Background

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

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

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

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

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

During FY03, the inheritance and estate taxes produced $95.9 million in General Fund revenues. This was a 15.0 percent increase from the prior year and accounted for 1.4 percent of the total General Fund tax receipts.

Tax Base

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

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

The estate tax or "pickup tax" consists solely of the excess of Kentucky's share of the state death tax credit allowed on the federal estate tax return over the Kentucky inheritance tax liability. Effective with the fiscal year ending on June 30, 2002, the amount of the tax credit allowed on the federal return is reduced by 25 percent each year until the credit is removed in Fiscal Year 2005.

Taxable Unit

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

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

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

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

Current Rate Structure

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

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

Tax Due

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

Table 10. Total Inheritance And Estate Tax Expenditures

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

Tax Expenditures

1. Class A Beneficiaries

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

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

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

2. Transfers to Educational, Religious, Charitable, or Certain Governmental Organizations

Kentucky Revised Statute 140.060, effective 1916

Transfers to these types of organizations are exempt.

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

3. Discount for Early Payment of Tax

Kentucky Revised Statute 140.210(1), effective 1924

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

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

4. Class B Beneficiaries

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

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

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

5. Class C Beneficiaries

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

Class C beneficiaries are granted a $500 exemption.

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

6. Life Insurance Proceeds

Kentucky Revised Statute 140.030(2), effective 1944

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

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

7. Assessment of Land at its Agricultural or Horticultural Value**

Kentucky Revised Statute 140.300 .360, effective 1978

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

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

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

Kentucky Revised Statute 140.020(3), effective 1978

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

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

9. Annuities Under Qualified Retirement Plans**

Kentucky Revised Statute 140.063, effective 1974

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

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

10. Individual Retirement Accounts**

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

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

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

11. Recurring Tax Credits

Kentucky Revised Statute 140.095, effective 1948

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

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

12. Lifetime Transfers**

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

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

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

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

Kentucky Revised Statute 140.015(2), effective 1980

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

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

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

Kentucky Revised Statute 140.015(1), effective 1944

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

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

15. Federal Estate Tax Credit

Kentucky Revised Statute 140.130

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

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

LIQUEFIED PETROLEUM GAS TAX

Background

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

The tax is imposed for the privilege of using the highways of the state. Consequently, the tax proceeds are deposited in the Road Fund. For FY03, the liquefied petroleum gas collections were $207,000 which accounts for 0.018 percent of total Road Fund tax receipts.

Current Rate Structure

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

Tax Base

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

Taxable Unit

The unit for levying the liquefied petroleum gas tax is a "per gallon" basis.

Tax Due

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

Table 11. Total Liquefied Petroleum Gas Tax Expenditures

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

Tax Expenditures

1. Dealer's Monthly Reporting Allowance

Kentucky Revised Statute 234.320(1), effective 1972

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

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

2. Approved Carburetion Systems

Kentucky Revised Statute 234.321(1), effective 1972

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

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

MOTOR VEHICLE USAGE TAX

Background

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

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

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

Current Rate Structure

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

Tax Base

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

For used vehicles, the retail price is the total consideration paid. A trade-in credit is allowed. The total consideration paid must be disclosed in a notarized affidavit signed by both buyer and seller. If an affidavit is not submitted, the price is defined as the value appearing in the automotive reference manual prescribed by the Revenue Cabinet. For an older used vehicle whose value no longer appears in the reference manual, the retail price is as stated in a signed affidavit or at a minimum of $100.

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

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

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

Tax Expenditures Enacted During Fiscal Years 2002 – 2003

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

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

Table 12. Total Motor Vehicle Usage Tax Expenditures

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

Tax Expenditures

1. Trade-In Allowance on Used Vehicles

Kentucky Revised Statute 138.450(4), effective 1976

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

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

2. Immediate Family Member

Kentucky Revised Statute 138.470(6),and (14), effective 1976, 1992, and 1994

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

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

3. Governmental Exemption

Kentucky Revised Statute 138.470(1), effective 1968

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

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

4. Enterprise Zone Exemption

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

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

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

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

5. Military Exemption

Kentucky Revised Statute 138.470(4), effective 1968

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

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

6. Repossessed Exemption

Kentucky Revised Statute 138.470(13), effective 1972

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

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

7. Transfers by Will or Court Order

Kentucky Revised Statute 138.470(9), effective 1970, 1990

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

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

8. Educational & Charitable Organizations

Kentucky Revised Statute 138.470(2), effective 1968

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

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

9. Enterprise Zone Exemption – U Drive-It Tax

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

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

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

10. Commercial Motor Vehicle Exemption

Kentucky Revised Statute 138.470(5), effective 1968

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

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

11. Change in Business Structure

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

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

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

12. Transfers Between a Limited Liability Company and its Members

Kentucky Revised Statute 138.470,(11), effective 1998

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

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

13. Transfers Between a Subsidiary and a Parent Corporation

Kentucky Revised Statute 138.470(10), effective 1970

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

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

14. Partnership Interests

Kentucky Revised Statute 138.470(12), effective 1970

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

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

15. Insurance Company Transfers

Kentucky Revised Statute 138.470(14), effective 1976

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

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

16. Adapted Equipment for Physically Handicapped Persons

Kentucky Revised Statute 139.450(4)(a), effective 1992

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

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

17. Large Truck Exclusion

Kentucky Revised Statute 138.470, effective October 1, 2003.

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

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

NATURAL RESOURCES SEVERANCE AND PROCESSING TAX

Background

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

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

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

Current Rate Structure

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

Tax Base

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

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

Taxable Unit

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

Tax Due

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

Table 13. Total Natural Resources Severance & Processing Tax

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

Tax Expenditures

1. Transportation Expense

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

Expenses incurred in transporting minerals are excluded from gross value.

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

2. Limestone Sold in Interstate Commerce

Kentucky Revised Statute 143A.035, effective 1984

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

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

3. Limestone Sold or Used for Agricultural Purposes

Kentucky Revised Statute 143A.030, effective 1984

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

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

4. Ball Clay, Fluorspar, Lead, Zinc, Tar Sands, Barite, and Stone Used for Privately Maintained but Publicly Dedicated Roads

Kentucky Revised Statute 143A.020 and 143A.030, effective 1980, 1984

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

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

5. Limit on Tax from Clay

Kentucky Revised Statute 143A.037, effective 1991

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

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

6. Clay Used in Landfill Construction

Kentucky Revised Statute 143A.037, effective 1991

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

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

7. Inactive Crude Oil and Natural Gas Wells

Kentucky Revised Statute 143A, effective 1998

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

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

Background

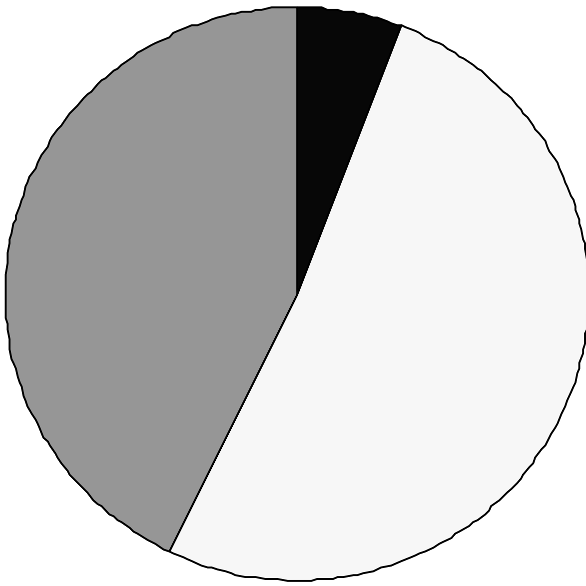
Kentucky has had a tax on property since becoming a state on June 1, 1792. The original method of taxation began with a set levy for each item of tangible property owned in the state. It was not until 1814 that the standard for establishing the tax liability was changed to the ad valorem, or fair value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

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

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

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

Figure 3. Allocation of Property Tax Receipts for FY03



Total: $434.8 million property tax receipts

Current Rate Structure

The state tax rate for real property must be adjusted annually to comply with the provisions of House Bill 44. For 2003, the rate was set at 13.3 cents per $100 of assessed value. The rate in effect prior to House Bill 44 was 31.5 cents per $100 of assessed value. It must be noted that an increase in the tax base will necessitate a corresponding decrease in the rate. Consequently, any estimates of the cost of exemptions in the real property area are based on the assumption that House Bill 44 would not affect the outcome. The normal state rates applicable to tangible and intangible personal property are 45 cents and 25 cents per $100 of assessed value, respectively. The General Assembly has reduced the rates for some classes of tangible and intangible personal property over the years. These reduced rates give rise to many of the expenditures detailed later.

Tax Base

The property tax is levied on the fair cash value of all real, tangible, or intangible property unless a specific exemption exists in the Kentucky Constitution or in the case of personal property, has been granted by the General Assembly. Taxpayers who are 65 years of age or older or are classified as totally disabled qualify for a Homestead Exemption. This exemption, applied against the assessed value of a qualifying single-unit residential property, is adjusted every two years in accordance with the cost of living index. The homestead exemption amount for 2003 and 2004 is $28,000.

Tax Due

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

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

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

Table 14. Total Property Tax Expenditures

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

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

Real Property Tax Expenditures

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

1. State Real Property Tax Yearly Revenue Ceiling

Kentucky Revised Statute 132.020(7), effective 1979

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

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

2. Alcohol Production Facilities

Kentucky Revised Statute 132.020(1), effective 1980

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

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

3. Leasehold Interests in Buildings Financed with Industrial Revenue Bonds

Kentucky Revised Statute 132.020(1), effective 1978

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

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

4. Homestead Exemption

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

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

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

5. Agricultural and Horticultural Land Assessment Protection

Kentucky Revised Statute 132.450, effective 1999

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

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

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

6. Intrastate Railroads and Railway Companies

Kentucky Revised Statute 132.020(10), effective 1990

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

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

Tangible Property Tax Expenditures

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

7. Business Inventories

Kentucky Revised Statute 132.020(9), effective 1990

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

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

8. Leasehold Interests

Kentucky Revised Statute 132.020(1), effective 1990

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

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

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

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

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

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

10. Livestock and Machinery Used in Farming, Livestock and Poultry

Kentucky Revised Statute 132.020(1), effective 1917

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

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

11. Agricultural Products

Kentucky Revised Statute 132.020(1), effective 1950

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

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

12. Foreign Trade Zone

Kentucky Revised Statute 132.020(1), effective 1982

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

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

13. Historic Vehicles

Kentucky Revised Statute 132.020(1), effective 1984

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

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

14. Intrastate Railroads and Railway Companies

Kentucky Revised Statute 132.020(10), effective 1990

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

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

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

Kentucky Revised Statute 136.1873, effective 1990

Commercial vehicles that have routes or systems partly within this state and partly within another state or states are taxed at a reduced rate. This rate is computed annually. The rate in effect January 1, 2002 was 23.49 cents per $100.

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

16. Carlines

Kentucky Revised Statute 136.120, effective 1990

Any company, other than a railroad company, which owns, uses, furnishes, leases, rents, or operates to, from, through, in, or across this state or any part thereof, any kind of railroad car is taxed at a reduced rate. The rate is computed annually. The rate in effect January 1, 2002 was 23.5 cents per $100.

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

17. Aircraft

Kentucky Revised Statute 132.020(12), effective 1999

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

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

18. Federally Documented Vessels

Kentucky Revised Statute 132.020(13), effective 1999

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

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

19. Floor Plan Machinery and Equipment

Kentucky Revised Statute 132.020(10), effective 1999

Machinery and equipment held in inventory in the regular course of business for sale or lease and originating under a floor plan financing arrangement is taxed at a reduced state rate of 5 cents per $100.

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

20. In-Transit Goods

Kentucky Revised Statute 132.095(1), effective 1999

Goods shipped into Kentucky and placed in a warehouse or distribution center with the purpose of continued shipment outside of Kentucky within six months are exempt from property tax at the state level.

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

21. Motor Vehicles With a Salvage Title

Kentucky Revised Statute 134.810, effective 1999

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

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

Intangible Property Tax Expenditures

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

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

Kentucky Revised Statute 132.020(2), effective 1968

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

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

23. Bank Deposits

Kentucky Revised Statute 132.030(1), effective 1917

Bank deposits are taxed at a reduced rate of 1/10 of a cent per $100.

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

24. Exemption of Stock from Intangible Tax

Kentucky Revised Statute 136.030(1), effective 1924

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

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

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

25. Retirement Plans

Kentucky Revised Statute 132.043, effective 1966

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

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

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

Kentucky Revised Statute 136.300(1), effective 1917

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

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

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

Kentucky Revised Statute 132.215(2), effective 1972

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

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

28. Credit Union Accounts and Shares

Kentucky Revised Statute 290.635, effective 1984

Deposits and shares are totally exempt from tax.

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

29. Broker's Accounts Receivable

Kentucky Revised Statute 132.050, effective 1948

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

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

30. Reserves and Capital of Domestic Life Insurance Companies

Kentucky Revised Statute 136.320(3), effective 1990

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

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