

1 FINANCE AND ADMINISTRATION CABINET

2 Department of Revenue

3 (Amendment)

4 103 KAR 16:290. Apportionment; property factor.

5 RELATES TO: KRS 141.120, 141.121

6 STATUTORY AUTHORITY: KRS 131.130[(+)], 141.120[(+)(b)]

7 [~~EFFECTIVE: February 10, 2006~~]

8 NECESSITY, FUNCTION, AND CONFORMITY: All[~~KRS 141.120(8) requires that all~~]

9 ~~business or apportionable income of multistate corporations be apportioned to Kentucky by~~

10 ~~multiplying the income by a fraction[, the numerator of which is the property factor plus the payroll~~

11 ~~factor plus a double weighted sales factor and the denominator of which is four (4). KRS~~

12 ~~141.120(10)(b) requires the cabinet to promulgate administrative regulations providing how to~~

13 ~~determine the property factor used in the multi state business income apportionment formula]~~KRS

14 131.130(1) authorizes the department to promulgate administrative regulations to administer and

15 enforce Kentucky's tax laws. This administrative regulation establishes the requirements for

16 determining the property factor of a multistate corporation.

17 Section 1. Definitions. (1) "Annual rent" means the actual sum of money or other consideration
18 payable, directly or indirectly, by the corporation for its benefit for the use of the property;

19 (a) Including:

20 1. Any amount payable for the use of real or tangible personal property whether designated

21 as a fixed sum of money or as a percentage of sales, profits or otherwise; and

1 2. Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance,
2 repairs or any other items which are required to be paid by the terms of the lease or other
3 arrangement; and

4 (b) Not including:

5 1. Amounts paid as service charges, such as utilities or janitorial services; and

6 2. Incidental day-to-day expenses such as hotel or motel accommodations, or daily rental of
7 automobiles.

8 (2) "Net annual rental rate" means the total annual rental paid, less total annual rental received
9 from subrentals, which shall:

10 (a) Be subtracted if they constitute nonbusiness or non-apportionable income; and

11 (b) Not be subtracted if they constitute business or apportionable income because the property
12 which produces the subrentals is used in the regular course of a trade or business of the taxpayer
13 when it is producing business or apportionable income.

14 (3) "Original cost" means the basis of the property for federal income tax purposes, prior to
15 any federal adjustments, at the time of acquisition by the corporation and adjusted by subsequent
16 capital additions or improvements thereto and partial disposition thereof, by reason of sale,
17 exchange, or abandonment.

18 Section 2. General. The property factor shall include all real and tangible personal property
19 owned or rented and used during the taxable year, except coin, and currency [~~and pollution control~~
20 ~~property located in Kentucky for which a tax exemption certificate is issued by the Department of~~
21 ~~Revenue~~].

22 Section 3. Property Used. (1) Property shall be included in the property factor if it is actually
23 used or is available for or capable of being used during the taxable year. Property held as reserves

1 or standby facilities or property held as a reserve source of materials shall be included in the factor.
2 For example, a plant temporarily idle or raw material reserves not currently being processed shall
3 be included in the factor.

4 (2) Inventory in process shall be included in the factor. Property or equipment under
5 construction during the taxable year shall be excluded from the factor until it is actually used or is
6 available for or capable of being used during the taxable year.

7 (3) Property used shall remain in the property factor until its permanent withdrawal is
8 established by an identifiable event such as its sale.

9 Section 4. Consistency in Reporting. (1) Year-to-year consistency. In filing returns with this
10 state, if the taxpayer departs from or modifies the manner of valuing property or of excluding
11 property from or including property in the property factor used in returns for prior years, the
12 taxpayer shall disclose in the return for the current year the nature and extent of the modification.

13 (2) State-to-state consistency. If the returns or reports filed by the taxpayer with all states to
14 which the taxpayer reports are not uniform in the valuation of property and in the exclusion of
15 property from or the inclusion of property in the property factor, the taxpayer shall disclose in its
16 return to this state the nature and extent of the variance.

17 Section 5. Property Factor: Numerator. (1) Property in transit between a buyer and seller shall
18 be included in the numerator according to the state of destination. Property in transit between
19 locations of the same corporation shall be considered at the destination location for purposes of
20 the property factor.

21 (2) The value of mobile or movable property such as construction equipment, trucks or leased
22 electronic equipment which is located within and without Kentucky during the taxable year shall
23 be determined, for purposes of the numerator of the factor, on the basis of total time within the

1 state during the taxable year. An automobile assigned to a traveling employee shall be included in
2 the numerator of the factor of the state to which the employee's compensation is assigned under
3 the payroll factor or in the numerator of the state in which the automobile is licensed.

4 Section 6. Valuation of Owned Property. (1) Property owned by the corporation shall be valued
5 at original cost.

6 (2) Capitalized intangible drilling and development costs shall be included in the property
7 factor whether or not they have been expensed for either federal or state purposes.

8 (3) If the original cost of property is not ascertainable, is nominal, or is zero, the property shall
9 be included in the factor at its fair market value at the date of acquisition by the corporation.

10 (4) Inventory shall be included in the factor by the valuation method used for federal income
11 tax purposes.

12 (5) Property acquired by gift or inheritance shall be included in the factor at its basis for
13 depreciation for federal income tax purposes.

14 Section 7. Rented Property. (1) Annual rental rate shall be determined as follows:

15 (a) If the property is rented for a twelve (12) month period, the annual rent;

16 (b) If the property is rented for less than a twelve (12) month period, the net rent paid for the
17 actual period of rental; or

18 (c) If the property is rented for a period of twelve (12) or more months, and the current tax
19 period covers a period of less than twelve (12) months due, for example, to a reorganization or
20 change of accounting period, the net rent paid for the short tax period shall be annualized.

21 (2)(a) Property rented by a corporation shall be valued at eight (8) times the net annual rental
22 rate.

23 (b) If this calculation results in a negative value or a clearly inaccurate valuation, any other

1 method which will properly reflect the value may be required by the department or may be
2 requested by the corporation, except the net annual rental rate shall not be less than the total annual
3 rental rate multiplied by a fraction, the numerator of which is the fair market value of rent
4 applicable to rental property used by the corporation divided by the fair market value of rent
5 applicable to all of the corporation's rental property.

6 (c) If a payment includes rent and other charges unsegregated, the amount of rent shall be
7 determined by consideration of the relative values of the rent and the other items.

8 (3) If property is used at no charge or rented for a nominal rate, the property shall be included
9 in the property factor on the basis of the fair market value of rent for comparable property in the
10 area.

11 (4) Leasehold improvements shall, for the purposes of the property factor, be treated as
12 property owned by the corporation regardless of whether the corporation is entitled to remove the
13 improvements or the improvements revert to the lessor upon expiration of the lease. The original
14 cost of a leasehold improvement shall be included in the factor.

15 Section 8. Monthly Averaging of Property. Averaging by monthly values shall apply if:

16 (1) Fluctuations in the values of the property exist during the tax period;

17 (2) Property is acquired after the beginning of the tax period or disposed of before the end of
18 the tax period; or

19 (3) Fluctuations in the percentage of property used in Kentucky exist during the tax period.

20 Section 9. This administrative regulation shall be effective for tax periods beginning on or after
21 January 1, 2005.

103 KAR 16:290

APPROVED:

Daniel Bork
DANIEL BORK, COMMISSIONER
Department of Revenue
Finance and Administration Cabinet

10-12-2018
DATE APPROVED BY AGENCY

PUBLIC HEARING AND PUBLIC COMMENT PERIOD

A public hearing on this administrative regulation will be held on November 26, 2018 at 10:00 a.m. in Room 8A, State Office Building, 501 High Street, Frankfort, KY 40601. Individuals interested in being heard at this hearing shall notify this agency in writing by five (5) workdays prior to the hearing, of their intent to attend. If no notification of intent to attend the hearing is received by that date, the hearing may be cancelled. This hearing is open to the public. Any person who wishes to be heard will be given an opportunity to comment on the proposed administrative regulation. A transcript of the public hearing will not be made unless a written request for a transcript is made. If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments will be accepted through November 30, 2018. Send written notification of intent to be heard at the public hearing or written comments on the proposed administrative regulation to the contact person.

CONTACT PERSON: Lisa Swiger, Revenue Tax Policy/Research Consultant II, Department of Revenue, 501 High Street, Station 1, Frankfort, Kentucky, 40601, (502) 564-9526 (telephone), (502) 564-3875(fax), Lisa.Swiger@ky.gov(email).

REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

Regulation Number: 103 KAR 16:290

Contact Person: Lisa Swiger
Phone Number: (502)564-9526
Email: Lisa.Swiger@ky.gov

(1) Provide a brief summary of:

(a) What this administrative regulation does: This regulation provides detailed guidance for calculating the property factor for taxpayers able or required to use this factor when apportioning income to Kentucky.

(b) The necessity of this administrative regulation: The detailed considerations of what constitutes "property" for purposes of calculating a property apportionment factor must be set forth for taxpayers to understand and comply with the law.

(c) How this administrative regulation conforms to the content of the authorizing statutes: The authorizing statutes direct certain taxpayers to utilize a property factor. Furthermore, some alternative apportionment formulae make use of a property apportionment factor. This regulation provides guidance in accordance with statutory requirements.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: This regulation will help taxpayers better understand how the property apportionment factor is calculated.

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation: The amendments to this regulation bring it into compliance with recent law changes as a result of the passage of HB 487/GA2018.

(b) The necessity of the amendment to this administrative regulation: This regulation must be amended to be compliant with the requirements of Chapter 13A.

(c) How the amendment conforms to the content of the authorizing statutes: See (1)(c) above.

(d) How the amendment will assist in the effective administration of the statutes: See (1)(d) above.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: Businesses, particularly providers of telecommunications, cable, and internet services, utilize the property factor when apportioning income to Kentucky.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions that each of the regulated entities identified in question (3) will have to take to comply with this administrative regulation or amendment: No additional actions are required as the guidance is merely updated.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3): No additional costs anticipated.

(c) As a result of compliance, what benefits will accrue to the entities identified in question

(3): Taxpayers will better understand how to calculate the property apportionment factor and will potentially avoid future tax assessments, penalties, and interest.

(5) Provide an estimate of how much it will cost to implement this administrative regulation:

(a) Initially: None.

(b) On a continuing basis: None.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation: The department's General Fund budget covers ongoing compliance related to this regulation.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change, if it is an amendment: No increased fees or funding are required by this amendment.

(8) State whether or not this administrative regulation establishes any fees or directly or indirectly increases any fees: No direct or indirect fees result from this regulation amendment.

(9) TIERING: Is tiering applied? Tiering was not applied, because all taxpayers utilizing the property apportionment factor are treated equally.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

Regulation Number: 103 KAR 16:290

Contact Person: Lisa Swiger
Phone Number: (502)564-9526
Email: Lisa.Swiger@ky.gov

1. What units, parts or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation? No government agencies other than the Department of Revenue are impacted by this regulation.

2. Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation. None.

3. Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year? None.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years? None.

(c) How much will it cost to administer this program for the first year? None.

(d) How much will it cost to administer this program for subsequent years? None.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

Revenues (+/-): \$0

Expenditures (+/-): \$0

Other Explanation: