TAX IN THE BLUEGRASS: AN OVERVIEW OF NEW DEVELOPMENTS IN FEDERAL AND STATE TAX
A NOTE CONCERNING THE PROGRAM MATERIALS

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Significant tax-related activity occurred in the Commonwealth during 2014 and early 2015. This summary presents the major highlights in legislative and judicial action over the past year.

I. LEGISLATIVE HIGHLIGHTS FROM 2014 AND EARLY 2015

In his 2014 State of the Commonwealth address, Kentucky Governor Steve Beshear called on the Kentucky General Assembly ("General Assembly") to work with him in modernizing the Kentucky tax structure. Pursuant to this address, both Governor Beshear and the General Assembly proposed and passed several Bills relating to Kentucky's tax structure in 2014. The following is a brief overview of legislation passed and proposed during the 2014 Regular Session.

A. Kentucky Competes Tax Reform Plan

On February 4, 2014, Governor Beshear proposed to the General Assembly the Kentucky Competes Tax Reform Plan (the "Plan"), which was based upon the recommendations of the Governor's Blue Ribbon Commission on Tax Reform. The Plan proposed major changes to Kentucky's tax structure and further sought to add-in several new tax credits for Kentucky taxpayers. The Plan's proposals were ultimately not adopted by the General Assembly during its 2014 General Assembly, but several of the proposals will likely come up again in future legislative sessions.

Major proposals under the Plan included the following: (1) reducing the overall top income tax rate for most individuals and corporations from 6 percent to 5.9 percent; (2) phasing out the three-factor formula to apportion the corporate income tax base in favor of a sales only factor apportionment formula; (3) changing the existing cost-of-performance-based formula for apportioning sales to a destination sourcing method for apportioning the sale of services; (4) adding a refundable earned income tax credit equal to 7.5 percent of the federal credit; (5) adding an exemption for some types of inventory from the Kentucky property tax; and (6) broadening the sales tax to include certain types of defined services, including the installation, maintenance, and repairs of taxable personal property.

B. House Bill 438

2014 House Bill 438 ("HB 438") was originally introduced to permit the Kentucky Department of Revenue (the "Department") to develop and publish regulations governing a whistleblower program that would reward those persons providing information to the Department which resulted in the collection of taxes, penalties, and interests from any persons relating to any taxes. However, the original language in HB 438 was deleted in
the House State Government Committee and substituted with a measure that would encourage the Department to study the advantages and disadvantages of establishing such a whistleblower program. HB 438 was unanimously passed by the House of Representatives and was pending review in the Senate's Appropriations & Revenue Committee at the close of the 2014 Regular Session.

C. 2014 House Bill 445

2014 House Bill 445 ("HB 445") provided several changes to Kentucky's tax structure. Overall, most of the changes contained in HB 445 were fairly minor when compared to the broad proposals in Governor Beshear's Kentucky Competes Tax Reform Plan.

HB 445 amended the individual and corporate income tax provisions contained in the Kentucky tax code to update the reference date of the Internal Revenue Code from the 2006 version to 2013 version. This change was made to reflect any changes made to the income level for the phase-out of itemized deductions and to further clarify the depreciation deduction adjustments.

Additionally, among the more important provisions in HB 445 were several new tax credits and rate reductions for certain Kentucky taxpayers. Specifically, Kentucky's wine and spirits industry benefited from HB 445 in the form of a reduction in the wholesale tax on distributors from 11 percent to 10 percent and a non-refundable corporate/individual income tax credit for bourbon distilleries equal to the amount of barrel taxes paid by such distilleries. Additionally, to promote economic growth within the state, HB 445 created an angel investor tax credit, doubled the amount of the cap for the new markets development program credit, and created a historic preservation tax credit. Lastly, HB 445 modified the pari-mutuel tax to impose a higher tax rate on those racetracks whose Average Daily Handle is in excess of $1,200,000.

D. Local Option Sales Tax Legislation Up Again in 2015

As Kentucky House Speaker Greg Stumbo predicted in late 2014, HB 1 is the proposed local option sales tax legislation (referred to as LIFT) during the 2015 Regular Session, the spot reserved for the House majority's top priority, after the 2014 version of the bill failed to pass in the 2014 Session. A constitutional amendment is necessary to implement the local option sales tax. Under the proposed local option sales tax bill, local governments will be allowed to impose an extra 1 percent sales tax to raise money for specified local projects. Importantly, local voters must approve any tax authorized under the local option sales tax, and such tax would expire upon completion of the specified project.

E. Taxpayer Bill of Rights Legislation

In early February 2015, two bills proposing various updates to Kentucky's Taxpayer Bill of Rights were introduced to the House. HB 361, the first
part of the Taxpayer Bill of Rights update, would impose strict administrative requirements on the Department on various topics, including requiring a six-month limit to when the Department must respond to a refund request, provide a Protest Conference and provide binding, written letter rulings requested by a taxpayer. Likewise, a companion bill, HB 399, was also introduced that would change the differential between the state's interest and penalty scheme, as currently, there is a four-percentage difference between deficiency interest (prime rate plus 2 percent) and refund interest (prime rate less 2 interest) which is harmful to taxpayers.

F. Bill Proposed to Close Alleged Corporate Tax Loopholes

HB 274 was introduced during the 2015 Session to close what some view as corporate tax "loopholes" through the use of subsidiaries in no or low-tax states or foreign "tax havens," and use the funding generated therefrom to fund the state Earned Income Tax Credit (EITC) to help working families. The legislation is modeled after similar legislation that has been introduced and/or passed in about half of the states to eliminate the use of tax havens by large corporations to avoid state corporate taxes.

II. JUDICIAL DEVELOPMENTS DURING 2014 AND EARLY 2015

Kentucky courts and the Kentucky Board of Tax Appeals ("KBTA") released a number of noteworthy decisions at trial and on appeal and faced interesting issues during 2014 and early 2015 in income, transactional, property and miscellaneous taxes.

A. Cement Company Located in Kentucky Qualified for Severance Tax Credit for Sales to Purchasers outside of the State despite the Purchaser Receiving the Products inside Kentucky

In Roanoke Cement Co., LLC v. Finance and Administration Cabinet, a first impression review, the KBTA held that a cement company, Roanoke Cement, qualified for a severance tax credit for limestone severed or processed within Kentucky and sold to out-of-state purchasers even though the purchasers took possession of the limestone aggregate at the company's Kentucky limestone quarry. The Franklin Circuit Court and Kentucky Court of Appeals affirmed the KBTA's decision.

The case concerned the proper statutory construction of KRS 143A.035(1) and (3), which provides for a credit against the severance tax under KRS 143A.020. KRS 143A.035 provides in relevant part:

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(1) A credit hereby allowed against the tax imposed by this chapter on the gross value of limestone which is severed or processed within this state and sold to a purchaser outside of this state.

(2) the credit allowed in this section shall extend only to a taxpayer who severs or processes limestone through the rip-rap construction aggregate or agricultural limestone stages, and who sells in interstate commerce not less than sixty percent (60%) of such stone. The credit shall not be allowed to a taxpayer who processes the limestone beyond the agricultural limestone stage.

The two issues presented in the case were: (a) whether the phrase "outside of this state" in subsection (1) modifies the location of the limestone purchaser or the location of the sale itself; and (b) whether a sale must be consummated outside of the state to be an "interstate sale" within the meaning of subsection (2).

The Department maintained that only sales consummated outside Kentucky could be considered "interstate sales" within the meaning of the severance tax statute. To support its position, the Department cited several sales tax cases which had held that sales completed entirely within a state are not transactions in interstate commerce. The KBTA stated, however, that the sales tax cases cited by the Department were not controlling because of the differences between the Kentucky sales tax and severance tax.

The KBTA explained that the requirement that a sale be consummated in Kentucky before Kentucky sales tax is applied and owed exists to ensure there is no undue burden on interstate commerce and to ensure that the person who bears the economic burden of the tax (the purchaser) has a clear connection to the state before being taxed. In the case of the severance tax, the out-of-state person is not being taxed; the incidence of the tax is on the severer. Therefore, the protections of the "consummated in this state" sales tax standard were not required for the administration of the severance tax or applicable in discerning the language of the severance tax statutes.

Ultimately the KBTA held that, by its plain meaning, KRS 143A.035 provides a mineral severance tax credit for sales of limestone aggregate made to out-of-state purchasers, regardless of the manner in which they receive the product. Thus, the 60 percent requirement in subsection (2) of the statute meant that 60 percent of the sales had to be made to purchasers with locations out-of-state and according to the stipulated facts, the taxpayer clearly met the statutory requirements for the credit. Accordingly, Roanoke Cement was entitled to a refund of overpaid sales tax and interest.

The Department subsequently appealed the KBTA’s decision to the Franklin Circuit which affirmed the KBTA’s decision on January 14, 2013.
The Department then filed an appeal with the Kentucky Court of Appeals, which affirmed the decisions of the KBTA and the Franklin Circuit Court on February 21, 2014. The Court of Appeals dismissed the Department's argument that the limestone sales did not qualify for the severance tax credit because they did not qualify as sales made in interstate commerce. The Court of Appeals took note that the parties agreed that 99 percent of the limestone was sold to out of state customers and concluded that such sales took place in interstate commerce because such sales would affect the price and supply of limestone around this region of the country. The Court of Appeals further dismissed the Department's contention that the amount of the severance tax credit should not include those sales in which the limestone purchasers picked up such limestone in Kentucky. In supporting this dismissal, the Court of Appeals held that entitlement to the severance tax credit does not depend on "the manner in which the limestone severed and processed in Kentucky reaches an out-of-state purchaser," but rather depends on whether the purchaser of such limestone resides out-of-state.

A motion for discretionary review filed with the Kentucky Supreme Court was denied in late 2014. This case is now final.

B. Supreme Court Affirms the Court of Appeals Decisions in Two Cases Concerning Budget Maneuvers Concerning the Transfer of License Fees to the General Fund

On June 19, 2014, the Kentucky Supreme Court affirmed the decision of the Kentucky Court of Appeals in two tax-related cases involving the constitutionality and propriety of the transfer of regulatory fees to Kentucky's General Fund to balance the Commonwealth's budget. See Louisville Soccer Alliance, Inc., et al. v. Beshear, etc., et al., No. 2012-SC-197-DG (Ky.) and Klein, et al. v. Flanery, etc., et al., No. 2012-SC-071-DG.

In Louisville Soccer Alliance, the Kentucky Supreme Court affirmed the Kentucky Court of Appeals' decision which held that the transfer of excess funds from the charitable gaming regulatory account to the General Fund in 2008 was constitutionally and statutorily authorized and that the suspension of the Kentucky Charitable Gaming Act ("Act") to allow the transfer did not operate to convert the charitable gaming fee into an unconstitutional tax, reversing the Circuit Court.

As background, the Act provided a comprehensive regulatory program for the licensing and regulation of all charitable gaming in Kentucky, established a fee to be levied on all licensed charitable gaming operations in Kentucky to fund the state oversight and regulation of charitable gaming, and required that all funds from the license fees be deposited in a restricted account with any unused funds carried forward to the next fiscal year. In 2008, however, the General Assembly "suspended" these

2 Klein v. Flanery, 439 S.W.3d 107 (Ky. 2014).
restrictions via a budget bill ("Budget Bill") to permit charitable gaming license fee funds collected but not used to be transferred from its restricted fund to Kentucky's General Fund, as well as allow license fees imposed against charitable gaming operations to be increased.

The plaintiffs in Louisville Soccer Alliance alleged that the license fee was, as a matter of law, "converted to a tax" after the "General Assembly's unlawful fund transfer of the restricted account into the general fund of revenue...." Although the Franklin Circuit Court acknowledged that the General Assembly's suspension of statutes "have now become a way of life" in helping balance the state budget, it held that "the power to suspend statutes in the budget is not unlimited," and thus agreed with the plaintiffs by holding that "any 'restricted' fund under state control has become, for all practical purposes, a tax which is deposited into the state's general fund...." Further, although Section 15 of the Kentucky Constitution specifically permits the General Assembly to suspend laws, the Circuit Court believed that "there is considerable doubt about the constitutional validity of the legislative practice of routinely and repeatedly suspending statutes in the budget, to the point that many statutes remain law in name only." Finally, the Circuit Court held that the General Assembly unlawfully extended its authority to suspend statutes under the Kentucky Supreme Court's previous decision in Commonwealth ex rel. Armstrong v. Collins, 709 S.W.2d 437 (Ky. 1986), beyond any meaningful limits and ignored the restrictions of Sections 51 and 180 of the Kentucky Constitution by routinely suspending multiple statutes in the Budget Bill.

Similar to the concerns involved in Louisville Soccer Alliance, the Kentucky Supreme Court also affirmed the Court of Appeals' decision in Klein in determining the constitutionality of the Budget Bill's permitting of the transfer of surpluses from the Department of Housing, Building and Construction ("HBC") agency accounts to the General Fund to help balance Kentucky's budget.

The HBC was created to unite all functions of Kentucky's building industry to provide a more uniform and effective building inspections process and enforcement of building standards. The HBC is partly funded by a statutory fee system imposing licensing fees on contractors and various building inspection fees with all funds received by the state to be kept in a separate agency fund account for the regulation of the industry. As is the case in Louisville Soccer Alliance, the 2008 Budget Bill suspended the restriction on the placement of the licensing and inspection fees to permit any excess funds derived from such fees to be transferred to the General Fund.

The plaintiffs in Klein sought a declaration of rights and injunctive relief from the Circuit Court, arguing that the transfers were invalid under Kentucky law and violated enumerated constitutional provisions as such fees paid were private, restricted funds and could not then be transferred to the General Fund via a Budget Bill. The Circuit Court, however, granted summary judgment to the Commonwealth as it determined that
the transfer of HBC funds was a valid exercise of legislative power. The Circuit Court concluded that the HBC was unlike the retirement systems and the workers' compensation funds that the Kentucky Supreme Court previously held to be nontransferable because those funds were not comparable to the HBC's regulatory fees. Accordingly, the Circuit Court concluded that the General Assembly had the authority to transfer the HBC excess funds to the General Fund through the Budget Bill, and that the transfers did not violate constitutional provisions.

On appeal, the Court of Appeals summarized the three issues involved therein as such: (1) whether the transfer of HBC funds was improper in light of Kentucky case law; (2) whether the transfer of HBC funds violated KRS 48.315; and (3) whether the transfer of HBC funds violated enumerated constitutional provisions. The Court of Appeals upheld the Circuit Court's decision by finding that because the primary purpose of the legislation imposing the fees paid to the HBC is to regulate the trades governed by the HBC, even if the transfer to the General Fund produced revenue for the public, it did not become a tax. Moreover, the Court of Appeals held that although prior Kentucky case law prohibited the transfer of commingled state funds, this was limited to preventing the transfer of public funds that were not commingled with private funds, and since the HBC funds are not private funds, nor public funds commingled with private funds, such precedent did not prevent their transfer. Finally, the Court of Appeals agreed with the Circuit Court that the Budget Bill did not violate any constitutional restrictions.

In affirming the decisions of the Court of Appeals, the Supreme Court relied on three primary conclusions: (1) the transfer of the charitable gaming and HBC funds to the General Funds did not violate the Kentucky Constitution; (2) the charitable gaming and HBC funds were not "Private Funds" in which transfers to the General Fund are prohibited; and (3) the transfers did not violate KRS 48.315. The Supreme Court concluded that the transfers were not prohibited under the Kentucky Constitution because the appellants did not present any evidence showing that the amount of the charitable gaming and HBC fees were unreasonable with respect to their respective purposes and thus a transfer of excess fees to the General Fund was allowed. The Supreme Court further concluded that the charitable gaming and HBC funds were not "Private Funds" because the funds existed for the physical safety and economic security of the public at large and not solely for the benefit of a private group of individuals. Lastly, the Supreme Court concluded that there was no violation of KRS 48.315 because the appellants offered no reason for exempting the charitable gaming and HBC funds beyond their absence from the KRS 48.315 list.
C. Transparency Development: Kentucky Court of Appeals determines that Kentucky Tax Return Information is not Fully Exempt from Disclosure under the Open Records Act

In Department of Revenue v. Eifler, the Kentucky Court of Appeals affirmed the decision of the Franklin Circuit Court to order the release of certain items of taxpayer information contained on a Kentucky tax return pursuant to the Kentucky Open Records Act ("ORR").

Eifler filed an ORR request with the Department to inspect documents on behalf of his client, Delta Resources, Inc. Specifically, Eifler requested either a list or access to records containing the names, addresses, and dates of registration for all taxpayers currently registered with the Department for the Utility License Tax. The Department denied Eifler's request stating that the documents and records containing the requested information did not exist and that there was no preexisting method to obtain such information. The Department further informed Eifler that they believed that his request came within an ORR exemption from inspection. The Department relied on KRS 61.878(1), which provides that public records are exempt from the ORR where they contain information of a public nature and the public disclosure would constitute an unwarranted invasion of personal privacy.

Eifler appealed the Department's denial to the Kentucky Attorney General ("AG") as allowed under Kentucky law. The AG determined that the Department did maintain the sought after documents and that they could be produced for inspection after redaction of confidential information. The Department then appealed the AG's findings to the Franklin Circuit Court, which affirmed the AG's decision.

Before the Kentucky Court of Appeals, the Department first argued that the information requested was not publically accessible under the plain meaning of KRS 131.081(15), which protects certain information provided by taxpayers on their Kentucky tax returns from disclosure. The Department further relied on KRS 131.190(1)(a), which provides that no employee of the Department shall divulge any taxpayer information where the information may have to do with the affairs of the person's business. The Department concluded that these two statutes exempt all information contained on Kentucky tax returns from being disclosed under the ORR except under circumstances that fit within the enumerated exceptions, including under KRS 131.190(1)(b)(2), which allows for the disclosure of any matter that is "an any way made a matter of public record." Additionally, the Department has the authorization, under KRS 131.190(7), to divulge to applicable school districts any utility gross receipts license tax return information that is necessary to enforce the tax

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itself. Importantly, these school tax returns set forth the information that Eifler sought.

The Department further argued that the legislative history of Kentucky supports an interpretation that the entire tax return is confidential and not subject to redaction. The Department relied on the preamble to the Kentucky Taxpayers' Bill of Rights, which set forth that taxes are a sensitive point of contact between the state and its citizens. The Department argued that this preamble provides that information that would normally be regarded as sensitive and private was contained in tax returns and should be protected. The Court seemingly agreed with this argument, to some extent, quoting U.S. v. Richey, 924 F.2d 857, 860 (9th Cir. 1991), which held that "confidentiality is both necessary to ensure compliance with federal tax laws and to ensure each individual taxpayer's right to privacy." However, the Court held that in determining whether the requested records were obtainable under the ORR, it must weigh the recognized legislative policy of protecting the affairs of the taxpayer against the competing public interest of the ORR.

The Court looked to Kenton County Fiscal Court v. Kentucky Enquirer, 2010 WL 890012 (Ky. App. Mar. 12, 2010), where the Kentucky Court of Appeals held that it was "in the interest of public policy for the public to have access to occupational license applications however limited the information may be once redacted to provide the name and location of the business." The Court concluded that the requested tax returns were similar in nature to the occupational license application and that they should be provided to Eifler. KRS 61.878 further requires that where a public record contains information that is both exempt and nonexempt from disclosure, that the Department is required to separate the material and provide the nonexempt information. Pursuant to this statute and the Court's holding in Kenton County, the Court held that the Department must provide Eifler with the requested documents after redacting the personal information that would be exempt from disclosure.

Lastly, as an alternative the Department sought out the cost and fees to create a query which would allow it to provide the requested information if the release was found to be non-exempt. The Court upheld the AG's determination that the Department already maintained the documents necessary to provide the requested information in their database and thus denied the Department's request for these costs. The Court held that Eifler was entitled to inspect the Department's database after the exempt information had been redacted.

The Department's Motion for Discretionary Review filed with the Kentucky Supreme Court was denied on August 13, 2014, and the case is now final.
D. Kentucky Tax Transparency Continues: Franklin Circuit Court Orders a Release of all Department Final Rulings and Case Pleadings made of Record and in Possession of the Department

In *Sommer and Tax Analysts v. Finance and Administrative Cabinet*, the Franklin Circuit Court rejected the Department's claims that redacted versions of final rulings issued by the Department from 2004 to 2012 were protected by state taxpayer privacy statutes and ordered their release as part of an Open Records Act request. In reaching this decision, the Court held that it was abundantly clear that the Department could "comply with its obligations under the Open Records Act to disclose to the public the substance of its final administrative rulings without unduly infringing on the privacy rights of taxpayers, or violating the general confidentiality statute."

After an initial denial of the Open Records request, the Attorney General's Office affirmed the denial. An appeal was then taken to the Circuit Court. Among other points, the Department argued that confidentiality statutes prevented it from disclosing its final rulings and, in the alternative, such final rulings would require so much redaction as to make them not helpful to taxpayers. Additionally, the Department argued that the burden of preparing the existing 700 final rulings for publication weighed in favor of such rulings being withheld from disclosure. However, the Court concluded that after weighing all relevant factors, public disclosure of the Department's final rulings was necessary in order for the public to know whether the Department has been fair and consistent in its rulings or whether the Department had displayed political favoritism to some taxpayers over others. The Court further concluded that the taxpayer confidentiality statute, on which the Department relied, applied only to information that the state compels such taxpayer to produce and provides no basis to shield the Department from public disclosure of its own rulings, and in so ruling ordered that an award of attorneys' fees was warranted.

E. Franklin Circuit Court Reverses KBTA Decision finding that Air Pollution Control Units Installed by Pollution Control Vendor in a Demonstration Facility Qualifies for Sales/Use Tax Exemption for Pollution Control Facilities and Further Remands Case Back to KBTA for Further Discussion

In *Eco Power Solutions Corp. v. Dep't or Revenue*, the Franklin Circuit Court reversed the decision of the KBTA holding that a taxpayer creating

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air pollution for demonstration purposes was still entitled to exempt status for the equipment it installed to eliminate air pollution.

Eco Power Solutions Corp. ("Eco") is a service provider that offers integrated energy recapture and emissions reductions solutions to customers seeking pollution control solutions. Eco engages in the development and delivery of patented turnkey emission control and energy recovery technology. Eco built a large demonstration facility to showcase some of its pollution reducing units. The facility has two fossil fuel burning emission units that produce air pollution and also two Eco COMPLY units which create significant reductions in the air pollution that comes from the exhaust of the two fossil fuel burning emission units.

To be exempt for Kentucky sales and use taxes, KRS 139.480(12) requires that the property must be certified as a pollution control facility. Eco applied for a pollution control certificate to allow it to purchase materials and equipment for its demonstration facility without paying sales or use tax. A "pollution control facility" is defined in KRS 224.01-300(1) as property designed, constructed, or installed as a component part of a commercial or industrial premise for the primary purpose of reducing air pollution. The Department denied Eco's request on the basis that the primary purpose of the equipment was to demonstrate its products and not for pollution control.

The KBTA determined that the COMPLY units were designed as a component part of a commercial premise for the purpose of air pollution control. In analyzing the primary purpose of the COMPLY units, the KBTA took note that the units were on the premises to control the air pollution that was created by the facility. Once the taxpayer created the air pollution, the COMPLY units became necessary to reduce the air pollution generated by the facility. Importantly, the KBTA held that there was no distinction under KRS 224.01-300(1) for air pollution which is the byproduct of a manufacturing process and air pollution which is the byproduct of a demonstration process. The KBTA further held that KRS 224.01-300(1) was neither ambiguous nor capable of two meanings. Since the statute was clear on its face, the KBTA applied it to the facts as presented to find that the primary purpose of the COMPLY units was to reduce the pollution created by the demonstration facility and thus fit within the exemption.

The Department appealed the KBTA's decision to the Franklin Circuit Court, which entered an order reversing the KBTA's decision and remanding the case back to the KBTA to reinstate the Department's Final Ruling. While the Franklin Circuit Court agreed with the KBTA's decision that KRS 224.001-300(1) was unambiguous, the Court did not agree that the COMPLY units qualified for the sales and use tax exemption under the plan meaning of the statute. The Circuit Court reasoned that under the plain meaning of the exemption, only those units installed as component parts of a pollution control facility for the primary purpose of reducing air pollution would qualify for the exemption. By Eco's own admission, the primary purpose of the COMPLY units was to market the
COMPLY units to potential customers and not to reduce its air pollution. Therefore, the Circuit Court concluded that the COMPLY units did not qualify under KRS 224.001-300(1).

F. The Sale of Horse Trailers Outfitted with Living Quarters Qualifies under Sales Tax Exception for the Sale of Trailers and Semi-Trailers

In Shinin’ B Trailer Sales, LLC v. Dep’t of Revenue, the KBTA held that the sale of horse trailers outfitted with living quarters qualified under the sales tax exception for semitrailers and trailers. The definitions of a semitrailer and trailer are provided in KRS 189.010(12) and (17) as vehicles designed to either be drawn by or attached to a motor truck or truck-tractor, intended for the carrying of freight or merchandise and having a load capacity of over one thousand pounds.

The Department did not dispute that the horse trailers had the necessary load capacity or that they were drawn/attached to a motor truck or tractor-trailer. The Department argued that the horse trailers were not intended to be used for the carriage of freight or merchandise because of the attached living quarters. The Department reasoned that the word "intended" in the trailer and semi-trailer definitions required that the primary purpose of the trailer must have been to carry freight or merchandise. The Department concluded that the presence of the living quarter section made it impossible for the trailers to be used primarily for the carrying of freight.

The KBTA determined that there were no limiting words used in the statutory definitions and that it did not have the power to modify or add language into the definitions. In determining that no limiting language should be added to the definitions, the KBTA looked to KRS 132.010(17), which defines a recreational vehicle as a vehicular type unit primarily designed as a temporary living quarters for recreational, camping or travel use. The KBTA took note that if that statute was at issue before the KBTA, it would then have to determine the primary purpose of the horse trailer with living quarters. Since there was no similar language in the definitions of a semitrailer and trailer, the KBTA concluded that all it must determine was whether the horse trailer with living quarters was intended for the carriage of freight or merchandise. The KBTA further took note that the definitions of a semitrailer and trailer under KRS 189.010(12) and (17) were used by the Transportation Cabinet as well as the Department. The KBTA concluded that the General Assembly could not have meant for the transportation statutes to apply to some horse trailers and not to others.

The Department conceded that a horse could be considered to be freight or merchandise where the horse was going to market for sale. However, the KBTA further concluded that a horse in a horse trailer would be

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considered freight no matter its destination. The KBTA held that within the plain meanings of KRS 189.010(12) and (17), there was no requirement that freight go to a particular destination before it can qualify as freight. As a matter of law, the KBTA further held that it made no difference whether the horse trailers were transporting horses to a sale or to a farm for personal usage. A horse transported in a horse trailer with living quarters is freight no matter the destination.

The KBTA decision was affirmed by the Franklin Circuit Court on June 11, 2014. The Department filed an appeal challenging the decisions of the KBTA and the Franklin Circuit Court with the Kentucky Court of Appeals, where the case still remains.

G. Circuit Court Overturns KBTA's Disallowance of Warehouse/Distribution Center Property Tax Exemption for Leased College Textbooks Shipped back into Kentucky, and Circuit Court and Court of Appeals Rule on whether a Taxpayer Must Post a Supersedeas Bond on Appeal

In Chegg, Inc. v. Department of Revenue, the KBTA originally held that textbooks stored in a Kentucky warehouse before such textbooks were leased to students generally outside the state did not qualify for the warehouse/distribution center property tax exemption as the property ultimately returned to Kentucky and thus the property’s final destination was not outside Kentucky. Under the KRS 132.097 property tax incentive, any property maintained in a warehouse or distribution center will be exempt where such property is to be shipped out of the state within six months. On appeal, however, the Franklin Circuit Court reversed the KBTA’s decision and found that under the plain meaning of the statute, all a taxpayer must show is that the property is shipped outside of Kentucky within six months, not that its “final” destination is outside of Kentucky. Thus, the taxpayer’s leased property met the exemption under KRS 132.097.

Chegg, Inc. (“Chegg”) rents textbooks to college students, generally for semester-long periods. The textbooks are stored and shipped from a warehouse located in Bullitt County to students throughout the country. Once the students’ semester ends, the textbooks are returned to the Bullitt County warehouse facility. Chegg then releases or sells the textbooks to other students, or ships them to a third-party seller.

In denying Chegg’s argument that it was entitled to the KRS 132.097 property tax benefit, the Department held that in order to qualify for such property tax exemption, the textbooks must never return to Kentucky after being shipped from the warehouse. Additionally, the Department refused to waive the penalties imposed on Chegg for its failure to pay the Kentucky property tax on the textbooks.

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The KBTA agreed with the Department's interpretation of the KRS 132.097 property tax exemption, noting that it must construe property tax exemptions narrowly. Since the clear majority of textbooks were ultimately shipped back into Kentucky, the KBTA agreed that the property tax exemption did not apply. Additionally, the KBTA upheld the Department's imposition of penalties holding that before Chegg would be entitled for a penalty waiver, Chegg must prove the following three things: (1) Chegg's unfamiliarity with the tax laws; (2) full disclosure by Chegg of all relevant facts to its tax adviser through supporting documentation; and (3) the exercise of reasonable care in deciding whether to seek further advice. Chegg was unable to prove each of these three things and thus the KBTA upheld the penalty imposition.

Chegg appealed the KBTA's Decision to the Franklin Circuit Court, at which point the Department requested that Chegg post a supersedeas bond or other alternative security during the pendency of the appeal. Importantly, in an Order entered March 25, 2014, the Circuit Court denied the Department's request, holding that pursuant to KRS 131.370 (the applicable statute) the posting of a supersedeas bond is only applicable for appeals taken from the Circuit Court and not for appeals taken to the Circuit Court. The Department filed a Writ of Mandamus with the Kentucky Court of Appeals against Judge Thomas D. Wingate of the Franklin Circuit Court seeking an Order requiring the posting of a supersedeas bond. The Department's Writ of Mandamus was denied by the Court of Appeals on August 14, 2014.

Shortly thereafter, the Franklin Circuit Court entered an Order on October 29, 2014 reversing the KBTA's decision, and again affirming that no supersedeas bond is needed on an appeal from the KBTA to the Circuit Court, as the exemption contained no statutory requirement that personal property be shipped to a final or permanent destination. The case is currently pending at the Court of Appeals.

H. Kentucky Court of Appeals Affirms Decision of Circuit Court to Exclude Out-of-State Subsidiaries from Consolidated Income Tax Returns

In Department of Revenue, Finance & Admin. Cabinet v. AT&T Corp., the Kentucky Court of Appeals upheld an earlier ruling of the Jefferson Circuit Court holding that AT&T Corp. did not have to include its non-Kentucky subsidiaries on its Kentucky consolidated income tax returns where such subsidiaries had no physical presence in Kentucky.

At issue in this case was AT&T Corp.'s ("AT&T") consolidated tax returns for the 1995, 1996, and 1997 tax years. AT&T originally included all of its subsidiaries on its Kentucky consolidated income tax returns for the years at issue. However, AT&T then sought to amend its consolidated income tax returns to include only those subsidiary corporations with a Kentucky

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physical presence. The Department denied AT&T’s request to amend its consolidated tax returns which entitled them to a refund claim, and the KBTA upheld such denial.

AT&T then appealed the Department and the KBTA’s denial of its amended consolidated tax returns to the Jefferson Circuit Court. The Jefferson Circuit Court agreed with AT&T’s claim that the Kentucky elective consolidated corporation income tax return statute was ambiguous because it simultaneously stated that corporations without a Kentucky nexus are exempt from taxation, but also that all members of a U.S. affiliated group must be a part of the consolidated return. The Jefferson Circuit Court ultimately concluded that only AT&T’s subsidiary corporations with a Kentucky nexus were required to be reported on the consolidated returns.

Almost six years later, the Court of Appeals affirmed the Circuit Court’s decision and concluded that since AT&T’s foreign subsidiary corporations did not own or lease property within Kentucky and had no individuals receiving compensation located in Kentucky, such subsidiary corporations could not be taxed in Kentucky. As such, AT&T was not required to include those subsidiary corporations on its Kentucky consolidated tax returns.

The Court of Appeals decision in this case may not provide much useful guidance for Kentucky corporate taxpayers. First, the opinion was unpublished and may only be cited in limited circumstances. Additionally, elective consolidated filing was effectively eliminated for tax years beginning on or after January 1, 2005 under the Tax Modernization Act. The Department filed a motion for discretionary review with the Kentucky Supreme Court, which is currently out on assignment.

I. KBTA Holds that Taxpayer Presented Insufficient Evidence to Support Alternative Valuation Method for its Tangible Personal Property

In Rent A Center East v. Dep’t of Revenue, the KBTA held that the taxpayer presented insufficient evidence in which to support an alternative valuation method for its tangible personal property tax returns.

Rent-A-Center East, Inc. ("RAC") is in the business of renting household goods to consumers through rental-purchase agreements. For the tax years 1997-2001, RAC entered into a settlement agreement with the Department concerning how to value these household goods for purposes of the tangible personal property tax. Post-2001, RAC filed its tangible personal property tax returns using an alternative valuation method based upon the prior settlement agreement. For RAC’s post-2001 property tax returns, the Department disregarded RAC’s alternative valuation method because the settlement agreement had not been a "going forward" agreement and further because RAC had not proved that

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the alternative valuation was necessary. Because it had concluded that
the alternative valuation used by RAC was improper, the Department
assessed RAC for additional property taxes, interest, and an omitted
property tax penalty.

RAC ultimately wanted the KBTA to render a legal determination as to the
proper way to value its rent to own household items for property tax
purposes. However, the KBTA determined that the evidentiary record
before it was insufficient to make such a determination.

As a preliminary matter, the KBTA first discussed the Department's
Motion in Limine requesting that the testimony of RAC's proposed expert
witness be excluded from the hearing. The KBTA granted the
Department's motion because RAC had not complied with the discovery
deadlines imposed by its Prehearing Order. Specifically, the Motion was
granted because RAC failed to timely name its expert witness in response
to the Department's discovery request for such information. Importantly,
the KBTA further concluded that RAC's listing of the proposed expert
witness in its prehearing compliance statement did not cure its failure to
timely disclose such witness in response to the Department's discovery
request nor authorizes a deposition of the witness.

In arguing that the settlement agreement should be treated as controlling
going forward, RAC argued that since the agreement itself did not
specifically state that it would not go forward, that it was meant to be
"going forward." However, the KBTA determined that the agreement was
clear and unambiguous in that it was intended to only cover the years at
issue. Additionally, the KBTA concluded that the transmittal letter for such
settlement agreement supported the conclusion that it was not meant to
be "going forward."

In arguing that its alternative valuation method was necessary because its
property would have been overvalued, RAC introduced documents from
its former property tax firm that prepared the property tax returns at issue.
Additionally, RAC's corporate representative testified generally about
RAC's business and why he believed that the property was overvalued.
The KBTA concluded that such evidence was insufficient to show that
RAC's property was overvalued because such evidence did not support a
finding that the property was overvalued. The documents from the former
firm did not provide any reasoning for why such property should be
valued in a certain manner and RAC's corporate representative did not
present any valuation evidence. Therefore, the KBTA held that RAC was
not entitled to the alternative valuation method used on its tangible
personal property tax returns.

The KBTA further upheld the Department's imposition of the omitted
property tax penalty was proper because it determined that RAC did not
have reasonable cause from its reliance on its former firm's advice to file
such tax returns using the alternative valuation method. By failing to seek
a determination with the Department as to its alternative valuation
method, as required by the tangible property tax returns, the KBTA
determined that RAC did not act with reasonable care and prudence. Therefore, the imposition of the omitted property tax penalty was proper.

RAC also argued that the Department was required to set forth its method for the assessment of tangible personal property in a regulation. However, the KBTA held that the Department's tangible property method of assessment did not need to be set forth in a separate regulation because the Kentucky courts do not require that the measuring stick for tax assessments be set forth in a statute or regulation. As such, the KBTA held that the listing of such assessment methods in the Department's returns and instructions was sufficient. And finally, the Board completely ignored the key issue of whether the involved property constituted household goods exempt under the Constitution of Kentucky. RAC, however, has since appealed such decision to the Jefferson Circuit Court where all briefs have been submitted and a decision should be forthcoming shortly.

J. KBTA Holds that Utility and Industrial Equipment Rental Agency Qualifies for Local Property Tax Exemption for other Equipment Held in its Inventory for Sale under a Floor Plan Financing Arrangement

In Wilson Equipment Company, LLC v. Department of Revenue, the KBTA held that a rental agency selling, leasing, renting, and repairing machinery and equipment qualified for the local property tax exemption for the utility and industrial equipment that it leased and sold to its customers.

At issue in this case was whether Wilson Equipment Company, LLC ("Wilson") was entitled to the local property tax exemption provided under KRS 132.200(16) for "new farm machinery and other equipment held in the retailer's inventory for sale under a floor plan financing arrangement by a retailer, as defined under KRS 365.800." The Department argued that Wilson was not entitled to the local property tax exemption because Wilson did not hold farm machinery or other farm equipment. Wilson claimed that it was entitled to the local property tax exemption because the words "other equipment" should not be interpreted to include only new farm equipment, but should include all "other equipment."

In its Conclusions of Law, the KBTA agreed with Wilson's interpretation of the meaning of the words "other equipment." The KBTA reasoned that the use of the word "other" indicated that it was a second category to be in addition to or different from that already named. As such, the KBTA concluded that other equipment was a second category set forth in the statute without qualification.

The KBTA then looked to the definition of the term "retailer," as defined under KRS 365.800, to determine whether Wilson was entitled to the local property tax exemption.

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property tax exemption. Under KRS 365.800, a retailer is defined to include anyone engaged in the business of selling and retailing farm implements, tractors, farm machinery, utility and industrial equipment, and lawn and garden equipment. Because Wilson was engaged in the business of selling and retailing utility and industrial equipment, Wilson was a retailer for purposes of the local property tax exemption.

Lastly, the KBTA concluded that the only limits of the term "other equipment" were the categories contained in the definition of a retailer under KRS 365.800. Provided that the machinery or equipment falls within the listed categories, such equipment or machinery will be classified as "other equipment" for purposes of the local property tax exemption. Since Wilson was a retailer that held utility and industrial equipment for sale, the KBTA held that such equipment was "other equipment" and that Wilson was entitled to the local property tax exemption.

The Department timely appealed the KBTA's Final Order to the Franklin Circuit Court where it is currently pending.

K. KBTA Upholds Validity of the Department's 2001 Regulation concerning Switch Access Services

In Sprint Communications Company, L.P. v. Department of Revenue, the KBTA upheld the validity of the Department's 2001 Regulation holding that switch access services could not be exempt from the sales tax in the years prior to an amendment to the controlling statute which expressly exempts such services from the sales tax.

At issue in this case was whether Sprint Communications Company, L.P ("Sprint") was exempt from the Kentucky sales tax during 2005 for its switch access services that it resold to other switch access service carriers. Specifically at issue was whether a regulation promulgated by the Department in 2001 stating that switch access services could not be exempted from the sales tax was valid and controlling in light of an amendment to the controlling statute occurring in 2005 stating that such services were not subject to the tax starting in 2006.

Sprint argued that the 2005 amendment merely clarified the existing law that such access services were exempt and further that the 2001 regulation should be disregarded because it was a change in the Department's prior position. Additionally, Sprint argued that prior to the 2005 amendment, the controlling statute was ambiguous and the Department should have been bound by its prior construction of the statutes. In response, the Department argued that there was a change in the 2000 law to broaden the scope of switch access services and that the 2001 regulation was promulgated to support such change. Additionally, the Department argued that the 2005 amendment was a change in the

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law to exempt switch access services and thus the regulation was still controlling in 2005.

While noting that Sprint presented no evidence that the Department held a contrary position prior to promulgating its 2001 regulation, the KBTA concluded that as long as the regulation was in conformity with the controlling statute, the Department would have been allowed to have changed its position. Citing Revenue Cabinet v. Lazarus, Inc., the KBTA took note that "the failure of a public officer to correctly administer the law does not prevent a more diligent and efficient public administrator to bring into the revenue proper subjects of taxation." Because Sprint introduced no evidence showing that the Department's 2001 regulation added to or detracted from the controlling taxing statute, the KBTA was bound by the clear plain meaning of the Department's regulation. As such, the KBTA held that Sprint was not exempt from the sales tax for the switch access services it resold to other switch access service carriers during 2005.

Sprint timely appealed the KBTA's Final Order to the Franklin Circuit Court where an Agreed Order for Dismissal was rendered on August 29, 2014.

L. Court of Appeals Upholds Validity of KRS 68.197(8) as being Reasonably Related to a Rational Purpose

In City of Corbin v. Knox County, the Kentucky Court of Appeals upheld the constitutional validity of KRS 68.197(8), which provided certain defined qualification rights for the off-set or credit of a county's occupational licenses fees for city occupational license fees incurred.

At issue in this case was KRS 68.197(8), which provided that in between March 14, 2013 and July 15, 2014, any set-off or credit arrangement by which a city's license fees were available to offset the taxpayer's county's license fees in effect as of March 15, 2012 would remain in effect through July 15, 2014 and both the city and the county were allowed to both levy and collect license fees. The City of Corbin had never collected its license tax, thus under KRS 68.197(8), its citizens would be unable to credit their county license tax through July 15, 2014 as a matter of law.

The City of Corbin and Joe White, a Corbin business owner, (collectively, the "appellants") filed a petition with the Knox Circuit Court asking the Court to declare KRS 68.197(8) unconstitutional. The Knox Circuit Court rendered a summary judgment opinion against the appellants, holding that the City of Corbin did not have standing to challenge the statute because the statute did not affect its ability to impose and/or collect its

12 49 S.W.3d 172, 175 (Ky. 2001).
occupational license fees. The Circuit Court further held that while White had standing to challenge the statute, KRS 68.197(8) was not unconstitutional.

The appellants first argued that KRS 68.197(8) was enacted in violation of the title or notice requirement under Section 51 of the Kentucky Constitution because such set-offs and credits did not within with the designated purposes of Act authorizing the enactment of KRS 68.197(8). The Court of Appeals disagreed, reasoning that where the title adequately expresses a general subject, any provision in the act that is reasonably embraced with that general subject must be considered to be within the scope of the notice of subject given by the title. The Court of Appeals held that the availability of set-offs and credits of city occupation license taxes against county license taxes was logically assumed to be within the broad category of fiscal matters and thus no Section 51 violation had occurred.

The appellants then argued that KRS 68.197(8) violated constitutional prohibition against special legislation contained in Sections 59 and 60 of the Kentucky Constitution because it distinguishes between cities that levied occupational taxes and those that did not. Once again, the Court of Appeals disagreed holding that the General Assembly had a rational basis to treat the two different types of cities differently. The Court of Appeals reasoned that KRS 68.197(8) rationally supported the settled fiscal interests of local governments that had come to rely on occupation license tax revenue by preserving the status quo during a period of fiscal turbulence.

Lastly, the appellants argued that KRS 68.197(8) was arbitrary, unreasonable, and discriminatory. The Court of Appeals dismissed these contentions as well, finding that KRS 68.197(8) was not arbitrary or unreasonable because it did not single out any particular entity for special taxation. Additionally, Court of Appeals upheld the time frame imposed under KRS 68.197(8) because it served a rational basis.

The appellants filed a Motion for Discretionary Review with the Kentucky Supreme Court, which was denied by the Court in February 2015. The case is now final.

M. Court of Appeals holds that Fee Imposed on Water Meters to Provide Funding for 911 Emergency Fund was not a Valid User Fee

In City of Lancaster v. Garrard County, the Court of Appeals reversed the Garrard Circuit Court's summary judgment opinion that a $0.25 fee imposed on each water meter located within Garrard County was a proper user fee to fund the 911 emergency telephone services within the county.

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At issue in this case was an Ordinance enacted by the Garrard County Fiscal Court to impose a $0.25 charge on each water meter located within Garrard County to help fund the county's 911 emergency telephone service. The Ordinance further created a concomitant duty on entities providing water in the county, including the City of Lancaster and the Garrard County Water Association (collectively, the "appellants"), to collect the water meter fee.

The appellants filed a verified complaint against Garrard County and the Garrard County Fiscal Court in the Garrard Circuit Court alleging that the Ordinance was an unconstitutional taking of property. The Garrard Circuit Court rendered summary judgment upholding the validity of the Ordinance. The Circuit Court reasoned that the fees levied under the Ordinance complied with the statutory provided governmental object of funding the 911 emergency telephone services and was constitutionally indistinguishable from the statutorily authorized land line fee, which has never been challenged.

In their appeal to the Court of Appeals, the appellants argued that the Ordinance did not impose a valid user fee, but rather imposed an invalid tax. The Court of Appeals agreed with this argument and held that the circuit court was in error. The Court of Appeals reasoned that prior case law has recognized that a valid user fee exists where there is a reasonable relationship between the fee charged and the benefit received. However, the Court of Appeals concluded that there was no reasonable relationship between a fee charged on each water meter and the benefit of a 911 telephone service. As such, the Ordinance could not be a valid user fee.

The Court of Appeals remanded the case to the Garrard Circuit Court to determine whether the Ordinance was a valid license or tax.

N. KBTA Upholds the Department's Denial of a Taxpayer's Refund Claim for Special Fuels Taxes Paid on Fuels Purchased for Exempt Non-Highway Purposes

In Revelation Energy v. Department of Revenue, the KBTA upheld the Department's denial of the taxpayer's refund claim for the special fuels taxes and petroleum environment assurance fees it paid on its special fuel purchases.

At issue in this case was the statutory requirement that a taxpayer have a refund permit issued by the Department before it can claim a refund for the special fuels tax and petroleum environment fees (collectively, the "special fuels taxes") on fuels purchase for non-highway uses. The Department issued a refund permit to Revelation Energy ("Revelation") on January 6, 2011 and granted Revelation's refund claim for the special fuels taxes.

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15 File No. K13-R-08, Order No. K-24660 (KBTA June 24, 2014), on appeal Civil Action No. 14-CI-00799 (Pike Cir. Ct.).
fuels taxes paid on or after such date. The Department disallowed Revelation's refund claim for the special fuels taxes paid before January 6, 2011 because Revelation did not have the refund permit required by the special fuels taxes statutes.

Revelation did not argue that the refund requirement in the special fuels taxes was not controlling. However, Revelation claimed that the refund permit requirement violated the due process and equal protection clauses of the U.S. and Kentucky Constitutions. Both Revelation and the Department classified this challenge as a facial challenge to the statute itself. The KBTA agreed with this classification and held that it did not have the authority to rule on a facial constitutional challenge to the refund permit requirement contained in the special fuels taxes statutes. As such, the KBTA upheld the Department's denial of Revelation's claim for refund.

Revelation timely appealed the KBTA's Final Order to the Pike Circuit Court where it is currently pending.

O. Kentucky Supreme Court holds that Taxpayer is not Required to Collect E-911 Fees on Pre-Paid Wireless Cards prior to Statutory Amendment, but that Taxpayer was not Entitled to Recoup its Current E-911 Fees with Fees it had previously Paid in Error

In Virgin Mobile U.S.A., L.P. v. Com. ex rel. Commercial Mobile Radio Service Telecommunications Bd.,\textsuperscript{16} the Kentucky Supreme Court held that although it was not statutorily required to collect "E-911" charges prior to a statutory amendment in 2006, the taxpayer was not entitled to the "self-help remedy" of recouping such prior E-911 payments made in error to the Commercial Mobile Radio Emergency Service Telecommunications Board (the "Board") and thus was required to pay all CMRS service charges for which such recoupment offset was due after 2006.

To provide a funding mechanism for the state's 911 emergency service system, the General Assembly created the Board and directed the Board to collect a CMRS service charge of $0.70 per month per CMRS connection in 1998. The General Assembly further provided that each CMRS provider, defined as an entity that provides mobile telephone service to a mobile phone user, was required to act as a collecting agent for the CMRS service charge by levying such charge as part of the provider's normal monthly billing process. Importantly, the General Assembly stated that mobile service providers had no obligation to take legal action against their customers that failed to pay the service charge. This statutory framework was designed and intended to integrate seamlessly into what was then the only mode of selling mobile service to consumers: a mobile service provider would enter into a contract with its customers.

customer to provide mobile phone service for an extended period of time and would be billed each month for such service.

Virgin Mobile U.S.A., L.P. ("Virgin") began doing business in Kentucky in 2002, which was after the General Assembly's enactment of the statutory structure for its CMRS service charge. Virgin engaged in the business of selling cell phones with pre-paid wireless communications services to third-party retailers. The retailers would then sell Virgin's services to their own customers. Virgin did not deal directly with the ultimate consumers of its services until such consumers wanted to purchase additional minutes for use. Importantly, there was never a fixed term contract or a monthly billing system in place between Virgin and the ultimate consumers of its wireless communications services.

Since there was no monthly billing system in place, Virgin could not impose the CMRS service charge in a manner consistent with the statutory requirements. Operating under the assumption that it was responsible for the collection of such CMRS service charges, Virgin instead estimated that its customers would have owed $289,807.20 in service charges between August 2002 and May 2005, and itself paid such amount to the Board from its own revenues. In May 2005, Virgin concluded that based on its industry research, it was not responsible to act as a collection agent for the CMRS service charge and stopped making payments to Board from its own revenues. Virgin then filed a refund request with the Board for the $289,807.20 in service fees it had paid from its own revenues. The Board denied such request, but took no further action against Virgin to compel it to resume making its CMRS service payments.

In 2006, the General Assembly amended the CMRS service charge statutory structure. The amendments expressly provided that prepaid mobile phone services were subject to the CMRS service charge and provided alternative collection methods by which the CMRS service fee could be collected and remitted to the Board. Virgin did not contest that it was responsible for the CMRS service fee after such amendments went into effect. Instead, Virgin once again requested that the Board refund the $289,807.20 in payments it had previously made and, starting in October 2006, it began to offset its liability under the new amendments with such prior payments after the Board did not promptly respond to its refund request.

The Board filed suit against Virgin in the Jefferson Circuit Court in October 2008 seeking to recover from Virgin all CMRS service charges owed from 1999 through July 2006. The Jefferson Circuit Court entered summary judgment against Virgin holding that under the pre-amendment statutory structure of the CMRS service charge, Virgin was required to collect the service charge. In addition to the $289,807.20 in fees recouped by Virgin, the Circuit Court also held that Virgin was liable for the service charges accrued between the time it quit making its voluntary payments and the 2006 amendments to the statutory structure. Additionally, the Circuit Court awarded attorneys' fees to the Board. On
appeal, the Kentucky Court of Appeals affirmed the Circuit Court's determination that Virgin was required to collect the CMRS service charge under the pre-amendment statutory structure. However, the Court of Appeals reversed the Circuit Court's attorneys' fees award, stating that it had concluded that Virgin acted in good faith in disputing the service charge.

The Kentucky Supreme Court reversed the Court of Appeals conclusion that Virgin was required to collect the CMRS service charge under its pre-2006 amendment statutory structure. The Supreme Court looked to the statutory language of the prior statutes as a whole and concluded that the General Assembly intended to impose the CMRS service charge on the CMRS user. Additionally, the General Assembly vested the primary responsibility for the collection of the CMRS service charge on the Board by delegating to the Board the duty to collect the service charge from each CMRS connection and further authorizing the state to initiate suit against any CMRS customer to enforce the collection of such charge on behalf of the Board. Importantly, the General Assembly did not authorize CMRS service providers, like Virgin, to exercise their discretion in collecting the CMRS service fee from its customers.

Prior to the 2006 amendments, the sole collection remedy authorized by the CMRS service fee statutes was the imposition of the fee as part of the billing provider's monthly billing process. Because Virgin had no monthly billing process in place with the consumers of its CMRS services, it was not required to act as a collection agent for the CMRS service charge because it was not a billing provider. In summary, the Supreme Court held that under the plain language of the law, a $0.70 service charge was imposed on all CMRS users and only billing providers were required to collect such charges. The mere fact that the General Assembly did not anticipate that there would one day be prepaid mobile service does not provide sufficient justification to ignore the specific words used by the General Assembly. Accordingly, the Supreme Court reversed the Court of Appeals decision holding to the contrary.

The Supreme Court then concluded that Virgin was not entitled to claim a self-help credit for its post-amendment CMRS service charge obligation based on the payments it had previously made in error. In supporting this decision, the Supreme Court dismissed Virgin's contention that it was entitled to a credit pursuant the tax refund provisions contained in KRS 134.580. Because the CMRS service charge was not money paid into the State Treasury, the Supreme Court concluded that such refund provisions were not applicable to Virgin. The Supreme Court further dismissed Virgin's common law argument that it was entitled to a refund for the CMRS service charges paid prior to the 2006 amendment. The Supreme Court reasoned that Virgin could not rely on these common law principles as support for its underpayment of its CMRS obligation because such principles only support a claim for refund and not as justification for the underpayment of an otherwise valid obligation. Because Virgin had no legal right to retain its current collections of the CMRS service charge as a credit for those earlier payments made in
error, the Supreme Court affirmed the Court of Appeals to the extent it affirmed the Circuit Court's judgment that Virgin was liable for its post-2006 amendment CMRS service charge collections.

Lastly, the Supreme Court held that the Court of Appeals improperly reversed the Circuit Court's award of attorneys' fees. The Supreme Court was satisfied that the Circuit Court gave appropriate consideration to the relevant factors and therefore did not abuse its discretion in awarding the Board attorneys' fees. However, because the Supreme Court's opinion significantly altered each party's extent of success, the case was remanded back to the Jefferson Circuit Court for reconsideration of the attorneys' fees issue.

P. KBTA Ignores Contrary Letter Ruling to hold that Parent Corporation with \textit{de minimis} Activities in Kentucky Cannot File a Consolidated Tax Return with Its Wholly Owned Subsidiary

In \textit{World Acceptance Corporation and World Finance Corporation Kentucky v. Department of Revenue}, the KBTA held that the parent corporation was not an includible corporation that could file as part of a consolidated return with its Kentucky subsidiary corporation.

World Acceptance Corporation ("WAC"), through its national accounting firm, requested a letter ruling anonymously from the Department on whether it had sufficient nexus with Kentucky to enable it to file a consolidated return with its wholly owned subsidiary corporation, World Finance Corporation Kentucky ("WFCKY"). Based on the facts presented in the letter, the Department held that WAC could file a consolidated return with WFCKY. Importantly, the Department made clear that its answer was based on the information presented in the letter ruling request and that additional facts could change its answer. Based on this letter ruling, WAC filed amended tax returns for the years to consolidate its earnings with those of WFCKY and sought a refund for its claimed income tax overpayments. The Department denied WAC's refund claim because WAC's actual facts were materially different from those represented in the letter ruling request and further because WAC was not an includible corporation.

The KBTA concluded that the Department was not bound by its letter ruling because the actual facts were materially different from those set forth in the request. WAC did not reveal that its managerial services performed for WFCKY were done out of state and that its one employee that worked in Kentucky also worked in other states. Without these two critical facts, the KBTA determined that the Department could not properly ascertain whether WAC's activities in Kentucky were more than \textit{de minimis}.

\footnote{File No. K13-R-18, Order No. K-24682, \textit{on appeal} (Franklin Cir. Ct.).}
The KBTA then concluded that WAC was not an includible corporation and thus could not be included in a Kentucky consolidated tax return. To be considered an includible corporation, a corporation having a net operating loss must have property, payroll, and sales within Kentucky that are not *de minimis*. WAC’s only connections with Kentucky were one of its employees that performed audit services in Kentucky between thirty-nine and fifty-five days a year and the management fees it received from WFCKY to cover the costs of its management, accounting, payroll, and administrative activities. The KBTA determined that the Department was correct in disregarding the services performed by WAC’s employee in Kentucky because such employee was a Tennessee resident who performed a majority of her work in Tennessee at the direction of WAC in South Carolina. The KBTA further determined that the Department was correct in disregarding the managerial fees received by WAC because such fees were paid for services performed in South Carolina. Lastly, the KBTA determined that the Department was correct in concluding that WAC’s Kentucky property was *de minimis* because only the company laptop used by the employee while in Kentucky could be considered WAC property within the state. As such, the KBTA held that WAC’s connections with Kentucky were *de minimis* and it was not an includible corporation.

WAC appealed the KBTA’s Final Order to the Franklin Circuit Court where it is currently pending.

Q. Kentucky Court of Appeals holds that Parent Corporation and its Wholly-Owned LLC Subsidiary Constituted One Unit for Purposes of Energy Exemption

In *Ohio Valley Aluminum Co., LLC v. Department of Revenue, Finance & Admin. Cabinet*, the Kentucky Court of Appeals held in an unpublished opinion that a scrap aluminum processor and its wholly owned subsidiary constituted one business operation for purposes of calculating the tax on energy. At issue in this case were provisions in Kentucky’s sales and school tax regime, which imposed a “school tax” on gross receipts derived from the furnishing of utility services to the extent such amounts received are in excess of 3 percent of their cost of production.

Ohio Valley Aluminum Company, LLC ("Ohio Valley") argued that the value of the processed aluminum it obtained from its subsidiary should not be included in its cost of production because the subsidiary owned the raw materials that were processed and had entered into a tolling contract with Ohio Valley. The elimination of the value of such processed aluminum would mathematically reduce Ohio Valley’s liability for the sales and “school tax.”

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The Court of Appeals agreed with the Shelby Circuit Court and the KBTA, holding that the statutes at issue must be expansively interpreted to encompass all production costs, including raw materials, and further that Ohio Valley did not demonstrate that it was truly a separate and complete operation from its subsidiary. Because Ohio Valley and its subsidiary were dependent on one another to produce a finished product, both companies' inputs were part of the total costs of production. As such, the subsidiary's cost to produce the aluminum provided to Ohio Valley must be included in Ohio Valley's total cost of production.

Ohio Valley filed a Motion for Discretionary review with the Supreme Court where it is currently pending.

R. Another Win for Tax Transparency: The Franklin Circuit Court Affirms Decision of the Attorney General's Office Holding that the Department must Provide Case Pleadings put into the Public Records to the Requesting Party under the Open Records Act

In Kentucky Department of Revenue v. Mark F. Sommer, the Franklin Circuit Court affirmed the decision of the Kentucky Attorney General's Office, which ordered the Department to produce certain documents and other writings that constituted a case pleading in response to an Open Records Act request.

At issue in this case was an Open Records Request from Mark F. Sommer ("Sommer") to the Department requesting "[a]ny document or writing constituting a case pleading (and any/all attachment(s) thereto) out of public records by any party, witness, agency, tribunal or court reported with the Kentucky Board of Tax Appeals, the Franklin Circuit Court, and/or the Kentucky Court of Appeals, in an action styled and referred to as Insight Kentucky Partners II, L.P. v. Commonwealth of Kentucky, Civil Action No. 01-CI-01528 (Franklin Cir. Ct., Div. II), for the period commencing November 8, 2001 through August 7, 2012." The Department's Custodian of Records denied Sommer's request citing Kentucky case law and Attorney General Opinions in support of the denial.

Sommer appealed the Department's denial to the Attorney General's Office (the "AG"), which rendered a decision finding that the Department's denial was a violation of the Open Records Act. The AG based its decision on the statutory language of the Open Records Act in which the AG concluded did not authorize the Department to deny access to public records "based on the assertion that another agency is the 'primary custodian' of those records." Further, relying on its prior reasoning from a similar case, the AG stated that "[t]he mere possession of records by the agency from which those records are requested is enough to compel that

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19 Civil Action No. 12-CI-01582 (Franklin Cir. Ct. Oct. 6, 2014), aff'g Attorney General's Order 12-ORD-216.
agency to make them available for public inspection or explain why they are exempt."

The Department then appealed the AG’s decision to the Franklin Circuit Court, which entered an order affirming the decision of the AG. In its analysis, the Circuit Court took note that the burden of proof is on the public agency seeking to withhold public records from disclosure under the Open Records Act and further that it would give great weight to the decision and reasoning expressed by the AG in an Open Records Act case. Because the AG had decades worth of decisions holding that there was no specific exemption authorizing the withholding of public records because access to the records could be more easily obtained from another public agency, the Circuit Court concluded that the Department could not deny Sommer's Open Records Act request. Additionally, the Circuit Court dismissed the Department’s reliance on *Ex parte Farley*, limiting the holding of such case to exclude only those public records "maintained by the courts, for the courts, and in the discharge of the courts' duties." Because Sommer's request involved only duplicates of such records maintained by the Department, the Circuit Court concluded that such documents would not be exempt under the holding of *Ex parte Farley*.

The Circuit Court further dismissed the Department's argument that the requested information should be considered privileged under the work product doctrine. The Department reasoned that Sommer should be prohibited from obtaining the requested information because Sommer would be unable to obtain such information through civil discovery and thus the information fits within the Open Records Act exception for materials protected under the Rules of Civil Procedure. The Circuit Court dismissed this argument because the Department had already voluntarily disclosed the requested materials to the public when they were filed in the applicable open court record and thus that the denial of such materials would "completely strip the Open Records Act of all meaning." Lastly, the Circuit Court denied Sommer’s motion seeking attorneys’ fees from the Department because the Court concluded that the Department produced sufficient evidence to show that it acted in good faith in denying Sommer’s Open Records Act request.

S. The KBTA holds that Railroad Track and Signal Items are not Exempt "Supplies" for the "Direct Operation" of Trains

In *CSX Transportation, Inc. v. Dep't of Revenue*, the KBTA determined that various track and signal items were not "supplies" and not used in the "direct operation" of trains and thus not exempt from Kentucky sales and use tax pursuant to KRS 139.480(1).

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20 570 S.W.2d 617 (Ky. 1978).

The involved items included rails, ties, turnouts, frogs, ballast, plates, fasteners, signals, fabric filter, weed control chemicals, and like items used in the daily operations of CSXT's trains. The crux of this matter before the KBTA was whether these items are considered (i) "supplies," (ii) for the "direct operation of locomotives and trains," where the purchase and use is exempt from sales and use tax under Kentucky's statutory Train Supplies Exemption of KRS 139.480(1).

As the meaning of these terms were not defined by KRS 139.480 or regulations concerning same, the taxpayer provided testimony from railroading experts, Kentucky case law, and multiple Texas rulings concerning its similar train supplies exemption, which demonstrated that all of the involved items were "supplies" in the railroad industry. The KBTA, however, disagreed and held that only the weed control chemicals were supplies, as the rest of the items were deemed to be "capital" projects and long-lived assets and thus did not meet the definition of supplies under a different Kentucky statutory exemption, the industrial supplies exemption of KRS 139.470, which specifically requires a supply be consumed within one (1) year. Further, the Court held that although the weed control chemicals are "supplies," they are not used in the "direct operation" of CSXT's trains because it believed it must "actually be used on or in the locomotive or train itself, so that the locomotive and train will function and be operable."

CSXT has since appealed the decision to the Greenup Circuit Court where it currently remains. Importantly, the Circuit Court recently granted a Motion to Stay to CSXT to prevent the Department from collecting against CSXT as the Court determined after oral arguments, similar to the Franklin Circuit Court's opinion in Chegg, supra, that no supersedeas bond or payment of the tax is required to appeal a KBTA decision which is an "original action" under KRS 23A, and that it has the power to order a Stay pursuant to KRS Chapter 13B, and thus the Department cannot collect against CSXT during the pendency of the appeal.

T. KBTA holds that Sleep Apnea Respiratory Therapy Products are not Exempt from Kentucky Sales Tax under KRS 139.472

In Praxair, Inc. v. Dept' of Revenue, 22 the KBTA determined that CPAPs, ventilators, nebulizers, TENS units, and other prescribed medical items sold by Praxair were not exempt from Kentucky sales and use tax under KRS 139.472 as either: (i) "prosthetic devices" as they are not "worn on or in the body," or (ii) oxygen delivery equipment as the items do not provide patients with "medical" oxygen. The KBTA instead held that such items were taxable durable medical equipment (DME) for the involved tax

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Moreover, the KBTA denied the taxpayer’s claims that such sales which were paid for or reimbursed by Medicare or Medicaid are exempt sales to the government under KRS 139.470(1) and (7). Lastly, the KBTA denied the taxpayer’s final argument that the Department violated Kentucky’s administrative rulemaking procedures under KRS 13A through its creation and enforcement of two, unpromulgated written policies, known as the Health Care Item List and Addendum, in which the Department lists and categorizes various medical items as being taxable or exempt based upon its administrative interpretation of KRS 139.472.

Praxair has since appealed the KBTA’s decision to the Franklin Circuit Court at the end of February 2015, where the matter currently remains.

U. Court of Appeals Clarifies that Appeals from KBTA to Circuit Court are Original Actions and thus must Meet all Filing Requirements under Civil Rules

In Wal-Mart Real Estate Business Trust v. Campbell County Property Valuation Administrator, the Kentucky Court of Appeals found a property tax appeal filed by Wal-Mart was properly dismissed because Wal-Mart did not file the appeal with the required filing fee within the statutory deadline and rejected Wal-Mart’s argument that it was not required to pay a filing fee because the appeal was not an original action.

The action began after Wal-Mart appealed the local PVA’s valuation of three parcels of property, in which the Campbell County Board of Assessment Appeals (BAA) upheld two of the assessments and reduced the third by approximately twelve percent. Wal-Mart then appealed the BAA’s rulings to the KBTA, which upheld the BAA’s rulings.

Pursuant to KRS 131.370 and KRS Chapter 13B, Wal-Mart filed a petition of appeal from the decision of the KBTA in the Campbell Circuit Court; however, the PVA moved to dismiss the action pursuant to CR 12.02, alleging the petition was not timely filed within the statutory thirty days when the petition was timely submitted to the Court but was not actually filed as it did not have the required filing fee. After re-filing the petition with the proper filing fee, it was after the thirty day window.

Wal-Mart contended it had fully complied with the statutory requirements of KRS 131.170 and KRS Chapter 13B when it tendered its petition, because nothing in those statutory provisions “requires an aggrieved taxpayer to accompany its petition of appeal with a ‘filing fee’ or any other

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23 Note that KRS 139.472 was legislatively amended in 2009 to also exempt DME. Thus, even if the KBTA’s Order is ultimately upheld on appeal, all of the involved items became exempt as DME beginning July 1, 2009.

payment." Further, Wal-Mart argued this action constituted a "special statutory proceeding" and therefore, pursuant to the plain language of CR 1(2), "the procedural requirements of the statute shall prevail over any inconsistent procedures set forth in the [Civil] Rules." Thus, it contended no filing or summons fee is required when filing an appeal pursuant to KRS 13B.140(1), and the Clerk acted erroneously in failing to file the original petition.

The Court of Appeals, however disagreed with Wal-Mart, and instead agreed with the trial court's order dismissing the action after it found that statutory appeals from administrative agencies constitute "original actions" under KRS 23A and thus the Civil Rules must be filed. The Court of Appeals noted that under Kentucky law, the right to appeal the decision of an administrative agency is not a right, but rather is a matter of legislative grace, and thus, the failure to strictly comply with the statutory guidelines is fatal to an appeal.

The Court ultimately held that the trial court correctly found the matter to constitute an original action, thereby invoking the requirements of CR 3.02, and further, that the Clerk was justified in refusing to file Wal-Mart's petition based on the failure to tender a filing fee.

Pursuant to KRS 23A.010(4), "[s]uch review shall not constitute an appeal but an original action." Thus, as the trial court correctly determined, CR 3.02 is controlling and Wal-Mart's reliance on judicial interpretations of CR 73.02 and other rules related to appeals is misplaced. Importantly the Court held that "[a]lthough this matter is an appeal from an administrative agency, the appellate rules are inapplicable because it is considered an original action [under KRS 23A.010], and the mandates for such actions are controlling." As such, CR 3.01 would apply which instructs the Clerk to collect the filing fee at the time of filing suit in circuit court, and such language is "mandatory and specifically references 'original actions of administrative agencies, special districts or boards.'" Therefore, the Court held that Wal-Mart's assertion that it was not required to tender a filing fee "rings hollow" and the trial court was correct to dismiss Wal-Mart's petition on this basis. This matter is now final.

V. KBTA Determines RV Dealer Liable for Property Tax on Inventory

In Pikeville RV Sales, Inc. v. Dep't, the KBTA upheld a decision denying an RV dealer property tax exemptions on RV inventory, finding the dealer did not meet exemption requirements and that the plain language of bank loan documents, a witness, and a transaction between the dealer and a manufacturer established the dealer's ownership of the inventory.

This is a tangible property tax case involving 2009-2012 tax years only on the taxpayer's RV dealer inventory, as a legislative amendment to KRS 132.200(23) gives this taxpayer the relief they are seeking in this case, for

tax years 2015 going forward. The taxpayer argued that there are two statutes that exempted this property from taxation during the involved years, and that the Department's instructions allow such inventory to be reported on line 34 of the return as "new farm machinery and other equipment held in the retailer's inventory for sale under a floor plan financing arrangement by a retailer as defined under KRS 365.800." The taxpayer claimed this is "other equipment." The taxpayer also argued that unlicensed RVs, which are removed from the Commonwealth within ninety days of January 1, are not subject to property tax pursuant to KRS 132.730. Finally, the taxpayer also argued that the assessments issued to Pikeville RV violate the Kentucky Constitution, because RVs are identical to boats for tax purposes and boats were exempted and RVs were not under Section 171 of the Constitution which provides that taxes are to be uniform upon all property of the same class.

The KBTA, however, agreed with the Department that no exemptions applied during the years involved and that the taxpayer owned the inventory on January 1 of each year in question based on the evidence presented and thus owes the assessed taxes. Further, the KBTA stated that it does not have the authority to decide on the taxpayer's constitutional argument, but if it did, it believed that the remedy would not be for the KBTA to expand the statutory exemption and make the taxpayer's RVs exempt as well as boats, but to strike down the exemption statute that is causing the unconstitutional classification, which the KBTA does not have authority to do.

W. Court of Appeals Upholds Creation of Special Taxing District for Library

In Howard v. McLean County Fiscal Court, the Kentucky Court of Appeals upheld the creation of a library taxing district by a county fiscal court that assesses ad valorem taxes on residents within the district because the court had statutory authority to create special taxing districts under KRS section 67.715(2) and was not limited to KRS 65.182 as argued by the taxpayers.

The matter involved the Livermore Community Library which was created in the 1950s and primarily operated by volunteers and was funded from private donations, fundraisers, and assistance from the City of Livermore and the McLean County Fiscal Court. Federal grants were received in 2008 and 2009 to expand the library's services, increase staffing, and aid in meeting the standards set by the Kentucky Department of Libraries and Archives ("KDLA"). Pursuant to the terms of a $250,000 grant for operating expenses, the Fiscal Court entered into an Interlocal Agreement with the KDLA on November 9, 2010, establishing a public library district. Under the Agreement, the Livermore Community Library would become the McLean County Public Library and would receive

funding from general fund appropriations, state aid and any grants for which it may be eligible.

Within a short time, the Fiscal Court determined it would have insufficient funds to satisfy the library's budget. The County Judge Executive and County Attorney consulted with the KDLA for guidance. The KDLA recommended termination of the Interlocal Agreement, termination of the current library district, and creation of a special taxing district. Pursuant to KRS 67.715(2), the County Judge Executive, with approval of the Fiscal Court, passed a resolution terminating the Interlocal Agreement, dissolving the McClean County Library District, creating the Library Special District, appointing a board of trustees for the newly formed taxing district, and setting the initial *ad valorem* tax rate. The new tax was levied and included in the 2011 tax bills sent to McLean County residents.

The Taxpayers (individuals affected by the decision) then filed a lawsuit asserting KRS 67.715(2) did not authorize creation of special taxing districts, and the Fiscal Court's reliance on that statute was in error. The Taxpayers contended KRS 65.182 provided the sole methods for creating special taxing districts and the Fiscal Court had failed to comply with the requirements set forth therein. Thus, the Taxpayers challenged existence of the Library Taxing District as having being created in contravention of statutory mandates. The complaint sought a declaration that the Library Taxing District was invalid, an injunction prohibiting expenditure of any funds received by the Library Taxing District from the 2011 tax levy, and a refund of all taxes collected by or on behalf of the Library Taxing District.

Following a period of discovery, opposing motions for summary judgment with accompanying memoranda of law were filed. The trial court convened a hearing on the motions, and at the conclusion of the hearing, the trial court denied the Taxpayers' motion and granted the motion filed by the Fiscal Court and Library Taxing District.

After a review of the above facts and the applicable statutes, KRS 65.182 and KRS 67.715, the Court of Appeals likewise disagreed with the Taxpayers' contention that KRS 65.182 controls based upon the plain language of same which recognizes that other methods for creating a taxing district exist (i.e., KRS 67.715), and upheld the lower court's determination that the taxing district was properly created under Kentucky law.

KRS 65.182, the statute relied upon by the Taxpayers, sets out how people in the community desiring to create a taxing district can do so. In summary, the process requires interested persons to present to the fiscal court for consideration a petition for the establishment of a taxing district. The petition must contain the signatures of a certain percentage of McLean County voters. The Taxpayers argued that this is the sole means by which a library taxing district can be created. However, KRS 65.182 acknowledges that there is another means provided by statute to establish a taxing district. The law specifically states, at its beginning, the phrase: "Except as otherwise provided by state law. . . ."
That other method is contained in the statute relied upon by the county judge executive and the fiscal court, KRS 67.715(2), which states in part that "the county judge executive may, with the approval of the fiscal court, create any special district." The Court of Appeals believed that it was apparent that the county judge, with the approval of the fiscal court, had statutory authority to create the public library taxing district at issue and used therein under KRS 67.715(2). The Court's determination was in part based on and supported by a Kentucky Attorney General Opinion, OAG 83-292, which simply states that in enacting KRS 67.715(2), the General Assembly provided another method of creation of special districts in addition to the traditional petition method. Accordingly, the Court denied the Taxpayer's request for relief and entered judgment in favor of the Defendants, as a matter of law.