for any taxpayer in any month at $1,500. This cap is effective for periods before July 1, 2008.

FY 2008	FY 2009	FY 2010
$ 21.2 million	$ 30.4 million	$ 31.8 million

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 Hopkinsville enterprise zone is the only one of the original ten enterprise zones in Kentucky still in existence, and it is due to expire on December 21, 2007.

FY 2008	FY 2009	FY 2010
$400,000	$0	$0

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.

FY 2008	FY 2009	FY 2010
$222.0 million	$232.0 million	$242.7 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 qualified as a non-profit educational institution are exempt.

FY 2008	FY 2009	FY 2010
$3.5 million	$3.8 million	$4.2 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.

FY 2008	FY 2009	FY 2010
$1.3 million	$1.3 million	$1.3 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.

FY 2008	FY 2009	FY 2010
$23.6 million	$23.9 million	$23.9 million

15. Tombstones and Other Grave Markers

Kentucky Revised Statute 139.480(13), effective 1976

Tombstones and other grave markers are exempt.

FY 2008	FY 2009	FY 2010
$3.8 million	$3.9 million	$4.0 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.

FY 2008	FY 2009	FY 2010
Substantial	Substantial	Substantial

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.

FY 2008	FY 2009	FY 2010
$2.0 million	$2.0 million	$2.0 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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

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.

FY 2008	FY 2009	FY 2010
$3.4 million	$3.4 million	$3.4 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.

FY 2008	FY 2009	FY 2010
$5.9 million	$5.9 million	$5.9 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.

FY 2008	FY 2009	FY 2010
$9.6 million	$9.6 million	$9.6 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.

FY 2008	FY 2009	FY 2010
$1.3 million	$1.3 million	$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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

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.

FY 2008	FY 2009	FY 2010
Substantial	Substantial	Substantial

25. Credit Unions

Kentucky Revised Statute 290.365, effective 1984

Sales to credit unions organized under Kentucky law are exempt.

FY 2008	FY 2009	FY 2010
$1.3 million	$1.4 million	$1.4 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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

27. 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.

FY 2008	FY 2009	FY 2010
Substantial	Substantial	Substantial

28. 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.

FY 2008	FY 2009	FY 2010
Substantial	Substantial	Substantial

29. 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.

FY 2008	FY 2009	FY 2010
$7.3 million	$7.7 million	$8.2 million

30. 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.

FY 2008	FY 2009	FY 2010
$5.8 million	$6.0 million	$6.2 million

31. Federal Taxes Imposed on Sales of Tangible Personal Property

Kentucky Revised Statute 139.470(20), 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.

FY 2008	FY 2009	FY 2010
$6.4 million	$6.4 million	$6.4 million

32. 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.

FY 2008	FY 2009	FY 2010
$0	$0	$0

33. 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.

FY 2008	FY 2009	FY 2010
$7.4 million	$8.4 million	$9.4 million

34. 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.

FY 2008	FY 2009	FY 2010
$0	$0	$0

35. 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.

FY 2008	FY 2009	FY 2010
$0	$0	$0

36. 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.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

37. 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.

FY 2008	FY 2009	FY 2010
$36.0 million	$38.0 million	$40.0 million

38. 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.

FY 2008	FY 2009	FY 2010
$1.7 million	$1.8 million	$1.8 million

39. Donated Goods

Kentucky Revised Statute 139.495, effective August 1, 2005

A sales tax refund equal to 25 percent (up to $1 million) of the tax collected on sales of donated goods by resident nonprofit educational, charitable or religious institutions is allowed, if the entity uses the refund exclusively as reimbursement for capital construction costs of additional retail locations in this state.

FY 2008	FY 2009	FY 2010
$350,000	$400,000	$450,000

40. Kentucky Enterprise Initiative

Kentucky Revised Statute 154-20.204, effective January 1, 2006

A new statewide tax incentive program replaces the Enterprise Zone program as the current zones expire. It extends to eligible companies the opportunity to receive refunds of sales and use tax paid on the purchase of building materials and research and development materials for tourist attractions, services, technology, manufacturing and company headquarters for any industry. The program gives preference to companies in existing enterprise zones. The minimum investment is $100,000 for companies within the enterprise zone boundaries, $500,000 elsewhere. It also creates a statewide cap in each year of $20 million for building materials and $5 million for research and development on all approved projects.

FY 2008	FY 2009	FY 2010
$45.0 million	$25.0 million	$25.0 million

41. Charter Bus Repair and Replacement Parts

Kentucky Revised Statute 139.480, effective August 1, 2005

Repair and replacement parts for directly operating and maintaining a charter bus certified by the Transportation Cabinet are exempt.

FY 2008	FY 2009	FY 2010
$100,000	$110,000	$120,000

42. County Fair Admissions

Kentucky Revised Statute 139.470, effective June 2005

The first $50,000 in county fair admissions are exempt from sales and use tax.

FY 2008	FY 2009	FY 2010
$270,000	$270,000	$270,000

43. Water Withdrawal Fees Paid to Kentucky River Authority

Kentucky Revised Statute 139.470 (12), effective July 1, 2005

Water withdrawal fees imposed by the Kentucky River Authority are exempt from sales and use tax.

FY 2008	FY 2009	FY 2010
$83,000	$83,000	$83,000

44. Interstate Business Communication Services

Kentucky Revised Statute 139.505, effective January 1, 2001

Certain businesses whose interstate communications service subject to sales taxes exceed five percent of its Kentucky gross receipts in the preceding calendar year are entitled to a refundable credit of the sales tax paid on the excess.

FY 2008	FY 2009	FY 2010
Minimal	Minimal	Minimal

45. Pay Phones

Kentucky Revised Statute 139.200(2)(e), effective January 1, 2006

Communication services furnished via a pay telephone are exempt from sales tax.

FY 2008	FY 2009	FY 2010
$200,000	$200,000	$200,000

46. Construction Expenses for Near Zero Emission Power Plants

Kentucky Revised Statute 139.537, effective January 1, 2007

Tangible personal property used to construct, repair, renovate or upgrade a coal-based near-zero emission power plant is exempt from sales tax, including repair and replacement parts.

FY 2008	FY 2009	FY 2010
$0	$0	$0

47. New and Replacement Machinery or Equipment for Energy Efficient Projects

Kentucky Revised Statute 139, effective January 1, 2008

A manufacturer who purchases machinery or equipment that reduces energy consumption at its facility by 15 percent or more is eligible for a refund of the sales tax on the purchase.

FY 2008	FY 2009	FY 2010
$0	$3.7 million	$3.7 million

48. Construction Expenses for Alternative Fuel or Gasification Facility

Kentucky Revised Statute 154.27, effective January 1, 2008

Sales taxes paid on tangible personal property used in the process of constructing an alternative fuel or gasification facility may be refunded at the end of the calendar year.

FY 2008	FY 2009	FY 2010
$0	$11.9 million	$21.3 million

Sales Tax Exemptions for Farmers

Table 17. Subtotal for Farming Tax Expenditures

FY 2008	FY 2009	FY 2010
$170.6 million	$177.3 million	$184.6 million

The following tax expenditures pertain to the farming industry.

49. 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.

FY 2008	FY 2009	FY 2010
$71.6 million	$74.6 million	$77.7 million

50. 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.

FY 2008	FY 2009	FY 2010
$12.5 million	$12.9 million	$13.3 million

51. 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

Kentucky Revised Statute 139.480(11), effective 1968

Farm machinery and repair and replacement parts for the operation of farm machinery are exempt.

Kentucky Revised Statute 139.480(14), effective 1978

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(15), (24), (26), and (29), effective 1990, 1994, and 1996

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.

FY 2008	FY 2009	FY 2010
$53.8 million	$56.0 million	$58.4 million

52. 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.

FY 2008	FY 2009	FY 2010
$7.9 million	$8.2 million	$8.6 million

53. 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.

FY 2008	FY 2009	FY 2010
$59,000	$61,000	$64,000

54. Equine Water

Kentucky Revised Statute 139.470(14), effective 1998

Water used in the equine-raising business is exempt.

FY 2008	FY 2009	FY 2010
$59,000	$61,000	$64,000

55. 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.

FY 2008	FY 2009	FY 2010
$166,000	$176,000	$187,000

56. 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.

FY 2008	FY 2009	FY 2010
$35,000	$36,000	$38,000

57. 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.

FY 2008	FY 2009	FY 2010
$19.0 million	$19.6 million	$20.2 million

58. 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.

FY 2008	FY 2009	FY 2010
$5.5 million	$5.7 million	$6.0 million

Exclusion of Services

Kentucky Revised Statute 139.100 and 139.160, effective 1960

Table 18. Total for Excluded Services

FY 2008	FY 2009	FY 2010
$1.6 billion	$1.8 billion	$1.8 billion

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

FY2008 .... $61.5 million
FY2009 .... $64.7 million
FY2010 .... $68.2 million

(b) Business services

FY2008 .... $273.9 million
FY2009 .... $297.0 million
FY2010 .... $322.6 million

(c) Specialized Design Services

FY2008 .... $6.7 million
FY2009 .... $7.2 million
FY2010 .... $7.8 million

(d) Computer System Designs

FY2008 .... $69.0 million
FY2009 .... $74.8 million
FY2010 .... $81.2 million

(e) Scientific Research and Development

FY2008 .... $7.8 million
FY2009 .... $8.5 million
FY2010 .... $9.2 million

(f) Advertising

FY2008 .... $33.9 million
FY2009 .... $36.7 million
FY2010 .... $39.9 million

(g) Other Professional Services

FY2008 .... $35.1 million
FY2009 .... $38.0 million
FY2010 .... $41.3 million

(h) Health services

FY2008 .... $776.3 million
FY2009 .... $832.3 million
FY2010 .... $888.4 million

(i) Legal services

FY2008 .... $100.6 million
FY2009 .... $109.1 million
FY2010 .... $118.5 million

(j) Educational services

FY2008 .... $19.6 million
FY2009 .... $21.0 million
FY2010 .... $22.4 million

(k) Social services

FY2008 .... $8.5 million
FY2009 .... $9.0 million
FY2010 .... $9.4 million

(l) Engineering, accounting, research, management

FY2008 ....$212.4 million
FY2009 ....$230.4 million
FY2010 ....$250.2 million

(m) Automotive and miscellaneous repair services

FY2008 .... $106.0 million
FY2009 .... $111.6 million
FY2010 .... $117.6 million

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

FY2008 .... $3.0 million
FY2009 .... $3.3 million
FY2010 .... $3.5 million

(o) Other Services

FY2008 .... $6.0 million
FY2009 .... $6.3 million
FY2010 .... $6.7 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 wholesale price, the special fuels tax base was changed accordingly. This change 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 law now 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 Commonwealth, therefore the receipts are deposited in the Road Fund. For FY07, the special fuels tax collections were $141.4 million, which was 11.5 percent of total Road Fund tax receipts.

Current Tax Structure

The current tax rate is a minimum of 12.1 cents per gallon. As the average wholesale price of gasoline increases above $1.342 per gallon, the special fuels 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 14.1 cents per gallon.

Tax Base

The minimum combined tax rate of 14.1 cents per gallon of special fuels applies. 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 Department of Revenue on or before the twenty-fifth day of the month.

Table 19. Total Special Fuels Tax Expenditures

FY 2008	FY 2009	FY 2010
$67.7 million	$73.4 million	$75.8 million

Tax Expenditures

1. Agricultural Use

Kentucky Revised Statute 138.358(2), effective 1988

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

FY 2008	FY 2009	FY 2010
$5.7 million	$6.1 million	$6.3 million

2. 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 city and suburban buses, taxicabs, senior citizen transportation and non-profit buses.

FY 2008	FY 2009	FY 2010
$428,000	$465,000	$480,000

3. 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.

FY 2008	FY 2009	FY 2010
$3.6 million	$3.9 million	$4.0 million

4. 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.

FY 2008	FY 2009	FY 2010
$34.2 million	$37.2 million	$38.4 million

5. 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.

FY 2008	FY 2009	FY 2010
$21.8 million	$23.6 million	$24.4 million

6. 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.

FY 2008	FY 2009	FY 2010
$441,000	$479,000	$494,000

7. Residential Heating

Kentucky Revised Statute 138.358(1), effective 1988

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

FY 2008	FY 2009	FY 2010
$1.2 million	$1.3 million	$1.3 million

8. 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.

FY 2008	FY 2009	FY 2010
$317,000	$344,000	$356,000

10. 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.

FY 2008	FY 2009	FY 2010
$45,000	$45,000	$45,000

Background

Kentucky was the twentieth state to enact a tax on cigarettes, which became effective in 1936. The original cigarette excise tax rate was one cent per ten cents of the sales price. Over time, the "two-cents-per-package" tax gradually became a three-cent levy as more and more retailers began to charge above twenty cents per pack of cigarettes.

On July 1, 1960, a proportionate rate of two and one-half cents on each twenty cigarettes sold within the Commonwealth was assessed.

The 1970 General Assembly created the Tobacco Research Trust Fund. The legislation increased the cigarette excise tax by one-half cent per pack, to three cents per pack. The revenue generated by this tax increase was earmarked for the Tobacco Research Trust Fund.

In 1982, the General Assembly provided for a cigarette enforcement fee, in an amount calculated annually by 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.

In 1994, the General Assembly enacted the Teen Tobacco Education Fund and provided that one-twentieth of one cent ($0.0005) of the three-cent-per-pack revenue be used to offset the cost of the education efforts.

In 2000, the General Assembly enacted the Teen Tobacco Enforcement Fund and provided that one-twentieth of one cent of the three-cent-per-pack revenue be deposited in a trust and agency account to offset the costs of enforcement.

In 2005, the General Assembly enacted a cigarette surtax of a proportionate rate of twenty-six cents on each twenty cigarettes. An additional one-cent was enacted and dedicated to the Cancer Research Matching Fund. The two additional surtaxes bring Kentucky's total tax on a pack of twenty cigarettes to thirty cents.

Additionally, a 7.5 percent gross receipts tax was imposed on other tobacco products and a tax on snuff was imposed at nine and one-half cents per unit.

In 2006, the General Assembly clarified the taxation of other tobacco products by making a distinction between moist snuff and dry snuff. Dry snuff is taxed at 7.5 percent as an other tobacco product (OTP). Moist snuff is taxed as snuff. Additionally, a new wholesale cigarette paper excise tax was created. The tax is twenty-five cents per package of 32 sheets of paper.

For FY07, tobacco tax collections deposited to the General Fund were $177.4 million and represented 2.1 percent of total General Fund tax receipts.

Current Tax Rate

The tax rate, including both the cigarette excise tax and the cigarette surtax, is thirty (30) cents per package of twenty cigarettes. The other tobacco products tax is 7.5 percent of gross receipts. The tax on snuff is nine and one-half cents per unit.

Tax Base

Both the cigarette excise tax and the cigarette surtax are paid through the purchase of stamps or meter units from the Department of Revenue. 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 generally allowed the equivalent of a 9.09 percent discount against only the cigarette excise tax when the evidence is purchased.

Tax Due

The wholesaler pays the tax at the time the tax stamps or meter units are purchased from the Department of Revenue. A monthly report is required by the twentieth of each month reflecting purchases and trafficking of cigarettes for the preceding month. A monthly report of other tobacco products and snuff is also due by the twentieth day of the succeeding month within which the transaction occurred.

Table 20. Total Tobacco Tax Expenditures

FY 2008	FY 2009	FY 2010
$1.3 million	$1.3 million	$1.3 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.

FY 2008	FY 2009	FY 2010
$1.3 million	$1.3 million	$1.3 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 21. Total Earmarked Funds

FY 2008	FY 2009	FY 2010
$40.3 million	$70.5 million	$72.4 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 Horse Racing Authority, 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.

FY 2008	FY 2009	FY 2010
$6.8 million	$6.8 million	$6.8 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 are 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.

FY 2008	FY 2009	FY 2010
$490,000	$490,000	$490,000

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.

FY 2008	FY 2009	FY 2010
$460,000	$460,000	$460,000

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 Horse Racing Authority, and 2 percent of wagering at receiving tracks in intertrack wagering as well as telephone account wagering, are deducted from the tax and deposited in this fund.

FY 2008	FY 2009	FY 2010
$180,000	$180,000	$180,000

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 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.

FY 2008	FY 2009	FY 2010
$590,000	$590,000	$590,000

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.

FY 2008	FY 2009	FY 2010
$190,000	$190,000	$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.

FY 2008	FY 2009	FY 2010
$2.7 million	$2.7 million	$2.7 million

8. 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.

FY 2008	FY 2009	FY 2010
$450,000	$450,000	$450,000

9. 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.

FY 2008	FY 2009	FY 2010
$5.6 million	$5.7 million	$5.8 million

10. 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 sales, property and income taxes are most utilized because of the dollar volume.

FY 2008	FY 2009	FY 2010
$3.3 million	$32.8 million	$34.0 million

11. Equine Breeder Development Funds - Sales Tax

Kentucky Revised Statute 230.800, 230.802 and 230.804, effective June 1, 2005

Sales tax receipts from stud fees for breeding of horses in this state are earmarked for use in creating breeder incentives. The sales tax is deposited into special funds for future disbursement by the Kentucky Horse Racing Authority. Eighty percent of the receipts are dedicated to the "Kentucky Thoroughbred Breeders Incentive Fund"; thirteen percent to the "Kentucky Standardbred Breeders Incentive Fund"; and 7 percent to the "Kentucky Horse Breeders Incentive Fund."

Kentucky Thoroughbred Breeders Incentive Fund

FY 2008	FY 2009	FY 2010
$15.6 million	$16.0 million	$16.5 million

Kentucky Horse Breeders Incentive Fund

FY 2008	FY 2009	FY 2010
$2.5 million	$2.6 million	$2.7 million

Kentucky Horse Breeders Incentive Fund

FY 2008	FY 2009	FY 2010
$1.4 million	$1.5 million	$1.6 million

12. County Clerk Share for Collection of Sales Tax on Nonresident Sales

Kentucky Revised Statute 139.778, effective January 1, 2007

In return for collecting sales and use taxes due on tangible personal property purchased out of state at the time of registration or titling, county clerks may retain three percent of the tax collected.

FY 2008	FY 2009	FY 2010
$100,000	$150,000	$150,000