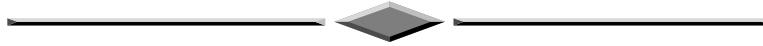


INTRODUCTION



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INTRODUCTION

This handout is to be used in conjunction with the training video.

You are encouraged to take notes. Although much information is being made available to you, it is most important to take good notes.

Some of you have had more exposure to this type of tax and audit than others; however the material will be presented as if your knowledge in this area is nil. The goal is that each auditor and/or reviewer should be knowledgeable of **KRS Chapter 131 and 139** and related regulations authorizing the Department of Revenue the statutory authority to tax persons doing business in this state.

If you have questions, please submit all questions to the central office by using the “contact us” link on the KREW-Video Training website. All questions are pertinent.

The quiz is to be taken after viewing the video. You will be required to print the document entitled “Quiz/Certification”, answer the questions, complete the remainder of the document and submit it to the Nancy Kaylor, Field Operations, Station 9. A graded exam will be given after viewing all the videos for Part I. A score of 75% is required to pass. The “Graded Exam” will be submitted to your supervisor and upon completion is to be sent to Nancy Kaylor, Field Operations, Station 9.

STATUTES AND REGULATIONS IN GENERAL

The Kentucky legislature is responsible for enacting tax laws in order to raise the revenues needed for the purposes of state government. These laws are contained within the Kentucky Revised Statutes (KRS). The statute must be written in a manner that complies with both federal and state constitutions. Additionally, statutes should be easily understood so they can be followed by the taxpayer. Therefore, statutes identify the taxpayers subject to tax, explain how the tax is to be computed, and state when and how the tax is to be reported. The Department of Revenue is responsible for administering most of the taxes contained in the Kentucky Revised Statutes.

To administer those statutes, **KRS 131.130(1)** authorizes the Department of Revenue may make administrative regulations for the administration and enforcement of all tax laws of this state. It is the combination of the Kentucky Revised Statutes (KRS) and the Kentucky Administrative Regulations (KAR) which must be cited as the authority for any action taken by the Department of Revenue.

The date(s), reflected in each statute and regulation, indicate the effective date of various law changes and/or updating over the years. Even though the various dates of when the statutes changed are known, the history section does not identify exactly which portion has changed and when it changed. Also, if the taxpayer requests an interpretation of such statutes or regulations in writing from the Department a formal request must be made. If this involves field personnel, the request is to be directed to the Taxpayer Service Center Manager.

HISTORY OF THE SALES & USE TAX LAW & LEGISLATIVE SUMMARIES

The first evidence of sales and use tax legislation in Kentucky can be traced back as early as 1934. This legislation was short-lived (the tax was later repealed on January 15, 1936) indicating the Commonwealth was not quite ready to support such legislation. Finally on July 1, 1960, Kentucky became the 34th state to enact a sales and use tax law. The rate was set at 3 percent. Effective April 1, 1968, the rate was increased from 3 percent to 5 percent. The latest increase occurred 22 years later, effective July 1, 1990, when the tax rate was raised to 6 percent. Over the years, the rate has increased to compensate for the narrowing of the tax base.

During the legislative years of 1962 and 1964, little change was made to the Sales and Use Tax Law, **Kentucky Revised Statutes Chapter 139**. The first changes to the original law occurred in 1966 and changes have continued to the present time.

The following various exemptions and/or changes have been enacted into law from 2003 - Present.

2003 **Vendor Compensation** – Effective July 1, 2003 through June 30, 2004. The amount paid to a vendor for the collection of sales tax is capped at \$1,500 for each reporting period. The change will appear on the July 2003 return which is due August 20, 2003. (*HB 269*)

Tax Tip: The \$1,500 cap has expired. For tax periods beginning on or after July 1, 2004, the compensation rate provided under **KRS 139.570** will apply because the notwithstanding language of the current budget provisions (*HB 269*) expired after June 30th. The Department must revert back to existing law. **KRS 139.570** provides: “To reimburse himself for the cost of collecting and remitting the tax, the taxpayer shall deduct on each return one and three-quarters percent (1.75%) of the first one thousand dollars (\$1,000) of tax due and one percent (1%) of the tax due in excess of one thousand dollars (\$1,000), provided the amount due is not delinquent at the time of payment.”

Commercial Printers – Effective March 26, 2003 through June 30, 2004. An out-of-state commercial printer or mailer is relieved from the liability to collect Kentucky use tax on the sale of printing or direct mail advertising materials that are printed out-of-state and delivered out-of-state to the US Postal Service for mass mailing to third party Kentucky residents. If the printer or mailer (1) maintains records on these sales and (2) assists the Revenue Cabinet with reports from these records to ensure the payment of the use tax by the customer who commissioned the printing. (*HB 269*)

Natural Gas Distribution – Effective June 1, 2003 through June 30, 2004. Kentucky sales and use tax is extended to service charges for the distribution, transmission, or transportation of natural gas for use in Kentucky. However, the tax does not apply to charges to residential customers. (*HB 269*)

Tax Tip: The tax will not apply to charges for gas transmission on or after July 1, 2004. Therefore, tax will not apply to service billed on or after July 1, 2004, regardless of when the transportation actually occurred.

Communications Services Sales Tax Credit – Effective June 1, 2003 through June 30, 2004. The basis for claiming a refundable credit for sales tax paid on communications services provided under **KRS 139.505** is adjusted as follows:

- 1) Eligible companies must have a minimum of \$1 million in annual Kentucky gross receipts.
- 2) The refund is based on the amount paid on interstate communications services which are billed to a Kentucky service address that exceeds 5 percent of the business's Kentucky gross receipts.
- 3) The majority of interstate communications services billed to a Kentucky service address must be for communications originating outside of this state and terminating in this state.
- 4) The cost of the interstate communications services included in the 5 percent calculation must be a deductible business expense for federal income tax purposes.
- 5) Companies eligible for the refundable tax credit shall be permitted to directly report and pay the sales tax on their purchase of communications services. (*HB 269*)

Streamlined Sales and Use Tax Agreement – Effective July 1, 2004. Legislation conforms Kentucky's sales and use tax laws under Chapter 139 to the Streamlined Sales and Use Tax Agreement in an effort to simplify and create uniformity among the 45 states and the District of Columbia which currently impose a sales tax. (*HB 293*)

Exemption for Certain Medical Items - Effective July 1, 2004, the prescription drug exemption expands to include a drug purchased for the treatment of a human being for which a prescription is required by state or federal law. The exemption applies whether the drug is dispensed by a licensed pharmacist, administered by a physician or other healthcare provider, or distributed as a free sample to or from a physician's office. Over the counter drugs will not be exempt unless purchased by a nonprofit healthcare provider. (KRS 139.495)

Prosthetic Devices - Effective July 1, 2004, the amended statute broadens the exemption and applies it to all healthcare providers. The exemption will also apply to individuals purchasing customized or prescribed prosthetic devices. (KRS 139.472)

Delivery Charges - Effective July 1, 2004, the meaning of “sales price” under KRS 139.050 included all delivery charges. Under the amended statute, “delivery charges” means charges by the retailer for the preparation and delivery to a location designated by the purchaser including transportation, shipping, postage, handling, crating, and packaging.

Downloaded Tangible Personal Property - Effective July 1, 2004, the meaning of tangible personal property under KRS 139.160 changed to include personal property which may be seen, weighed, measured, felt or touched, or which is in any other manner perceptible to the senses, regardless of the method of delivery, and includes natural, artificial and mixed gas, electricity, water, steam, and pre-written computer software. Therefore, effective July 1, 2004, pre-written software and other tangible personal property such as books and movies that are downloaded electronically to Kentucky customers are taxable on the same basis as comparable products delivered by mail or purchased over the counter.

Exempt Grocery Food - The changes to KRS 139.485 are effective July 1, 2004, and apply the uniform definition structure adopted by the Streamlined Sales Tax Project.

Candy means a preparation of sugar, honey, or other natural or artificial sweeteners in combination with chocolate, fruits, nuts, or other ingredients or flavorings in the form of bars, drops, or pieces. Candy shall not include: 1) any preparation containing flour; or 2) any item requiring refrigeration.

Soft drinks mean nonalcoholic beverages that contain natural or artificial sweeteners. Soft drinks do not include beverages that contain milk or milk products, soy, rice, or similar milk substitutes, or greater than 50 percent of vegetable or fruit juice by volume.

Prepared food is defined as follows:

1. Food sold in a heated state or heated by the retailer;
2. Two or more food ingredients mixed or combined by the retailer for sale as a single item except food that is only cut, repackaged, or pasteurized by the retailer; eggs, fish, meat, poultry, and foods containing these raw animal foods requiring cooking by the consumer as recommended by the Food and Drug Administration in Chapter 3, Part 401.11 of the FDA Food Code so as to prevent food borne illnesses; or
3. Food sold with eating utensils provided by the retailer, including plates, knives, forks, spoons, glasses, cups, napkins, or straws.

Prepared food shall not include the following items if sold without eating utensils provided by the seller:

1. Food sold by a seller whose proper primary North American Industry Classification System (NAICS) classification is manufacturing in sector 311 (food manufacturing), except subsector 3118 (bakeries); or
2. Bakery items, including bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, danishes, cakes, tortes, pies, tarts, muffins, bars, cookies, and tortillas.

Sourcing Sales Transactions - Sourcing rules provide guidelines on determining the location of the sale so that retailers can determine which jurisdiction's tax to charge. The new sourcing guidelines codified under KRS 139.105 become effective on July 1, 2004. In many states sales tax is due on both the state and local levels; however, since Kentucky has only a state-based sales and use tax, sourcing issues primarily relate to multi-state transactions. For example, what tax should an out-of-state retailer charge for products delivered to a customer in Kentucky? The commonwealth currently treats the retail sale of products into the state as subject to Kentucky tax. Kentucky's adoption of the new sourcing rules will not change the taxability of products delivered into the state because the new guidelines merely confirm our existing destination-based sourcing for sales of tangible personal property and taxable services. In addition, the new statute includes the sourcing of telecommunications services, some of which were previously addressed in the current version of KRS 139.100, under the discussion of service address in subsection four. Since every state participating in the Streamlined Sales Tax Project must adopt these sourcing rules, this change represents tremendous progress in developing uniformity and simplicity in the administration and compliance of both state and local sales and use taxes.

Exemption for Repair and Replacement Parts – Effective January 1, 2004. Exempts repair or replacement parts for the direct operation or maintenance of a motor vehicle, including any towed unit, used exclusively in interstate commerce for the conveyance of property or passengers for hire from the sales tax. This exemption requires that the motor vehicle is licensed for use on the highway and its declared gross vehicle weight with any towed unit is 44,001 pounds or greater. Repair and replacement parts are defined to exclude fuel, machine oil, fluids, grease, supplies, and accessories not essential to the operation of the motor vehicle itself. *(HB 293)*

Tobacco Buydown Receipts – Removes tobacco buydown receipts from receipts subject to sales tax. These receipts are payments made by the tobacco manufacturer or wholesaler to retailers based upon the number and price of tobacco products the retailer sells to customers during a “buydown” promotional period. The provision applies retroactively. *(HB 346)*

2005 **Equine Breeders**—*(Effective June 1, 2005.)* KRS 230 is amended to provide that all receipts collected under KRS 139.531(1)(a) from the sales and use tax on the fees paid for breeding a stallion to a mare will be deposited into a fund, which will be administered by the Kentucky Horse Racing Authority to enhance the breeding industry in the state. This fund will be used to provide rewards for breeders or owners of thoroughbred, standard bred and other horses. This fund will be divided 80 percent to thoroughbred breeders, 13 percent to standard bred breeders and 7 percent to other horse breeders. Taxpayers will be required to report sales tax on breeding fees on a supplemental sales tax form, beginning with the June return to be filed on or before July 20. This provision also expands the exemption on horses younger than two years old sold to nonresidents by eliminating the requirement that the horse be transported out of state. *(HB 272)*

Natural Gas—(*Effective June 1, 2005.*) KRS 139.200 is amended to extend sales tax to the distribution, transmission or transportation services for natural gas that is for storage, use or other consumption in this state, excluding those services furnished for natural gas that are classified as residential use as provided in KRS 139.470(8), or to a seller or reseller of natural gas. KRS 139.480(3) is also amended to include charges for related distribution, transmission and transportation for energy that are billed to the user and included in the cost of production when calculating the 3 percent cost of production for energy direct pay. *(HB 267)*

Sales and Use Tax Vendor Compensation—(*Effective for periods after June 30, 2005.*) KRS 139.570 is amended to limit the vendor compensation a taxpayer may receive for collecting and remitting sales and use tax to \$1,500 per month for timely filed tax returns. *(HB 267)*

Commercial Printers or Mailers—(*Effective July 1, 2005.*) KRS 139.340 is amended to provide that a commercial printer or mailer engaged in business in this state shall not be required to collect use tax on sales of printing or direct-mail advertising materials that are both printed out of state and delivered out of state to the United States Postal Service for mass mailing to third-party Kentucky residents who are not purchasers of the advertising materials. The commercial printers or mailers must: (1) maintain records relating to these sales to assist in the collection of the use tax owed; and (2) file reports as provided in KRS 139.730 if requested by the Department of Revenue (DOR). If the commercial printer or mailer complies with these reporting provisions, the purchaser of the printing or direct-mail advertising materials described in this section shall have sole responsibility for payment of the use tax imposed in KRS 139.310. *(HB 267)*

Donated Goods—(*Effective Aug. 1, 2005.*) KRS 139.495 is amended to provide that an institution shall be entitled to a refund equal to 25 percent (up to \$1 million) of the tax collected on its sale of donated goods if the refund is used exclusively as reimbursement for capital construction costs of additional retail locations in this state. The institution must: (1) routinely sell donated items; (2) provide job training and employment to individuals with workplace disadvantages and disabilities; (3) spend at least 75 percent of its annual revenue on job training, job placement or other related community services; (4) submit a refund application to the department within 60 days after the new retail location opens for business; and (5) provide records of capital construction costs for the new retail location and any other information the DOR deems necessary to process the refund. *(HB 267)*

Repair and Replacement Parts for Charter Buses— (*Effective Aug. 1, 2005.*) Motor carriers operating under a charter bus certificate issued by the Transportation Cabinet under KRS Chapter 281 are exempt from sales and use tax on repair and replacement parts for directly operating and maintaining a charter bus. *(HB 267)*

2005—(*Effective Aug. 1, 2005.*) KRS 139.340 is amended to broaden the nexus standard to encompass remote sellers who use a representative in Kentucky, either full time or part time, to facilitate remote sales. The bill language specifically addresses remote sellers who allow merchandise to be received and exchanged at an *affiliated store or any location* within Kentucky. (**HB 272**)

Enterprise Initiative Act—(*Effective Jan. 1, 2006.*) A new section of KRS 154 is created to provide a statewide tax incentive program that allows eligible companies the opportunity to receive **refunds of sales and use tax paid** on the purchase of building materials and research and development materials. Only businesses primarily engaged in manufacturing, service or technology, or developing a tourism attraction are eligible to apply for the tax incentives. Companies seeking to participate in the incentive program must apply for eligibility through the Kentucky Economic Development Finance Authority. Applications may be submitted on or after Oct. 1, 2005; however, no approvals will be effective before Jan. 1, 2006. The plan gives preference to companies in existing enterprise zones, requiring them to invest a minimum of \$100,000. All other areas require a minimum investment of \$500,000. A yearly statewide cap of \$20 million for building materials and \$5 million for research and development on all approved projects is set. In addition, the existing enterprise zones and accompanying exemptions will continue until expiration. (**HB 272**)

Telecommunications—(*Effective Jan. 1, 2006.*) KRS 139.195 is amended to exclude switch access and pay phone receipts from communications services subject to sales tax. All other communications services as outlined in KRS 139.200 *remain* subject to sales tax unless specifically exempted. Effective Jan. 1, 2006, a new gross revenues tax of 1.3 percent will also apply to communication service providers. Additional information about the new 3 percent excise and 2.4 percent gross revenues taxes that will apply to multi-channel video programming service will be forthcoming. (**HB 272**)

County Fair Admissions—(*Effective June 20, 2005.*) Gross receipts from the first \$50,000 in sales of admissions to county fairs held in Kentucky are exempt from sales and use tax. (**HB 497**)

Hospital Beds - In accordance with the Streamlined Sales Tax Agreement uniform medical equipment definitions, KRS 139.472(1) was amended to exclude hospital beds purchased for private, noncommercial use from Kentucky sales and use tax. As part of Kentucky's legislative efforts to conform to the multi-state Streamlined Sales and Use Tax Project (SSTP), the 2005 General Assembly amended KRS 139.472 to maintain the long-standing exemption for hospital beds. The new exemption language reads "hospital beds purchased for private noncommercial use." This provision preserves the previous exemption by creating a use-based exemption in conformity with SSTP. Vendors need to maintain the normal payment and customer records to document this exemption. An exemption certificate is not necessary. The department assumes private, noncommercial use by the customer if the payment instrument indicates such.

GENERAL SALES AND USE TAX DEFINITIONS

KRS 139.180 "Taxpayer" -- "Department"

"Taxpayer" means any **person** liable for tax under this chapter; "department" means the Department of Revenue.

Effective: June 20, 2005

History: Amended 2005 Ky. Acts ch. 85, sec. 409, effective June 20, 2005. – Created 1960 Ky. Acts ch. 5, Art. I, sec. 18, effective February 5, 1960.

KRS 139.080 "Person"

"Person" includes any individual, firm, co-partnership, joint venture, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, trustee, syndicate, cooperative, assignee, governmental unit or agency, or any other group or combination acting as a unit.

History: Created 1960 Ky. Acts ch. 5, Art. I, sec. 7, effective February 5, 1960.

A subsidiary is a different person, thus different taxpayer, while a division is the same person, thus same taxpayer.

The unitary and consolidated concept for income tax purposes does not extend to sales tax. As long as there are two (2) separate legal entities, there are two different persons, thus two different taxpayers.

KRS 139.040 "Business"

"Business" includes any activity engaged in by any person or caused to be engaged in by him with the object of gain, benefit or advantage, either direct or indirect.

History: Created 1960 Ky. Acts ch. 5, Art. I, sec. 3, effective February 5, 1960.

KRS 139.060 "In this State"

"In this state" or "in the state" means within the exterior limits of the Commonwealth of Kentucky and includes all territory within these limits owned by or ceded to the United States of America.

History: Created 1960 Ky. Acts ch. 5, Art. I, sec. 5, effective February 5, 1960.

"In this state" includes Ft. Knox and Ft. Campbell. While the Department does not tax sales made by the federal government, we do tax private entrepreneurs conducting business on the base. Ft. Knox and portions of Ft. Campbell are within the exterior limits of the Commonwealth.

KRS 139.100 "Retail Sale" – Notice the effective dates.

139.100 "Retail sale" -- "Communications service" -- "Service address." (Effective until July 1, 2004)

- (1) "Retail sale" or "sale at retail" means:
 - (a) 1. A sale for any purpose other than resale in the regular course of business of tangible personal property, or
 2. The furnishing of the facilities and services mentioned in subsection (2) of this section;
 - (b) The delivery in this state of tangible personal property by an owner or former owner thereof or by a factor, or agent of such owner, former owner or factor, if the delivery is to a consumer or person for redelivery to a consumer pursuant to a retail sale made by a retailer not engaged in business in this state. The person making the delivery shall include the retail selling price of the property in his gross receipts.
- (2) "Retail sale" or "sale at retail" shall include but shall not be limited to the following:
 - (a) The rental of any room or rooms, lodgings, or accommodations furnished by any hotel, motel, inn, tourist camp, tourist cabin, or any other place in which rooms, lodgings, or accommodations are regularly furnished to transients for a consideration. The tax shall not apply, however, to rooms, lodgings, or accommodations supplied for a continuous period of thirty (30) days or more to an individual;
 - (b) The furnishing of sewer services;
 - (c) The sale of admissions, except those taxed under KRS 138.480;
 - (d) The furnishing of communications services, other than mobile telecommunications services as defined in 4 U.S.C. sec. 124, to a service address in this state, regardless of where those services are billed or paid, when the communications service:
 1. Originates and terminates in this state;
 2. Originates in this state; or
 3. Terminates in this state;
 - (e) The furnishing of mobile telecommunications services as defined in 4 U.S.C. sec. 124 to a customer with a service address in this state.
- (3) For the purposes of this chapter, "communications service" means the provision, transmission, conveyance, or routing, for a consideration, of voice, data, video, or any other information or signals of the purchaser's choosing to a point, or between or among points, specified by the purchaser, by or through any electronic, radio, light, fiber optics, or any similar medium or method now in existence or later devised. "Communications service" includes but is not limited to local telephone services, long-distance telephone services, telegraph services, teletypewriter services, teleconferencing services, private line services involving a direct channel specifically dedicated to a customer's use between specific points, channel services involving a path of communications between two (2) or more points, data transport services involving the movement of encoded information between points by means of

any electronic, radio, or other medium or method, caller ID services, voice mail and other electronic messaging services, mobile communications service, and Internet telephony involving telephone service in which messages originate or terminate over the public switched telephone network but are transmitted in part using transmission control protocol, Internet protocol, or other similar means. "Communications service" does not include any of the following if the charges for the goods or services are separately itemized on the bill provided to the purchaser:

- (a) Information services;
 - (b) Internet access;
 - (c) Installation, reinstallation, or maintenance of wiring or equipment on a customer's premises. However, this provision does not apply to any charge attributable to the connection, movement, change, or termination of a communication service;
 - (d) The sale of directory and other advertising and listing services;
 - (e) The sale of one-way paging services;
 - (f) Billing and collection services provided to another communications service provider; or
 - (g) Cable service, satellite broadcast, satellite master antenna television, and wireless cable service, including direct to home satellite service as defined in Section 602 of the Federal Cable Act of 1996.
- (4) For the purposes of this chapter, "service address" means:
- (a) The location of communications equipment from which communications service is originated or at which communications service is received by the purchaser. In the event that this is not a defined location, as in the case of maritime systems, air-to-ground systems, third number and calling card calls, service address means the location of the purchaser's primary use of the communications equipment, as determined by telephone number, authorization code, the purchaser's billing address, or other street address provided by the purchaser as the location of primary use, but the address must be within the licensed service area of the communications service provider;
 - (b) In the case of a communications service, other than mobile telecommunications services as defined in 4 U.S.C. sec. 124, paid through a credit or payment mechanism that does not relate to a service address, such as a bank, travel, debit, or credit card, the service address is deemed to be the address of the origination of the communications service; and
 - (c) In the case of mobile telecommunications service as defined in 4 U.S.C. sec. 124, the service address shall be the place of primary use as defined and determined under 4 U.S.C. secs. 116 to 126.

Effective: July 15, 2002

History: Amended 2002 Ky. Acts ch. 69, sec. 1, effective July 15, 2002. -- Amended 2000 Ky. Acts ch. 547, sec. 6, effective January 1, 2001. -- Amended 1992 Ky. Acts ch. 165, sec. 3, effective July 14, 1992. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 9, effective February 5, 1960.

Legislative Research Commission Note (7/15/2002). The amendments made to subsections (2)(d) and (e) and (4)(a), (b), and (c) of this statute in 2002 Ky. Acts ch. 69, sec. 1, "take effect for customer service bills issued after August 1, 2002." 2002 Ky. Acts ch. 69, sec. 6.

139.100 "Retail sale." (Effective July 1, 2004)

"Retail sale" means any sale, lease, or rental for any purpose other than resale, sublease, or subrent in the regular course of business of tangible personal property.

Effective: July 1, 2004

History: Amended 2003 Ky. Acts ch. 124, sec. 2, effective July 1, 2004. -- Amended 2002 Ky. Acts ch. 69, sec. 1, effective July 15, 2002. -- Amended 2000 Ky. Acts ch. 547, sec. 6, effective January 1, 2001. -- Amended 1992 Ky. Acts ch. 165, sec. 3, effective July 14, 1992. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 9, effective February 5, 1960.

2002-2004 Budget Reference. See State/Executive Branch Budget, 2003 Ky. Acts ch. 156, pt. IX, item 57(c), at 1884; and State/Executive Branch Budget Memorandum, 2003 Ky. Acts ch. 143, at 1277 (Final Budget Memorandum, at 906).

Tax Tip:

	LOCATION PRIOR TO JULY 1, 2004	LOCATION AFTER JULY 1, 2004
RETAIL SALE:		
The furnishing of the facilities and services...	KRS 139.100(1)(a)(2)	KRS 139.110(a)
The delivery in this state of tangible personal property by an owner or former owner thereof or by a factor or agent...	KRS 139.100(1)(b)	Covered under KRS 139.110(2)
"Retail sale" or "sale at retail" shall include...		
(a) The rental of any room or rooms...	KRS 139.100(2)(a)	KRS 139.200(2)(a)
(b) The furnishing of sewer services...	KRS 139.100(2)(b)	KRS 139.200(2)(b)
(c) The sale of admissions...	KRS 139.100(2)(c)	KRS 139.200(2)(c)
(d) The furnishing of communication services...	KRS 139.100(2)(d)	KRS 139.200(2)(d)
(e) The furnishing of mobile telecommunications services...	KRS 139.100(2)(e)	KRS 139.200(2)(e)
"Communication service" means	KRS 139.100(3)	KRS 139.195(4)
"Service address" means:		
(a) The location of communication equipment...	KRS 139.100(4)(a)	KRS 139.195(14)
(b) In the case of communication equipment service, other than mobile telecommunications service...	KRS 139.100(4)(b)	KRS 139.195(11)
(c) In the case of mobile telecommunications service...	KRS 139.100(4)(c)	KRS 139.195(9)

KRS 139.110 "Retailer" – Notice the effective dates.

139.110 "Retailer." (Effective until July 1, 2004)

- (1) "Retailer" includes:
 - (a) Every seller who makes any "retail sale" or "sales at retail," or who furnishes any services and facilities included in KRS 139.100, and every person engaged in the business of making retail sales at auction of tangible personal property owned by the person or others;
 - (b) Every person engaged in the business of making sales for storage, use or other consumption or in the business of making sales at auction of tangible personal property owned by the person or others for storage, use or other consumption;
 - (c) Every person making more than two (2) retail sales during any twelve (12) month period, including sales made in the capacity of assignee for the benefit of creditors, or receiver or trustee in bankruptcy;
 - (d) Any person conducting a race meeting under the provision of KRS Chapter 230, with respect to horses which are claimed during such meeting.
- (2) When the cabinet determines that it is necessary for the efficient administration of this chapter to regard any salesmen, representatives, peddlers, or canvassers as the agents of the dealers, distributors, supervisors or employers under whom they operate or from whom they obtain the tangible personal property sold by them, irrespective of whether they are making sales on their own behalf or on behalf of such dealers, distributors, supervisors or employers, the cabinet may so regard them and may regard the dealers, distributors, supervisors or employers as retailers for purposes of this chapter.

Effective: February 5, 1960

History: Created 1960 Ky. Acts ch. 5, Art. I, sec. 10, effective February 5, 1960.

139.110 "Retailer." (Effective July 1, 2004)

- (1) "Retailer" means:
 - (a) Every person engaged in the business of making retail sales or furnishing any services included in KRS 139.200;
 - (b) Every person engaged in the business of making sales at auction of tangible personal property owned by the person or others for storage, use or other consumption;
 - (c) Every person making more than two (2) retail sales during any twelve (12) month period, including sales made in the capacity of assignee for the benefit of creditors, or receiver or trustee in bankruptcy;
 - (d) Any person conducting a race meeting under the provision of KRS Chapter 230, with respect to horses which are claimed during the meeting.
- (2) When the cabinet determines that it is necessary for the efficient administration of this chapter to regard any salesmen, representatives, peddlers, or canvassers as the agents of the dealers, distributors, supervisors or employers under whom they operate or from whom they obtain the tangible personal property sold by them, irrespective of whether they are making sales on their own behalf or on behalf of the dealers, distributors, supervisors or employers, the cabinet may so regard them and

may regard the dealers, distributors, supervisors or employers as retailers for purposes of this chapter.

Effective: July 1, 2004

History: Amended 2003 Ky. Acts ch. 124, sec. 3, effective July 1, 2004. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 10, effective February 5, 1960.

The definition of *consideration* is “A benefit to the party promising, or a loss or detriment to the party to whom the promise is made.” Huff Contracting v. Sark, 12 S.W.3d 704, 707 (Ky. App. 2000)

Consideration is a key element in determining whether or not a sale has taken place. If something is given away (a gift), a sale has not occurred. The mere transfer of assets from one person, i.e., corporation to another without consideration being exchanged is not a sale. As indicated above, consideration is what a promisor (a person who makes a promise) demands and receives as the price for his promise. The promisee is the person to whom the promise is made. For example, A (promisor) agrees to sell B (promisee) a book for \$5.00. A promise usually is binding upon a person only when such person has received consideration. In this example, the \$5.00 received for the book is deemed the consideration. Consideration does not have to be money. It can be the assumption of a liability, etc. If consideration is not present, it may be possible to assess an entity for use tax on its original purchase price.

KRS 139.120 "Sale" – Notice the effective dates.

139.120 "Sale." (Effective until July 1, 2004)

"Sale" means, the furnishing of any services and facilities included in KRS 139.100 or, any transfer of title or possession, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration, and includes:

- (1) The producing, fabricating, processing, printing or imprinting of tangible personal property for a consideration for consumers who furnish, either directly or indirectly, the materials used in the producing, fabricating, processing, printing or imprinting;
- (2) A transaction whereby the possession of property is transferred but the seller retains the title as security for the payment of the price;
- (3) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated or printed to the special order of the customer.

Effective: August 1, 1985

History: Amended 1985 (1st Extra. Sess.) Ky. Acts ch. 6, Pt. III, sec. 7, effective August 1, 1985. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 11, effective February 5, 1960.

Legislative Research Commission Note. Acts 1985 (1st Extra. Sess.) Ky. Acts ch. 6, Pt. III, sec. 11, directed that the provisions of this section would be effective August 1, 1985.

139.120 "Sale" -- "Lease or rental." (Effective July 1, 2004)

- (1) "Sale" means, the furnishing of any services included in KRS 139.200 and any transfer of title or possession, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration, and includes:

- (a) The producing, fabricating, processing, printing or imprinting of tangible personal property for a consideration for purchasers who furnish, either directly or indirectly, the materials used in the producing, fabricating, processing, printing or imprinting;
- (b) A transaction whereby the possession of property is transferred but the seller retains the title as security for the payment of the price;
- (c) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated or printed to the special order of the purchaser.

- (2) "Lease or rental" means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. A lease or rental shall include future options to purchase the property or extend the terms of the agreement and agreements covering trailers where the amount of consideration may be increased or decreased by reference to the amount realized upon sale or disposition of the property as defined in 26 U.S.C. sec. 7701(h)(1). "Lease or rental" shall not include:

- (a) A transfer of possession or control of property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments;

- (b) A transfer of possession or control of property under an agreement that requires the transfer of title upon completion of the required payments and payment of an option price that does not exceed the greater of one hundred dollars (\$100) or one percent (1%) of the total required payments; and
- (c) Providing tangible personal property and an operator for the tangible personal property for a fixed or indeterminate period of time. To qualify for this exclusion, the operator must be necessary for the equipment to perform as designed, and the operator must do more than maintain, inspect, or setup the tangible personal property.

These definitions shall apply regardless of the classification of a transaction under generally accepted accounting principles, the Internal Revenue Code, or other provisions of federal, state, or local law.

Effective: July 1, 2004

History: Amended 2003 Ky. Acts ch. 124, sec. 4, effective July 1, 2004. -- Amended 1985 (1st Extra. Sess.) Ky. Acts ch. 6, Pt. III, sec. 7, effective August 1, 1985. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 11, effective February 5, 1960.

Legislative Research Commission Note. Acts 1985 (1st Extra. Sess.) Ky. Acts ch. 6, Pt. III, sec. 11, directed that the provisions of this section would be effective August 1, 1985.

The definition of "**Sale**" in **KRS 139.120** includes exchange and barter.

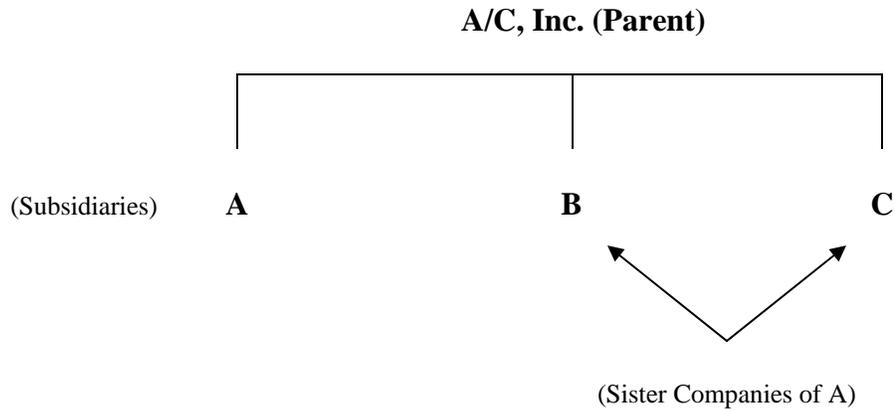
In a 'barter or exchange situation' the base for the tax would be the consideration received, i.e., the value of the item tendered by the offeree. The exchange of tangible personal property at a swap meet would constitute a "retail sale" subject to sales tax unless one of the statutory exemptions would apply. In other words, the same exemptions which would apply to the sale of tangible personal property would apply to the exchange or barter of tangible personal property.

The determinative factor for when a sale has occurred is when physical possession of the property has been transferred, not when all conditions of the sales contract have been fulfilled.

KRS 139.090 "Purchase"

Even though a transaction is deemed to be exempt, it is still considered a purchase.

Assume that Company A, subsidiary of A/C, Inc., purchased mining equipment under a new and expanded exemption certificate for use in its mining activities. At some point it was decided to share the use of the equipment with affiliated companies of A/C, Inc. (Companies B & C). This use occurred at the affiliated company's mining location and the affiliated companies were not charged for use of such equipment.



KRS 139.120 and **139.090** in defining “sale” and “purchase” include the transfer of possession of tangible personal property for a consideration, i.e., something of value given or done in exchange for something of value given or done by another. Since something of value was not given for use of equipment no basis exists for the levy of the tax.

Tax Tip: This does not mean that a taxing event has not occurred. Company A has used the property contrary to the certificate, therefore Company A would owe use tax based on the original purchase price of the property to Company A.

KRS 139.130 “Sales Price” – Notice the effective date.

139.130 "Sales price." (Effective until July 1, 2004)

- (1) "Sales price" means the total amount for which tangible personal property is sold, valued in money, whether paid in money or otherwise, without any deduction on account of any of the following:
 - (a) The cost of the property sold;
 - (b) The cost of materials used, labor or service cost, interest charged, losses, or any other expenses;
 - (c) The cost of transportation of the property prior to its purchase.
- (2) The total amount for which property is sold includes all of the following:
 - (a) Any services that are a part of the sale;
 - (b) Any amount for which credit is given to the purchaser by the seller, other than credit for property traded when the property so traded is of like kind and character to the property purchased and the property traded is held by the seller for resale.
- (3) "Sales price" does not include any of the following:
 - (a) Cash discounts allowed and taken on sales (excluding trading or premium stamps);
 - (b) The amount charged for property returned by customers when the entire amount charged therefor is refunded either in cash or credit; but this exclusion shall not apply in any instance when the customer, in order to obtain the refund, is required to purchase other property at a price greater than the amount charged for the property that is returned;
 - (c) The amount charged for labor or services rendered in installing or applying the property sold;
 - (d) The amount of any tax (not including, however, any manufacturer's excise or import duty) imposed by the United States upon or with respect to retail sales, whether imposed upon the retailer or the consumer.

Effective: July 15, 1996

History: Amended 1996 Ky. Acts ch. 226, sec. 2, effective July 15, 1996. -- Amended 1968 Ky. Acts ch. 40, Part I, sec. 3. -- Created 1960 Ky. Acts ch. 5, Art. 1, sec. 12.

Effective July 1, 2004, **KRS 139.130** was repealed with the affect of the definition of “Sales Price” being now part of **KRS 139.050**. This results in the meaning of “Gross Receipt” and “Sales Price” being the same.

KRS 139.130, Section 1 defines “sales price” as: “The total amount for which tangible personal property is sold, valued in money, whether paid in money or otherwise.” Accordingly, the full amount satisfies the definition of “sales price” and represents the tax base.

KRS 139.140 “Seller” – Notice the effective dates.

139.140 "Seller." (Effective until July 1, 2004)

"Seller" includes every person engaged in the business of selling tangible personal property or services of a kind, the gross receipts from the retail sale of which are required to be included in the measure of the sales tax.

Effective: February 5, 1960

History: Created 1960 Ky. Acts ch. 5, Art. I, sec. 13, effective February 5, 1960.

139.140 "Seller." (Effective July 1, 2004)

"Seller" includes every person engaged in the business of selling tangible personal property or services of a kind, the gross receipts from the retail sale of which are required to be included in the measure of the sales tax, and every person engaged in making sales for resale.

Effective: July 1, 2004

History: Amended 2003 Ky. Acts ch. 124, sec. 5, effective July 1, 2004. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 13, effective February 5, 1960.

The Department has interpreted seller to mean that if a vendor makes a retail sale that particular receipt is the measure of the tax. This is not saying that if such vendor makes an exempt sale, i.e., the sale of tombstones, the person making the sale is not a seller. A sale of tangible personal property is still a sale even though exempt. The sale was exempt because the legislature enacted a specific exemption for this type of property. Therefore, the Department has interpreted the statute to mean that even though the vendor makes an exempt sale, such vendor can still be a seller. The mere fact of the vendor not making any taxable sales, does not mean such person is not a seller.

If such person is involved in an activity that does not require the holding of a permit, i.e., service activity, such person would not be a seller. Normally, a service activity is not the subject of a retail sale. Examples of service activities which are taxable include: sewer services and communication services.

Effective 7/1/04, the statute was amended to specifically include in the definition of seller every person engaged in making sales for resale.

KRS 139.150 "Storage"

The statute indicates what type of storage is taxable and what type is exempt.

KRS 139.150(1) applies to in-state vendors. If an item is purchased within Kentucky (in-state vendor) and stored in Kentucky, such storage is taxable unless the item is for resale.

KRS 139.150(2) applies to property purchased from an out-of-state vendor and brought or shipped into Kentucky. If the item is purchased outside Kentucky, brought into Kentucky and stored in a warehouse in Kentucky, and a year later shipped to Ohio, such storage is not deemed to be taxable use/storage. If an item goes from without to within (use tax situation) to without it is not subject to the tax. In this situation, if all the taxpayer does is store the item in the warehouse, a taxable activity has not taken place.

Consider the following:

An out-of-state manufacturer (Company A) with a warehouse in Kentucky orders samples, order forms and supplies for its sales personnel and catalogs and dealers aids for its dealers for which there will be no charges. These items are ordered from the manufacturer's suppliers (Company B) and shipped by the suppliers to the warehouse in Kentucky. Subsequently, the items are distributed from the warehouse to sales personnel and dealers who are located throughout the country.

The items which are supplied by out-of-state suppliers to the manufacturer's warehouse in Kentucky for storage and are subsequently transported outside the state for use outside the state **are not subject to tax**. Any of these items which have been purchased out of state and then distributed to sales personnel or dealers in Kentucky would be subject to use tax based on the purchase price of the items.

If the same item came from within Kentucky, it would be taxable unless being used for an exempt purpose.

Also, once an item is removed from inventory it ceases to be in storage and would become taxable unless used in an exempt manner.

Section 2 also indicates that manufacturing is not considered taxable use. For example, a manufacturer buys parts from a supplier in Ohio and has such parts shipped to a warehouse in Kentucky. Subsequently, these parts are removed from storage and assembled into a computer. This activity (manufacturing) is not deemed to be taxable use. The mere fact of taking such parts and assembling them into a finished product is not considered taxable use. The tax will be levied when the item is the subject of a retail sale.

The length of time an item is stored in the warehouse is not critical. For example, a common carrier has a terminal and central office/storage in Lexington. They acquire tires from suppliers across the nation and such tires are shipped to the warehouse in Lexington. These tires may be

stored for three (3) days or ten (10) months before being needed. The length of time does not have a bearing on the tax status.

Taxing Event – Time of Purchase vs. Time of Use

Is an inventory item (which is used in a taxable way) taxable at the time of purchase or the time of use? As long as the taxpayer is consistent, we can live with either taxing at the time of purchase or when such item is pulled from inventory and used in a taxable manner.

Many taxpayers will buy on a volume basis, place in inventory and use when needed. From a practical standpoint it is standard procedure to determine an item's tax status when it is used in contrast to when it is purchased. The item was most likely purchased tax free, (direct pay, resale certificate or outside Kentucky) and its exact use is not necessarily known when first placed into inventory. Consistency is the key.

The purchase date in contrast to use date can be critical at times, as our statutes of limitations is four years, our audit period is four years, and an item could have been purchased outside the statutes, but used within the audit period. As long as the Department and the taxpayer are consistent it is felt both parties can live with the situation. It is acceptable audit procedure to assess the tax when the properties' use has been determined (pulled out of inventory).

Example: Audit Period 3/1/02 – 2/28/06

3/1/02-3/31/02 due 4/20/02 statute runs 4/20/06

It would be permissible to pick up an item purchased prior to March 2002, placed in inventory and used within the audit period.

KRS 139.160 "Tangible Personal Property" – Notice the effective dates.

139.160 "Tangible personal property" -- "Prepaid calling arrangements." (Effective until July 1, 2004)

"Tangible personal property" means personal property which may be seen, weighed, measured, felt or touched, or which is in any other manner perceptible to the senses and includes natural, artificial and mixed gas, electricity, water, and prepaid calling arrangements. For the purposes of this chapter, the term "prepaid calling arrangements" means any right to purchase communications service, which must be paid in advance and which enables the origination of calls using an access number or authorization code, whether manually or electronically dialed. "Prepaid calling arrangements" includes, but is not limited to, prepaid cards and prepaid accounts which are decremented as calls take place.

Effective: January 1, 2001

History: Amended 2000 Ky. Acts ch. 547, sec. 7, effective January 1, 2001. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 16, effective February 5, 1960.

139.160 "Tangible personal property" -- Prewritten computer software. (Effective July 1, 2004)

- (1) "Tangible personal property" means personal property which may be seen, weighed, measured, felt or touched, or which is in any other manner perceptible to the senses, regardless of the method of delivery, and includes natural, artificial and mixed gas, electricity, water, steam, and prewritten computer software.
- (2) "Prewritten computer software" means:
 - (a) Computer software, including prewritten upgrades, that are not designed and developed by the author or other creator to the specifications of a specific purchaser. The combining of two (2) or more prewritten computer software programs or portions thereof does not cause the combination to be other than prewritten computer software.
 - (b) Software designed and developed by the author or other creator to the specifications of a specific purchaser when it is sold to a person other than the original purchaser.
 - (c) Any portion of prewritten computer software that is modified or enhanced in any manner, where the modification or enhancement is designed and developed to the specifications of a specific purchaser. When a person modifies or enhances computer software of which the person is not the author or creator, the person shall be deemed to be the author or creator only of the modifications or enhancements the person actually made. In the case of modified or enhanced prewritten software, if there is a reasonable, separately stated charge on an invoice or other statement of the price to the purchaser for the modification or enhancement, then the modification or enhancement shall not constitute prewritten computer software.

Effective: July 1, 2004

History: Amended 2003 Ky. Acts ch. 124, sec. 6, effective July 1, 2004. -- Amended 2000 Ky. Acts ch. 547, sec. 7, effective January 1, 2001. -- Created 1960 Ky. Acts ch. 5, Art. I, sec. 16, effective February 5, 1960.

Sales tax is based on the retail sale of tangible personal property. The sale of real estate and the sale of intangible property such as stocks, bonds, patents, trademarks, etc., are not subject to **KRS Chapter 139** taxation because such items do not meet the definition of tangible personal property.

For example, Corporation A develops a process and licenses its use. The licensee (Corp. B) manufactures the product and sells same to the consumer (Corporation C). The fee paid by the licensee for the privilege of use of the process is not considered the sale of tangible personal property. However, the licensee's subsequent sale of the product is the sale of tangible personal property. The licensee cannot claim that part of the selling price represents the sale of an intangible. Sometimes it is a fine line between what is and what is not "tangible personal property".

Another example: Company A sells a list of names and addresses to individuals or to a business. If the sale involves a printed list of names and addresses or a floppy disk with names and addresses on it, such transactions would be considered the sale of tangible personal property. **However, prior to 7/1/04, if a fee is charged to have someone access your system and download this information, this would not be a sale of tangible personal property because no tangible personal property has changed hands.**

Effective 7/1/04, the definition of tangible personal property was modified to include personal property which may be seen, weighed, measured, felt or touched, or which is in any other manner perceptible to the senses, **regardless of method of delivery**, and includes natural, artificial and mixed gas, electricity, water, steam and **pre-written computer software**. The change recognizes the fact that the method of delivering tangible personal property should not alter the taxability of the product. Therefore, pre-written software and other tangible personal property such as books and movies that are downloaded electronically to Kentucky customers are taxable on the same basis as comparable products delivered by mail or purchased over the counter.

The amended statute also defines pre-written computer software to mean computer software, including pre-written upgrades, that are not designed and developed by the author or other creator to the specifications of a specific purchaser. The combination of two or more pre-written computer software programs or portions thereof are also included within the definition.

Tax Tip #1: If an activity is treated as a service before 7/1/04, it is still a service after 7/1/04.

Tax Tip #2: Effective 7/1/04, the definition of "Prepaid Calling Arrangements" was switched from **KRS 139.160** to **KRS 139.195(12)**.

Question: What are the tax consequences of paying a fee for the right to access electronic services? An example would be a lawyer who subscribes to a legal service or a broker subscribing to a stock market service.

Answer: On or after 7/1/04, fees paid to be able to access a system still remain **exempt** because such services do not constitute the sale of tangible personal property.

Question: In the newspaper industry it is quite common for the newspaper publisher to receive unedited text from the wire services with such text being received electronically. Under the “Agreement” are charges for such services subject to **Chapter 139** taxation?

Answer: No. On or after 7/1/04, charges for wire services for the transmission of unedited text still remains exempt because such activity does not constitute the sale of tangible personal property.

Real Property or Tangible Personal Property

Real property has been defined as land and anything permanently affixed to the land such as buildings, fences and fixtures attached to the buildings such as light fixtures, plumbing and heating fixtures, and other such items that would be personal property if not attached. See **103 KAR 26:070 sec 2(4)** (regarding construction contractors). A fixture is an article of personal property that has been attached or associated with the realty in such a way that it is regarded as a part of the real property. An item is deemed to be affixed to real property when it is attached to it by roots, imbedded in it, permanently resting upon it, or permanently attached to what is thus permanent, as by means of cement, plaster, nails, bolts or screws. Personal property embraces all objects and rights, which may be the subject of ownership, other than real property.

Generally, **tangible personal property** is defined as moveable property that can be weighed, measured, felt, or touched that is not permanently affixed to or a part of real estate. Items remain personal property if they can be removed without serious injury either to the realty or to the item itself. For example: A machine bolted to the floor to prevent its moving while in operation would remain personal property. If, however, a fan were installed in a wall in such a way as its removal would damage the wall, the fan would become part of the realty.

Distinguishing between real property and tangible personal property entails the application of two legal concepts – fixtures and improvements.

Fixtures

When an item that was originally an article or object of tangible personal property becomes so annexed or affixed to the real property that it is regarded as being part of the real property it is deemed to be a fixture.

In Kentucky, the courts have held that in order for an item to be a fixture, there must be:

- 1) Annexation to the realty, either actual or constructive;
- 2) Adaptation or application to the use or purpose to which that part of the realty to which it is connected is appropriated; and
- 3) Intention to make the article a permanent accession to the freehold.

The more securely an item is attached to the realty, the more likely a court is to find or rule that the item is a fixture. For example, in State Automobile Mutual Insurance Co. v. Trautwein, 414 S.W.2d 587 (Ky. 1967), air conditioners were determined to be fixtures where they had been fastened by screws and a rubber seal to a sleeve permanently attached to a building and could not be removed without considerable force and probable damage to the sleeves, which could not themselves be removed without serious damage to the building's walls.

An item is more likely to be viewed as a fixture if it serves a purpose or use that is closely connected with the real property or if it is necessary or useful for the proper operation or utilization of the realty than if that item could easily be used elsewhere. If an item is particularly suited to the use of the land or building where it is located so that the land or building would largely lose its value and usefulness if the item were removed, then the item will probably be viewed as a fixture.

The permanence referred to in the test stated above does not mean in perpetuity or forever but instead means that the item in question is intended to remain where affixed until worn out, until the purpose to which the realty is devoted is accomplished or until the item is superseded by another item more suitable for the purpose.

Intention under the fixtures test stated above means the objectively manifested intention of the owner or annexor--that is, **what is disclosed by the outwardly appearing circumstances** such as the nature of the article affixed, the relation and situation of the party making the annexation, the structure and mode of annexation and the purpose or use for which the annexation has been made—and **not the owner's or annexor's subjective or secret intentions**. Thus, the applicable test is whether a reasonable person—a natural and detached observer—would conclude from the outwardly appearing facts and circumstances that the item in question is intended to remain where affixed until worn out, until the purpose to which the realty is devoted is accomplished, or until the item is superseded by another item more suitable for the purpose.

It cannot be emphasized enough that this intention prong of the fixtures test is an objective standard. You do not look at what the parties may have agreed upon between themselves or

secretly or actually intended. Instead, the focus is on the outwardly appearing facts and circumstances.

Improvements

An improvement is a valuable addition made to realty amounting to more than mere repairs or restoration that enhances its value, beauty or utility or adapts it for new or further purposes. In other words, an improvement includes everything that permanently enhances the value of the premises for general uses, enhances the beauty or utility of that property or adapts it to different or further uses. Improvements include such things as buildings, sidewalks, fences, the clearing and preparations of land for building sites and the construction and paving of roads.

There is considerable overlap between fixtures and improvements. A fixture is by definition an improvement. The term “improvement” has been viewed as having a broader signification than fixture and consists of all additions and betterments to the freehold. The courts have not had many occasions to articulate precisely what distinguished improvements from fixtures. It has been said that a fixture retains its separate identity despite becoming part of the realty while those materials going into the making up of an improvement do not.

Property may be changed from real property to personal property by severance, i.e., the sale of dirt and/or sod.

The sale of dirt and/or sod to a purchaser is subject to sales tax when both parties contemplate the immediate severance and removal of the dirt and/or sod. At the time the property changes hands and is severed, it loses its identity as real property and becomes tangible personal property.

Manufactured Housing – The Retail Sale of Mobile or Manufactured Homes and Installation

In *Home Folks Mobile Homes, Inc. v. Revenue Cabinet*, 700 S.W.2d 75 (Ky. App. 1985), the Court of Appeals of Kentucky found that a mobile home sitting on a dealer’s lot was tangible personal property rather than real property. A *mobile home* is defined in **KRS 227.550(10)** to mean “a structure, transportable in one (1) or more sections, which, in the traveling mode, is eight (8) body feet or more in width and forty (40) body feet or more in length, or, when erected on site, is three hundred twenty (320) or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling, with or without a permanent foundation.”

A *manufactured home* is defined in **KRS 227.550(7)** to mean “a single-family residential dwelling constructed in accordance with the federal act, manufactured after June 15, 1976, and designed to be used as a single-family residential dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air conditioning, and electrical systems contained therein. The manufactured home may also be used as a place of business, profession, or trade by the owner, the lessee, or the assigns of the owner or lessee and may comprise an integral unit or condominium structure.”

The following options and components are normally bundled into the sale of a manufactured home and included in the sales and use tax base:

- 1) Heating, ventilation and air conditioning units;
- 2) Skirting materials;
- 3) Furniture;
- 4) Steps, decks and porch components;
- 5) Large household appliances (i.e., washers and dryers);
- 6) Awnings;
- 7) Gutters and downspouts;
- 8) Ceiling fans; and,
- 9) Delivery and set up on the lot including set up components.

The following items are typical components used by a certified manufactured home installer when the home is set up on the customer's lot:

- 1) Concrete block and gravel;
- 2) Heat tape;
- 3) Anchoring and strapping;
- 4) Water and sewage lines;
- 5) Wedges;
- 6) Miscellaneous hardware such as roofing materials, door locks, and dead bolts;
- 7) Lumber or construction component material for miscellaneous use; and,
- 8) Vapor barrier material.

The terms "manufactured home" and "mobile home" are interchangeable. In addition, the use of the term "set up" means the installation of the manufactured home at the customer's location.

Land-Home Transactions

Question: A Kentucky licensed retail manufactured home dealer owns the real property (lot) on which the manufactured home is set-up and sells the manufactured home and the lot as a single package to the consumer/homeowner.

Answer: The manufactured home dealer is selling real property when he sells the manufactured home and lot as a package; accordingly, sales tax does not apply to the package price.

However, the dealer is liable for use tax on his cost (purchase price) of:

- 1) the manufactured home; and,
- 2) the set up components used in placing the home on the real property.

A dealer engaged in "Land-home Transactions" should report his use tax liability on line 23 of the dealer's sales and use tax return.

Question: A residential developer (third party who owns the real property on which the manufactured home will be set up) purchases a manufactured home from a licensed dealer who sells the home out of his inventory with improvements and options to the developer. The developer sells the home, improvements and lot as a turn key transaction to the consumer/homeowner.

Answer: The residential developer is considered making an improvement to real property; therefore, the licensed dealer must collect sales tax from the developer based on the sales price of the manufactured home transaction, including the set up price of the manufactured home, if applicable.

Question: A consumer (homeowner, end user) owns the real property and purchases the manufactured home from a licensed dealer and pledges the real property and the home as collateral for a mortgage loan.

Answer: The consumer (homeowner, end user) is considered making a purchase of tangible personal property for incorporation into real property; therefore, the licensed dealer must collect sales tax from the consumer based on the sales price of the manufactured home transaction, including the set up of the manufactured home.

Conventional Sale of a Manufactured Home as Tangible Personal Property by a Licensed Retail Dealer

Question: A consumer (homeowner, end user) owns the real property and purchases the manufactured home from a licensed dealer for set up on the consumer's lot.

Answer: The consumer (homeowner, end user) is considered making a purchase of tangible personal property; therefore, the licensed dealer must collect sales tax from the consumer base on the sales price of the manufactured home transaction, including the set up of the manufactured home.

Question: A licensed retail dealer sells a home as tangible personal property to an end user (consumer/homeowner) to be placed on land that the dealer may own or that someone else owns and the real property will be rented or leased to the homeowner.

Answer: The manufactured home dealer is selling real property when he sells the manufactured home and lot as a package; accordingly, sales tax does not apply to the package price.

Repossession Transactions

Question: A home is left on the lot and resold to a consumer/homeowner by a lender who is a licensed retail dealer. The land is owned by a third party and the lender does not transact a mortgage loan on the real property. In this scenario, the lender may or may not have installed dealer options to the home.

Answer: The sale of the home by the lender would not be considered a sale of tangible personal property as long as the intent of the buyer is to leave the home set up on the lot. Since the transaction is not considered a sale of tangible personal property, sales tax would not apply.

However, should the buyer intend to move the home to another location, then the sale would be classified as a sale of tangible personal and the lender/dealer is responsible for collecting sales tax from the buyer.

Question: A manufactured home is physically removed, by the lender, from the lot upon which it was installed and the home is consigned to a licensed dealer for resale of the home as tangible personal property. In this scenario, the licensed dealer may not have installed options to the home.

Answer: The sale of the consigned manufactured home will be treated the same as a new home sold from the dealer's inventory.

Question: Is it permissible for a lender, who is a licensed retail dealer, to sell a home to a wholesaler who purchases the home for resale or for rent/lease to the consumer (end user) without charging tax?

Answer: The sale to the wholesaler would not be subject to sales tax provided the wholesaler issues the lender a properly completed resale certificate (**Revenue Form 51A105**) **and** the lender exercises "good faith" as required by **KRS 139.260**. Until 7/1/04, "Good faith" is defined in **KRS 139.270(2)**.

- (2) "Good faith" shall be demonstrated by the seller if he:
 - (a) Accepts a properly completed resale certificate;
 - (b) Maintains a file of such certificate in accordance with **KRS 139.720**; and
 - (c) Determines that the kind of property being sold to the purchaser is normally offered for resale in the type business operated by the purchaser and that the property, if delivered by the seller, is delivered to the purchaser's business address. The seller is also relieved if the purchaser is unable to ascertain at the time of purchase whether the property will be sold or will be used for some other purpose.

However, effective 7/1/04...

- (2) “Good faith” shall be demonstrated by the retailer or seller if the retailer or seller:
 - (a) Accepts a properly completed resale certificate or certificate of exemption; and,
 - (b) Maintains a file of the certificate in accordance with **KRS 139.720**.

In a related matter, if the wholesaler intends to rent/lease the home, then the wholesaler is not authorized to issue a resale certificate and the lender must collect sales tax.

Question: A lender may assign the manufactured home for public sale or auction by a qualified auctioneer.

Answer: Pursuant to **KRS 139.110 1(a)** until 7/1/04, and **KRS 139.110(2)(a)**, effective 7/1/04, the auctioneer is considered the retailer of the manufactured home. As a retailer, the auctioneer must collect sales tax on the sale of the home, unless the transaction is otherwise exempt, i.e., sold for resale, sold to an exempt entity, etc.

Foreclosure Transactions

Question: The land and the manufactured home are combined in one transaction and resold as a package.

Answer: This transaction is considered the sale of real property. Therefore, sales tax would not apply.

General Questions

Question: Must a dealer responsible for delivery **and** set up on the customer’s designated home site collect sales and use tax on the delivery charge?

Answer: Yes. A dealer that is responsible for delivery and set up on the customer’s designated home site shall collect sales and use tax on his delivery charges (**KRS 139.050(1)(d)** – effective 7/1/04). In addition, **Regulation 103 KAR 30:070, Section 3** requires that when a retailer is under duty to install the property after delivery by him, delivery charges shall be considered a part of the selling price and subject to sales and use tax, regardless of the method of delivery. This is regardless of the time frame involved.

Question: How is a manufactured home dealer’s tax liability affected if he hires a third party to deliver and/or set up the home pursuant to the terms of the sales agreement with his customer?

Answer: The charges the dealer invoices the customer for the sale, delivery and set up of the home are still subject to the 6% sales and use.

Question: Must a dealer charge sales and use tax on installation labor charges included with the sale of manufactured homes?

Answer: Based on the practice of the industry to bundle the set up fee with the price of the home, the installation is a service that is part of the sales of the manufactured home. In accordance with **KRS 139.050**, the set up fee is subject to tax.

Question: Is the dealer a retailer or consumer of the materials such as concrete block, anchor bolts, gravel, heat tape, electrical wiring, duct work, etc., that he uses in the set up of the manufactured home on the customer's lot?

Answer: Based on the practice of the industry, the dealer is considered a retailer of the components utilized in the set up of the home. As a retailer, the dealer may issue a resale certificate to the supplier(s) of the components.

Question: Can a manufactured home dealer issue a resale certificate for the purchase of a heating or cooling unit that is being sold and installed as a part of the sale of the home at the time the home is set up on the customer's lot?

Answer: Yes. Based on the practice of the industry, the dealer is considered a retailer of the components utilized in the set up of the home. As a retailer, the dealer may issue a resale certificate to the supplier(s) of the components.

Question: What happens if a dealer does not follow the industry practice as outlined at the beginning of this document?

Answer: A dealer not following the practice of the industry will be required to comply with the requirements of **Regulation 103 KAR 26:070 – Construction Contractors** and **Regulation 103 KAR 30:180 – Installing Property Sold**. Under the terms of **Regulation 103 KAR 26:070** the dealer is not permitted to issue resale certificates for the set up components. Instead, the dealer must pay tax on his purchase price of materials consumed in the set up of the manufactured home.

Log Homes

Depending on the exact situation a manufacturer of log homes can be treated as a retailer or contractor and taxed accordingly. Kentucky sales and use tax law provides that the sales tax is levied on the sale at retail of tangible personal property. At times, the manufacturer sells the "log home package" without an agreement to install, and other times the manufacturer enters into such an agreement.

In instances where the manufacturer sales and installs, the manufacturer should be treated as a contractor. However, the sale of the "log home package" without installation would come under

the definition of tangible personal property as set forth in **KRS 139.160**. Consequently, the receipts from the retail sales of a "log home package only" would be a taxable sale which must be measured for the sales tax.

Boat docks

A boat dock can be 100% real, part real and part personal or 100% personal.

100% Real – this is a dock which is constructed permanently and affixed to the land, i.e., a wharf or pier.

Part Real and Part Tangible – docks which float on fiberglass pontoons which are permanently affixed to the bottom of the dock. The top pontoon of the dock is molded fiberglass, the sides are wood stringer and fiberglass, and the bottom is comprised of fiberglass pontoons. Gangways are used to provide access to the floating docks. One end of the gangway is hinged to a permanent pier on the shore. The other end rides upon rollers which rest on the decks of the floating docks. The gangway can thus rise and fall with the tide. The docks are hinged to pilings sunk in the basin of the marina by the use of U bolts and as long as the dock remains hinged, lateral movement is restricted. However, by merely unhinging the dock and by removing a very few pilings, the docks can be removed from their present location. The floating docks can be moved by towing or pushing by small vessels or may be propelled through the water by use of an outboard motor attached to the dock. They also can be moved in sections over land by trucks. The conclusion is that the pilings would be classified as real property and the floating dock would be tangible personal property.

100% Personal – a dock as described above but without the pilings.

Sales tax would apply to receipts applicable to the sale of a boat dock which is tangible personal property and whose business usage requires the holding of a seller's permit.

Conclusion

There is not a hard and fast rule to determine whether something is real or tangible. It is necessary to look at each case individually at the date you are trying to make that determination and the circumstances surrounding that item in question. Just keep in mind that to decide whether or not a thing is personal property or real estate, the courts have indicated that three (3) things must be considered: 1) Annexation, 2) Adaptation and 3) Intention.

The table below shows the appropriate classification for sales and use tax and property tax purposes of selected items. Any difference in treatment between property tax and sales tax is based upon long-standing administrative construction and is supported by **Regulation 103 KAR 26:070**.

Table – Classification for Sales and Use Tax and Property Tax Purposes

Tax Situation	Sales Tax	Property Tax
Carports:		
Attached to house.	Real	Real
Free standing, support post bolted to concrete slab.	Real	Real
Free standing, support post imbedded in concrete.	Real	Real
Signs:		
Free standing, support post bolted to concrete slab.	Real	Tangible
Free standing, support post imbedded in concrete.	Real	Real
Bill board beside highway.	Real	Tangible
Sign bolted to side of building.	Real	Tangible
Sign hanging by eye hooks from pole that is bolted to building.	Tangible	Tangible
Gas pumps:	Real	Tangible
Canopies:		
Canopy over gas pumps, support post bolted to concrete slab.	Real	Tangible
Canopy over gas pumps, support post imbedded in concrete.	Real	Real
Storage sheds:		
Pre-built, delivered to site and set on 4 X 4 supports, not bolted down.	Tangible	Real
<p>Note: For property tax, (1) if held for resale, these are considered merchant's inventory and (2) the real property classification applies only to storage sheds. Generally, property that is not bolted down is moveable and considered tangible personal property.</p>		
Pre-built, delivered to site and set on concrete slab, bolted down.	Tangible	Real
<p>Note: For sales tax purpose, this situation is no different than the sale and installation of a mobile home.</p>		
Pre-fab, assembled on site.	Tangible	Real
MRI installation in a hospital		
For sales tax purposes only, the equipment would be treated as a sale and installation of tangible personal property. Any special wiring, special flooring, etc. would be treated as a contract situation.	Real/Tangible	Tangible