

# Tax Matters

connecting and informing  
employees



OFFICE OF INCOME TAXATION  
COMMUNICATIONS & TRAINING BRANCH

Spring 2011

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## DOR Spotlight GOVERNMENTAL PROGRAMS

Many employees do not realize that there are two distinct Governmental Programs sections. One section is within Individual Income Tax, the other section is within Corporation Income Tax.

### Governmental Programs

**Location:** 6th Floor, State Office Building

**Workforce:** 24 Employees

- 16 – Individual Income Tax
- 8 – Corporate Income Tax

### Management:

- **Individual Income Tax**
  - o Bill Breeze – Assistant Director
  - o Marianne Richardson – Section Supervisor
- **Corporation Income Tax**
  - o Angie Morris – Branch Manager
  - o Steve Ramsey – Section Supervisor

The Governmental Programs Section was created within the Kentucky Department of Revenue (DOR) to utilize the vast amount of data the Internal Revenue Service (IRS) has on individual and corporate income taxpayers of Kentucky. During its history, new programs have been added and new software has been written. However, the mission has remained the same: to use an exchange of information agreement with the IRS to increase compliance and collections in Kentucky.



## **Corporate Income Tax Section**

Using the information provided by the federal government, the Corporate Income Tax area administers two federal programs:

The Exams Program – Used by DOR to identify multistate corporations (headquartered outside of Kentucky) who have had changes made by the IRS to their federal return. Once a year, Governmental Programs compiles a database of all multistate corporations whose returns were adjusted by the IRS.

Federal Abstract Program – The report generated through this program is based on actual numbers from an IRS adjustment, referred to as a Revenue Agent Report (RAR). This information is then used to make sure those corporations are making the appropriate adjustments on their Kentucky return.

## **Individual Income Tax Section**

The Individual Income Tax Section is similar to the Corporate Income Tax Section in that it uses IRS information to make adjustments on Kentucky taxpayers returns. However, the Individual Section runs five different programs:

Federal Abstracts – Report which outlines adjustments made by an actual IRS agent.

AGI – Compares the federal adjusted gross income reported on the Kentucky return to that reported on the Federal return.

CP2000 – Identifies taxpayers who have omitted income.

Non-Filer Program – Identifies taxpayers who filed a federal return with a Kentucky address and who have not filed an Individual Income Tax return with Kentucky.

Individual Income Tax Reconciliation – Identifies taxpayers who have not filed a federal return or a Kentucky return and have 1099 and/or W-2 income.

## **Enhanced Security**

The IRS maintains strict controls over the use and distribution of federal tax information. Because of this, areas within the building that have access to this information are restricted; two levels of special employee badge access are required to enter either Governmental Programs sections on the 6th floor. Dedicated computer hardware and special computer applications are used in order to protect the confidentiality of the federal tax information. DOR is subject to inspections and audits by IRS staff to ensure proper procedures are being followed.

## **Benefit to DOR**

Governmental Programs is important to the mission of DOR to administer and collect taxes in a fair and consistent way. Every year, both Individual and Corporate Income Tax Sections are responsible for the assessment and collection of tens of millions of dollars.

## Division of Individual Income Tax

Mail Station #68

Phone: 564-5432

Fax: 564-0167

**Bill Breeze**

**Assistant Director**

### Governmental Programs Section 1

Natalie Brown ..... 47731  
Michele Dunavent ..... 47704  
Katie Kirk ..... 47733  
Mary Beth Kratzer ..... 47040  
Scott Kries ..... 47728  
Matthew McLaughlin ..... 47714  
Jeffrey Neal ..... 47723  
Regina Oliver ..... 47729  
**Marianne Richardson ..... Supervisor ..... 47703**

### Governmental Programs Section 2

Paul Adams ..... 47724  
Paula Adams ..... 47782  
Fernando Briones ..... 47747  
Shannon Cole ..... 47769  
Tina Corn ..... 47719  
Billie Dunavent ..... 47748  
Jessica Gorman ..... 47745

## Division of Corporation Tax

Mail Station #69

ACD GROUP: 564-9837

Phone: 564-8139

Fax: 564-0058

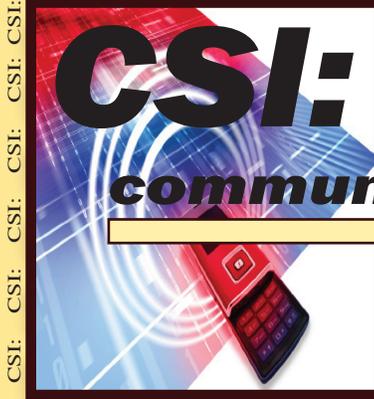
**Angie Morris**

**Branch Manager**

### Governmental Programs Section

Frankie Eden ..... 47394  
Jessica Honican ..... 42169  
**Steve Ramsey ..... Supervisor ..... 47385**  
Jeannette Relford ..... 47393  
Dustin Rose ..... 42099  
Lisa Saylor ..... 42046  
Charles Williams ..... 47387  
Darrel Young ..... 42127

CSI: CSI: CSI: CSI: CSI:



**communicating significant information**

## REVENUE 101: A History Lesson

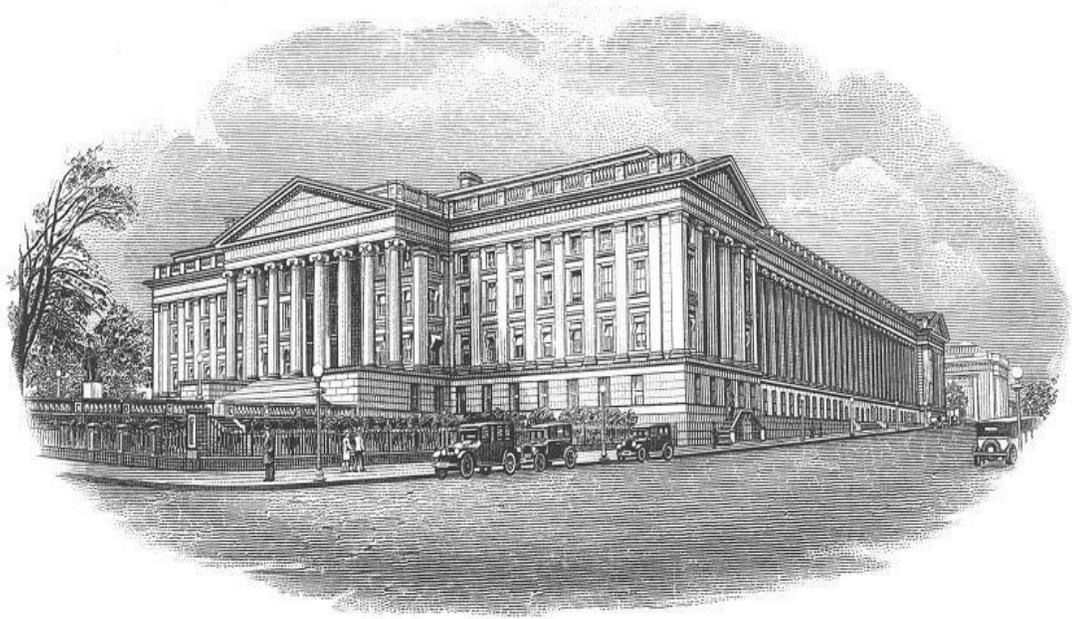
In 1793 at the age of 93, Benjamin Franklin, a prominent statesman, scientist, writer, and founding father, commented: “Our Constitution is in actual operation. Everything appears to promise that it will last; but in this world nothing is certain but death and taxes.”

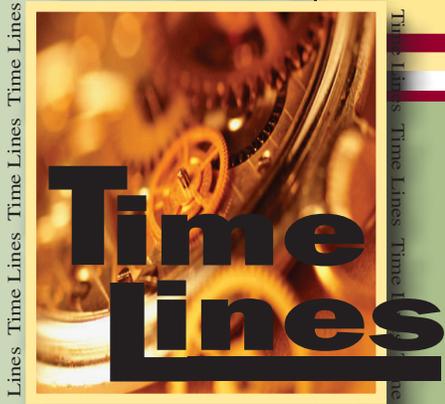
As the timeline of the history of the Department of Revenue shows, Kentucky made certain that Franklin was right about taxes. Some taxes were collected *before* Kentucky even became a state.

Additionally, our organizational structure has changed many times over the years under different administrations. The timeline presented on the next page is a brief snapshot of the background and history of the Department of Revenue.

“...the more things change, the more they stay the same.”

—popular French proverb





## Department of Revenue Timeline

- 1782:** Property, poll, and legal taxes are collected in Kentucky Co., Virginia
- 1792:** Kentucky becomes a state; four weeks later Governor Shelby enacts first state taxes:
- |                                     |         |
|-------------------------------------|---------|
| Horses:                             | \$ .11  |
| Cattle:                             | \$ .04  |
| Recording fees (closing fees)/land: | \$ .50  |
| Billiard Table:                     | \$33.30 |
- 1793:** Property tax collects just under \$15,000 of the **total** receipts of \$17,500 (2010 DOR Annual Report: Total receipts **\$8.2 Billion**)
- 1849:** Property tax allocated to education: \$.02 per \$100.00
- 1884:** State Board of Equalization created to develop a central tax system for the state
- 1891:** Fourth and **current** Constitution is adopted
- 1910:** Motor vehicles are taxed based on horsepower
- 1917:** Kentucky Tax Commission created
- 1920:** Kentucky becomes the fifth state to adopt a gasoline tax
- 1934:** Sales tax of \$.03 is enacted
- 1936:** Key tax year:
- o Governor Chandler creates Revenue Department
  - o Individual income and corporation tax replace sales tax
  - o “Sin Tax” enacted – includes cigarettes, beer, and alcohol
- 1946:** Division of Property Tax created
- 1950:** The General Assembly increases income tax to help poor school districts. Top tax rate is 6% on income > \$8,000
- 1952:** The Back Tax Unit was created to collect back taxes
- 1960:** Under Governor Combs, sales tax is reinstated at 3%
- 1961:** Division of Sales Tax created
- 1968:** Under Governor Nunn, sales tax is increased to 5%
- 1982:** Governor Brown changes title to the Revenue Cabinet
- 1986:** 50th Anniversary of Revenue and 1st FAX machines installed
- 1989:** Governor Wilkinson establishes the State Lottery
- 1990:** Sales tax rate is increased to 6%
- 1993:** Revenue begins accepting electronic filing
- 1994:** Revenue relocates to the 100 & 200 Fair Oaks location
- 2004:** Governor Fletcher changes us back to the Department of Revenue
- 2005:** Tax modernization enacted. Individual income tax rates changed. Family Size Tax Credit and Education Tax Credit adopted.
- 2007:** DOR consolidates locations and moves to the State Office Building, 501 High Street

F  
Y  
I

...THIS -n- THAT

## Taxes: From A to Z

**A is for Schedule A.** This is the form taxpayers use to claim itemized deductions on their federal and/or Kentucky returns.

**B is for Business Income (or Loss).** This needs to be reported on Schedule C of the federal return.

**C is for Child and Dependent Care Credit.** A nonrefundable credit that may be available on both the federal and Kentucky returns for those taxpayers with child care expenses.

**D is for Depreciation.** A deduction claimed for the decrease in value of an asset with the passage of time, due in particular to wear and tear. Must complete Form 4562.

**E is for Electronic Filing.** The fastest, most accurate, easiest way to submit your tax return or a request for an extension of time to file to the IRS and/or Department of Revenue. Almost 65% of individual taxpayers filed returns electronically in Kentucky last year.

**F is for Federal Adjusted Gross Income (FAGI).** The Kentucky return typically begins with the Federal Adjusted Gross Income.

**G is for Gambling Income.** Any income that is the result of games of chance or wagers on events with uncertain outcomes (gambling) is subject to taxation and should be reported on the federal return.

**H is for Head of Household.** A taxpayer may possibly qualify for Head of Household filing status if they are unmarried at the end of the year, provided at least half the cost of keeping up the home for the tax year and a “qualifying” person lived with them.

**I is for IRA Contributions.** In certain situations, taxpayers can deduct the amount of contributions made to a traditional Individual Retirement Account (IRA) on their federal return (up to a \$5,000 general limit).

**J is for Joint Return.** A joint return is a tax return filed on behalf of both the husband and wife, resulting in a combined tax liability.



**K is for K-4.** This form is used to help determine the correct number of withholding exemptions for any taxpayer earning wages in the Commonwealth of Kentucky.

**L is for Long-Term Care Insurance.** An insurance policy to cover some of the costs incurred by a person in a long-term care facility; premiums are considered 100% deductible on Schedule M for Kentucky.

**M is for Schedule M.** This Kentucky form is used to make adjustments (i.e. additions or subtractions to income) to account for differences between the federal and Kentucky returns.

**N is for Net Operating Loss.** A net operating loss (NOL) occurs when certain tax-deductible expenses exceed taxable revenues for a taxable year. For Kentucky purposes, an NOL can be carried forward for up to 20 years.

**O is for Ordinary and Necessary.** A statutory requirement for the deductibility of any expense claimed by the taxpayer as an unreimbursed job expense on Schedule A.

**P is for Penalty & Interest.** If you don't file and/or pay for your taxes on time you could owe penalties and interest. The filing deadline this year was April 18.

**Q is for Qualified Mortgage Insurance Premiums.** Premiums paid by homeowners on mortgage insurance for FHA loans; generally reported on a Form 1098 and claimed as an itemized deduction on Schedule A.

**R is for Refundable Tax Credit.** Kentucky has added two new refundable credits for individuals in the 2010 tax year – the Certified Rehabilitation Credit and the Film Industry Tax Credit.

**S is for Standard Deduction.** This year the standard deduction for Kentucky is \$2,210 per taxpayer.

**T is for Taxable Income.** The amount of income that is considered taxable after all adjustments have been made to the gross income and amounts for personal deductions, exemptions and allowable deductions have been subtracted.

**U is for Unemployment Compensation.** Financial compensation paid to recently unemployed workers by state governments for a specified period of time for those actively looking for work; considered taxable income on both the federal and Kentucky returns.

**V is for VITA.** The Volunteer Income Tax Assistance program; provides FREE assistance to taxpayers in completing individual income tax returns at various locations throughout Kentucky.

**W is for W-2.** A wage and tax statement used by employers to report a taxpayer's wages earned and taxes withheld to the IRS, as well as any state and local governments.

**X is for 740-X.** This is the form taxpayers would use if they need to amend their individual income tax returns.

**Y is for Year.** Most taxpayers will file their individual tax returns on a calendar year basis. However, qualified taxpayers can opt to file on a fiscal year, which is a 12-month period that does not parallel a calendar year.

**Z is for Zero.** The goal, when you file your return at the end of the year, is to have the amount of your refund (or tax due) be as close to zero as possible, so that you are not giving the government an interest free loan. If you receive a large refund, you may actually want to consider adjusting your withholding.

# Communications and Training Branch

F  
Y  
I

## Form 1099 Reporting Requirements Recent Changes

A change has been made to some of the information the Training Branch presented to you during our 2010 Income Tax Update School. At that time, we informed you of a new law expanding the 1099 reporting requirements for businesses but that law has since been repealed.

If you were not in the class or need a refresher, the 1099 reporting requirements were a provision included in *The Patient Protection and Affordable Care Act*. In short, this provision would have required businesses to issue 1099 forms for all purchases of goods and services over \$600 annually.

However, on April 14, 2011 President Obama signed into law H.R. 4, the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011. This act repealed all of the changes in the 1099 reporting requirements for businesses.

The repeal was enacted due to the strong negative reaction from the small business community on the costs of having to meet the expanded requirements.

**HONEY, I SWEAR I WAS WORKING...** The IRS disclosure office has issued a written opinion that a compliance officer who is working at a taxpayer's location after hours cannot tell the spouse where he or she is. The decision says naming the specific location is forbidden, if the location would identify the taxpayer, but the examiner can give "his general location."

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# BUDGET WISE

## Summer Savings Tips

Even though it's only May, it's not too early to start thinking ahead to summer. As the summer months begin to heat up and temperatures climb towards triple-digits, houses in neighborhoods constantly run their air conditioners in an attempt to cool things off and the utility bills begin to soar. However, there are some steps you can take to cut down on your electricity usage during the summer months. Below you will find some simple and practical tips to help save energy and money.

- **Turn off your air conditioning**—This doesn't mean you have to suffer through sweltering heat, but you should be aware of the weather so that you can maximize efficiency and try to save money by using your air conditioner only when needed. For example, if it is going to be a cool night, turn off the air before going to bed and open a few windows or use a ceiling fan.

- **Cook outside on the grill**—Using the stove or baking in the oven can create a lot of excess heat in your house. Consider meal plans that take advantage of the barbecue grill outside so that you can keep your house cool inside during the summer.



- **Hang your laundry outside to dry**—If you have the ability to hang up laundry outside, let the sun and the warm summer breeze dry your clothes for you. Even if you can't hang clothes outside, try using a lower heat setting on your dryer or only partially drying your clothes and then hanging them up and letting them air dry the rest of the way.



- **Wash dishes by hand more often**—One of the ways to compensate for increased air conditioning use is to cut down on using other major appliances. You should only use the dishwasher when it is fully loaded; using a half-loaded dishwasher is a waste of energy and water. If you only have a few dishes to wash, try washing and drying them by hand instead. It may seem old fashioned and take a little more time, but it can save you a lot of money.



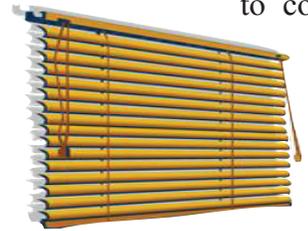
- **Unplug unused appliances**—Most people are unaware that items left plugged into an electrical outlet continue to drain electricity even when not in use. Be sure to unplug your cell phone and digital camera chargers. Turn off all televisions, DVD players, and surround sound systems.



The easiest way to do this is by plugging these appliances into a power strip – just hit the “off” switch and you’re done. Also, always switch your computer to sleep mode during prolonged absences. However, remember to never unplug the refrigerator, clocks, or any essential appliances that you rely on.

- **Replace your air conditioner filters on a regular basis**—This can be easy to overlook, but a dirty air conditioner filter can increase cooling costs. Dirty filters restrict the airflow and impact the efficiency of the air conditioner, which translates into more run time and higher cooling costs. Filters are fairly inexpensive, so you should replace them regularly.

- **Close your curtains or blinds**—It may look like a beautiful, sunny day outside, but it may actually be hot and humid. Opening your curtains will not only bring in sunlight, but often the outside heat and humidity as well. Don’t make your air conditioner work harder than it already has to; the hotter your home is, the harder your air conditioner has to work off your home. Be sure to close your curtains or blinds when you have the air conditioner working extra hard during the hottest parts of the day. Also, close them when you leave for the day so your home doesn’t heat up while you’re gone (it’s not like you can enjoy the view or the sunlight when you’re not at home anyway).



- **Invest in a home energy audit**—This shows you what changes you may need to make to your home in order to make it more energy-efficient. A professional home energy assessment may help pinpoint where your house is losing energy, determine the efficiency of your home’s heating and cooling systems and find ways to conserve hot water and electricity. And keep in mind, a minimal financial investment upfront may help save you significant amounts of money not only during the summer months, but year round.



#### **Collections**

Daniel Bullard  
Leah Duff  
Kathryn Hoffman  
Matthew Hosley  
Anna Owens

#### **Field Operations**

David Clouse  
Shawn "Eric" King  
Brenda Maloney  
Mark McGuire  
Whitney Payne

#### **Individual Income Tax**

Fernando Briones  
Margaret Dickens  
Billie Dunavent  
Danielle Lipscomb  
Kayla Senn

#### **Miscellaneous Tax**

Anna Bratt  
Elizabeth Bruce  
Neesa Whitis

#### **Operations**

Travis Baney  
Doris Brown

## **CONNECTIONS:**

### **ACKNOWLEDGEMENTS**

Rebecca Willis, Newsletter Design

### **INPUT**

Bill Breeze  
Steve Garrett  
Chundra Lott

Steve Ramsey  
Marianne Richardson  
OIT Training Branch Staff

## **YOUR INPUT IS REQUESTED:**

Your input, comments, and suggestions are welcomed. Please submit via e-mail to contact below.

## **CONTACT:**

Gayle.Fields@ky.gov