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October 26, 2009

Scott C. Peterson
Executive Director
Streamlined Sales Tax Governing Board
4205 Hillsboro Pike, Suite 305
Nashville, TN 37215

Dear Mr. Peterson:

It is our understanding that for the 2009 annual compliance recertification process, Kentucky was the one state chosen to receive an exhaustive review of all our statutes to determine full compliance with every detail of the Streamlined Sales and Use Tax Agreement (SSUTA). We appreciate the benefit of this scrutiny and the opportunity to respond to the preliminary report findings. Since its initial compliance with the SSUTA in 2005, Kentucky has made several additional changes to its tax code to keep pace with the ongoing amendments to the SSUTA. Below is our state's response for consideration by the Compliance Review and Interpretations Committee (CRIC).

Issue #1: Digital products are sourced to the place of primary use while the Agreement sources such transactions under Section 310.

Response

While Section 309 paragraph A specifies that "the provisions of Section 310 apply regardless of the characterization of a product as tangible personal property, a digital good, or a service," this language was original to the SSUTA when adopted in November 2002. All of the September 2007 amendments relating to the "specified digital goods" definition and accompanying Rule 332 resulted in updates to several sections of the Agreement; however, Section 310 was not updated to address digital goods "transferred electronically."

As part of the adoption of digital property definitions during the 2009 Kentucky General Assembly, our state also adopted the definition of "transferred electronically" which means accessed or obtained by the purchaser by means other than tangible storage media. This definition is based upon Rule 332.2 B.4. This rule elaborates further that "it is not necessary that a copy of the product be physically transferred to the purchaser. So long as

the purchaser may access the product, it will be considered to have been electronically transferred to the purchaser. The term "transferred electronically" has a broader meaning than the term "delivered electronically" used in the computer related definitions."

This concept of accessing by means other than tangible storage media beyond an electronic download is not included within the current sourcing scheme of Section 310. Outside the realm of services, the existing sourcing hierarchy contemplates only physical receipt of tangible personal property or an electronic download of digital goods. For example, in Section 310(5) the default rule is the address "from which the digital good . . . delivered electronically was first available for transmission by the seller."

With this limitation in mind, Kentucky adopted a placeholder provision to source the access of digital property until Section 310 can be appropriately updated. For Kentucky purposes, sourcing the sale of digital property to the place of primary use means the street address where the end user receives the digital property or from where the end user primarily accesses the digital property" (http://www.lrc.ky.gov/KRS/139-00/105.PDF). "The place of primary use" standard still results in destination sourcing for digital property that is electronically downloaded.

To further clarify Kentucky's compliance with the provisions of Section 310, we are working to promulgate an administrative regulation that will add back the applicable sourcing defaults for electronically downloaded digital property. However, we would also appreciate recommendations from the Governing Board or CRIC on what additional steps we should take to address the mere access of a digital product until Section 310 is updated to include this concept.

Issue #2: The provision for when a cause of action against a seller accrues does not specify that the notification to the seller has to be in writing.

Response

Under Customer Refund Procedures in Section 325, paragraph C provides that "a cause of action against the seller for the over-collected sales or use taxes does not accrue until a purchaser has provided written notice to a seller and the seller has had sixty days to respond. Such notice to the seller must contain the information necessary to determine the validity of the request."

Kentucky adopted the Section 325 verbiage almost verbatim under KRS 139.771(1). The link for this language is as follows: http://www.lrc.ky.gov/KRS/139-00/771.PDF. The word "written" does not appear in our statute, but the requirement in substance is in place. For example, the notice must contain information necessary to determine the validity of any refund claim. This codification was part of Kentucky's original conforming legislation enacted by the 2003 General Assembly. If the Governing Board subsequently deems the omission a non-compliance issue, then the Department will work to amend the statute at the earliest opportunity. We would also appreciate guidance on what types of notices that our language currently allows that will then be subsequently prohibited.

Issue #3: The state exempts "rate increases" for the school tax and any other taxes and surcharges relating to telecommunications service. The school tax and many of the other charges are imposed on the provider of the service and the definition of sales price includes them. Sales price only excludes such charges if they are imposed directly on the consumer.

Response

Under KRS 139.470(9) Kentucky exempts from sales and use tax any rate increase for school taxes and any other charges or surcharges added to the total amount of a residential telecommunications service (http://www.lrc.ky.gov/KRS/139-00/470.PDF). The language in question provides an exemption for certain charges associated with a residential telecommunications service. Below is further explanation of the presence of this exemption in our statutes.

- This provision has been in the Kentucky tax code since 1979 and was maintained with the adoption of the "sales price" definition and other uniformity provisions within our initial SST conforming legislation in 2003. Although the sales price definition in the SSUTA has been subsequently amended, we do not believe these amendments have added any prohibition against the exemption in place regarding residential telecom services.
- In 2007 Kentucky amended the exemption statute in KRS 139.470(9) to include the SST definition of residential telecommunications service. This exemption for certain charges related to residential telecommunications service meets the guidelines for the enactment of exemptions provided in Sections 316 and 327. There are also no definitions used in this provision that are contrary to established SST terms.
- The definition of sales price does not include a product definition for the terms within our statute ("any rate increase for school taxes and any other charges or surcharges added to the total for residential telecom"). To the extent any of these charges or surcharges would normally be included in subparagraph B or any other part of the sales price definition, this exemption clarifies that the charges when related to a residential telecommunications service are exempt from Kentucky sales and use tax.

Thank you again for the opportunity to provide further explanation regarding Kentucky's compliance with the SSUTA. If you should have any additional questions or need more detail on these topics, then please advise.

Sincerely yours,

Richard Dobson

Richard Dobson
Executive Director
Office of Sales and Excise Taxes