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Commonwealth of Kentucky

Court of Appeals

NO. 2012-CA-000840-MR

ESTATE OF MILDRED L. MCVEY — APPELLANT

v.

APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE THOMAS D. WINGATE, JUDGE
ACTION NO. 11-CI-00933

DEPARTMENT OF REVENUE, FINANCE AND ADMINISTRATION CABINET, COMMONWEALTH OF KENTUCKY — APPELLEE

OPINION
AFFIRMING

** ** ** ** **

BEFORE: CAPERTON, CLAYTON, AND TAYLOR, JUDGES.

CLAYTON, JUDGE: The Estate of Mildred L. McVey appeals from the April 11, 2012 order of the Franklin Circuit Court concerning an inheritance tax assessment. First, the circuit court reversed the decision of the Kentucky Board of Tax Appeals (hereinafter "KBTA") and reinstated the decision of the Department of Revenue,

Finance and Administration Cabinet (hereinafter the "Department") that had disallowed the deduction for inheritance taxes as a "cost of administration." Further, the circuit court reversed the KBTA's decision regarding the Department's adjustment to the bequests of certain beneficiaries, wherein the Department had added the value of the estate's payment of inheritance taxes to the bequests.

After careful consideration, we affirm the decision of the circuit court.

FACTUAL AND PROCEDURAL BACKGROUND

Mildred L. McVey died testate on January 23, 2007. Her will was probated in Pike County District Court. The facts of the case are not disputed. The inheritance tax assessment of her estate, however, is the subject matter of this appeal. The issues in the case devolve from an interpretation of statutes concerning Kentucky's inheritance and estate taxes found in Kentucky Revised Statutes (KRS) Chapter 140. In particular, the construction, application, and interpretation of KRS 140.010 and KRS 140.090 are in dispute.

The conflict revolves around the impact of the following language of the Will. Item I of Mrs. McVey's Last Will and Testament states:

> Any death or inheritance taxes payable at my death on my estate whether on property passing under this will or otherwise shall be paid out of my residuary estate as a cost of administration and shall not be charged in any way to any beneficiary or recipient of my estate.

The obvious rationale of this directive was to enable the Estate to deduct the payment of the inheritance taxes as a "cost of administration" and for the Estate to pay inheritance taxes on the bequests to certain beneficiaries. Therefore, based on

this provision, the Estate of Mildred McVey (hereinafter the "Estate") deducted $134,369.48 of inheritance tax liability as a debt of the estate, that is, as a cost of administration, and made tax-free bequests pursuant to the dictates of the Will.

After the Estate filed its inheritance and estate tax return, the Department conducted an audit. As a result of the audit, the Department assessed an additional inheritance tax in the amount of $14,818.10, plus applicable interest. The basis for the imputation of additional inheritance tax was the Department's decision that the Estate's deduction of the inheritance tax liability of $134,359.48 as a "cost of administration" was improper under KRS 140.090(1).

Furthermore, the Department adjusted the distributive shares of certain beneficiaries to reflect an additional inheritance tax on the "bequest of tax." The Department reasoned that since McVey's Will provided for the inheritance taxes to be paid out of the residuary estate, rather than by the beneficiaries, they were relieved of paying the inheritance tax but not relieved of its tax implications. Thus, according to the Department, the amount of the bequest was increased by the value of the "bequest of tax," and this value represented an additional gift, subject to inheritance tax.

When the Department adjusted the distributive shares of these beneficiaries to reflect the bequest of the tax on those gifts, the adjustment was made by increasing each beneficiary's share by an amount equal to the inheritance tax on their distribution. Hence, the Department adjusted the gifts of three heirs to reflect an additional value to their bequests: $45,595; $91,182; and, $4,143.

In fact, the Estate had calculated and reported on the return an amount for the bequest of the tax for the beneficiaries but the Department ascertained that the Estate's calculation was incorrect and assessed an additional inheritance tax of $10.00. The Estate protested this additional inheritance tax assessment.

On July 2, 2010, after the Department and the representatives of the Estate had a conference, the Department issued its Final Ruling No. 2010-41 affirming the assessment of additional tax. Then, pursuant to KRS 131.110(5), the Estate appealed the Department's ruling to the KBTA, which is an administrative agency created under KRS Chapter 131 and vested with exclusive jurisdiction to hear and determine appeals from final rulings, orders, and determinations of any agency of state or county government affecting revenue and taxation. KRS 131.340.

After its review, the KBTA held that the inheritance taxes were properly deducted as a "cost of administration" because the Will so directed. With reference to the Department's adjustment of certain distributive shares to reflect the "bequest of tax," the decision cited *Glessner's Estate v. Carman*, 146 W.Va. 282, 118 S.E.2d 873 (W.Va. 1961), and said:

> that taxing authorities have no right to artificially increase bequests and that taxes cannot be imposed upon the transfer of property in amounts larger than the bequest and that the algebraic formula required to compute taxes as the Cabinet did in this case is not to be lightly imputed to the Legislature.

Estate of Mildred L. McVey v. Finance and Administration Cabinet Department of Revenue, 2011 WL 2001830 (May 2011), *2.

Subsequently, the Department appealed the KBTA's decision to the circuit court. It argued in its appeal that the KBTA erred as a matter of law when it reversed the Department's final ruling because the KBTA erroneously interpreted the law to allow inheritance taxes to be deducted as an administrative cost of an estate. And it maintained that KBTA erred in deciding that the Department did not have the legal authority to adjust certain distributive shares to account for the "bequest of tax." The Estate disagreed on both points.

On April 11, 2012, the circuit court entered its Opinion and Order, which reversed the KBTA's decision. It concluded that the Estate is not permitted a deduction under KRS 140.090, notwithstanding the provision in the Will; and further, the Will's direction to pay the inheritance tax out of the residual estate created an additional gift, that is, the "bequest of tax," which is also subject to an inheritance tax. In making this decision, the circuit court used a *de novo* standard of review since the facts were undisputed and the case involved statutory interpretation. The Estate appeals from this order.

On appeal, the Estate argues the following four issues. First, the Estate maintains that deference should be given to the KBTA's administrative opinion since it is based on a permissible construction of the statute. Second, the Department's disallowance of a deduction for inheritance tax as a debt of the estate was in error. Third, the Department may not assess a tax on a distribution that has

not been and never will be made to the beneficiary, that is, the "bequest of tax." Lastly, the Estate alleges that Section 2 of the Kentucky Constitution, which forbids the arbitrary exercise of power by governmental authorities, is violated by the Department's taking of a tax on the Will's specific directive to grant the bequest tax-free.

Initially, the Department counters that while three issues are properly preserved for review, the fourth issue concerning the Kentucky Constitution is not preserved. The Department argues that the Estate's Constitutional issue was neither raised nor argued before the lower court and, hence, is not preserved for review.

The other three issues, as outlined by the Department, are whether the circuit court applied the proper standard of review; whether the circuit court erred in reversing the KBTA and reinstating the Department's ruling that the deduction of the inheritance tax is not permissible under KRS 140.090; and finally, whether the circuit court erred in reversing the KBTA and reinstating the Department's adjustment of certain distributive bequests as subject to additional inheritance tax.

ANALYSIS

Kentucky's inheritance tax is imposed upon the privilege of receiving property from a decedent by reason of the decedent's death. *Martin v. Storrs*, 277 Ky. 199, 126 S.W.2d 445, 447 (Ky. 1939). The statute provides as follows:

> All real and personal property . . . which shall pass by will or by the laws regulating intestate succession . . . to any person or to any body politic or corporate . . . is

> subject to a tax upon the fair cash value as of the date of the death of the grantor or donor of the property in excess of the exemptions granted . . . .

KRS 140.010. In essence, an inheritance tax is an excise tax on the privilege of receiving property from the deceased. *Martin*, 126 S.W.2d at 447.

The rate of the inheritance tax is determined by the relationship of the beneficiary to the decedent. KRS 140.070. Moreover, the statutory requisites allow certain deductions when calculating the value of the beneficiary's distributive share. KRS 140.090(1). The interpretation of this statute is one issue in this case. Usually, Kentucky inheritance taxes are paid out of the shares received by the beneficiaries, "unless the will of the decedent directs to the contrary," as is the case here. *Gratz v. Hamilton*, 309 S.W.2d 181, 182 (Ky. 1958). We now turn to the specific issues herein.

Standard of Review

The order of the KBTA was a final and appealable order and, accordingly, subject to judicial review in accordance with KRS Chapter 13B. In reviewing this decision, the circuit court cited *Kentucky State Racing Commission v. Fuller*, 481 S.W.2d 298, 300- 301 (Ky. 1972). In its Opinion and Order, the circuit court quoted *Fuller* stating that it "may only overturn the decision if the agency acted arbitrarily or outside the scope of its authority, if the agency applied an incorrect rule of law, or if the decision itself is not supported by substantial evidence on the record." *Id*. It then noted that no facts were in dispute and the matter involved the construction and application of statutory law. The circuit court

then explained that because statutory review is a matter of law, it is reviewed *de novo*.

While the Department concurs with the circuit court's determination of the standard of review, the Estate disagrees. It maintains, relying on *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984), that the circuit court must give deference to the decision of an administrative agency when the legislature has not directly addressed the issue. Therefore, according to the Estate, the case must not be reviewed *de novo*, but rather, the court must affirm the agency's answer if it is based on a permissible construction of the statute.

Appeals to the circuit court from the KBTA are governed by KRS 131.370. An aggrieved party, except in a case concerning an appeal from a county board of assessment, may appeal to the Franklin Circuit Court or to the circuit court of the county in which the party resides or conducts his place of business in accordance with KRS Chapter 13B. KRS 131.370. The KBTA is an administrative agency under KRS Chapter 131.

We concur with the circuit court's analysis of the standard of review. Thus, when a court reviews the agency's final order, the court may only overturn the agency's decision if the agency acted arbitrarily or outside its scope, if the agency applied an incorrect rule of law, or if the decision itself is not supported by substantial evidence on the record. In the case at bar, no facts are disputed and, consequently, no evidentiary issues are implicated. No party argues that the

agency acted outside the scope of its authority. Instead, the issues require the court to decipher meaning and application of statutes. Statutory construction is an issue of law and, accordingly, is reviewed *de novo*. *Cumberland Valley Contractors, Inc. v. Bell County Coal Corp.*, 238 S.W.3d 644, 647 (Ky. 2007).

In fact, a court reviewing an administrative agency's decision is limited only with regard to weighing the evidence. *Bowling v. Natural Resources and Environmental Protection Cabinet*, 891 S.W.2d 406, 409-410 (Ky. App. 1994). But, once a reviewing court determines that the agency's decision is supported by substantial evidence, it must next decide whether the agency applied the correct rule of law to those factual findings in making its determination. *Id*. at 410. Such deliberations on matters of statutory construction are subject to *de novo* review. Hence, the circuit court was not bound by the KBTA's statutory interpretation, nor are we bound by the circuit court's statutory interpretation. *Halls Hardwood Floor Co. v. Stapleton*, 16 S.W.3d 327, 330 (Ky. App. 2000).

The specific issue of a proper standard of review in KBTA cases was discussed in *Camera Ctr., Inc. v. Revenue Cabinet*, 34 S.W.3d 39, 41 (Ky. 2000). Therein, the Supreme Court noted that the reviewing court is not to substitute its own judgment as to questions of fact, but may either affirm the final order of the KBTA, or reverse it, in whole or in part. *Id*.

While Kentucky courts have recognized that an appellate court must defer to an administrative agency's interpretation of its own regulations, the agency cannot by its rules and regulations, amend, alter, enlarge or limit the terms

of legislative enactment. *Brown v. Jefferson County Police Merit Board*, 751 S.W.2d 23 (Ky. 1988). Therefore, the reviewing court acts within its authority in reversing the KBTA if it finds the order is in violation of "constitutional or statutory provisions." KRS 13B.150(2)(a).

The Franklin Circuit Court was well within its jurisdiction to review this matter *de novo*, and the Estate is incorrect in suggesting that deference to the KBTA's decision is required by the circuit court. Because this matter is purely legal, that is, one of statutory interpretation, we review the decision of the circuit court *de novo*.

Disallowance of Deduction Taken on Kentucky Inheritance and Estate Tax Return

Next, we address the issue of whether the Department properly disallowed the deduction taken by the Estate for the payment of inheritance taxes. Mrs. McVey's Will provided that after the payment of the inheritance taxes, they were to be deducted as a "cost of administration." Based on this testamentary language, the Estate contends that it is allowed to deduct the payment of the inheritance taxes as a debt of the Estate.

Statutory language describing permitted deductions is as follows:

> In calculating the value of the distributive shares the following deductions and no others shall be allowed:
>
> > (a) Debts of the decedent, except debts secured by property not subject to the tax jurisdiction of Kentucky; and except debts barred by the statute of limitations;

> (b) Taxes accrued and unpaid, except those on property not subject to the tax jurisdiction of Kentucky;
>
> (c) Death duties paid to foreign countries;
>
> (d) Federal estate taxes, in the proportion which the net estate in Kentucky subject to federal estate taxes bears to the total net estate everywhere subject to federal estate taxes; all calculations are subject to approval by the Department of Revenue;
>
> (e) Drainage, street, or other special assessments due and unpaid which are a lien on said property;
>
> (f) Funeral, monument, and cemetery lot maintenance expenses actually paid not exceeding in total five thousand dollars ($5,000);
>
> (g) Commission of executors and administrators in the amount actually allowed and paid;
>
> (h) Cost of administration, including attorney's fees actually allowed and paid.

KRS 140.090(1). Both the Estate and KBTA maintain that the Estate was allowed to deduct the inheritance tax liability as a "cost of administration" because the Will so directed.

This contention is contrary to well-settled law. "Debts of the decedent," for the purposes of KRS 140.090, are debts that have accrued and are unpaid at the instance of death. Nonetheless, this characterization of debt does not include debts that accrue by reason of death. *Lynch v. Kentucky Tax Commission*, 333 S.W.2d 257, 261 (Ky. 1960). Likewise, "accrued and unpaid" taxes are allowed as a deduction since they are "obligations existing prior to death." *Id*.

While the Estate indicates that because the inheritance tax under review in *Lynch* was a North Carolina inheritance tax, *Lynch* is not relevant here. But the Estate's reasoning is in error, and the holding in *Lynch* is applicable here. Therein, the inheritance tax was paid "in satisfaction of an obligation that arises by reason of the death and incident to the transfer of the property occasioned thereby; hence, it is not a debt of the decedent." *Id*. Accordingly, the Estate's payment of the inheritance tax is not a deductible as a debt or tax pursuant to KRS 140.090.

Moreover, the Estate's argument that because in *Cochran's Ex'r and Trustee v. Commonwealth*, 241 Ky. 656, 44 S.W.2d 603 (Ky. App. 1931), federal income taxes were considered deductible, so, too, should these inheritance taxes, is also not persuasive. Although the *Cochran* Court held that federal income taxes were deductible as a "debt of the decedent," the Court so reasoned because the federal income taxes had accrued and were vested at the time of the testator's death. Consequently, the federal income taxes were due and owing prior to the testator's death, even though the exact dollar amount was unknown.

In *Martin*, the Court explained that inheritance tax is measured by: "1. [t]he passage of title; 2. by reason of death; 3. from the decedent; 4. to the beneficiary or beneficiaries." *Martin*, 126 S.W.2d at 447. Hence, since inheritance tax is imposed because of the death of the grantor, it is not an accrued tax due and owing prior to the testator's death.

The Department and the circuit court maintain that notwithstanding the language in the Will that the inheritance taxes be deducted as a "cost of

administration," the Estate is statutorily prohibited from doing so. Since the inheritance taxes were not owed prior to Mrs. McVey's death, they are not debts of the decedent under KRS 140.090, nor is the payment of inheritance tax a cost of administration. Therefore, the deduction for the inheritance tax liability does not meet any of the specifically stated deductions found in KRS 140.090(1).

We agree with this analysis. Supporting this position is the language of KRS 140.090, which says that "the following deductions and no others shall be allowed[.]" Therefore, based on the statute and explained in *Lynch*, "[t]he language of the statute disallows any deduction not specifically mentioned. The legislative intent is plain that the only deductions to be allowed are those mentioned in the statute." *Lynch*, 333 S.W.2d at 261.

Regarding the Estate and the KBTA's argument that the deduction taken by the Estate was proper because Mrs. McVey's Will so directed, we note that even though the intent of the testator is the cardinal rule in the construction of wills, the testator's intent must not be contrary to the rule of law. *Citizens' Trust Co. v. Fidelity Trust Co.*, 136 Ky. 540, 124 S.W. 824, 825 (Ky. App. 1910). Mrs. McVey's Will cannot disregard statutory directives by characterizing the payment of an inheritance tax as "a cost of administration."

In conclusion, we concur with the circuit court's decision that reversed the KBTA's decision and acted in consort with the Department's decision that the Estate's deduction of the inheritance tax liability as a "cost of administration" must be disallowed. This is true notwithstanding Mrs. McVey's

direction in her Will to pay the inheritance taxes out of the residual estate as a "cost of administration."

In fact, "cost and charges of the administration of an estate" . . . "refers to such cost and charges as are necessarily incurred by the personal representative in the settlement of the estate, such as court costs, attorney's fees, the compensation of the personal representative, and other necessary incidental expenses that he may be put to in the discharge of his fiducial duties." *Brown's Ex'r v. United States Trust Company*, 185 Ky. 747, 215 S.W. 815, 817 (Ky. App. 1919). The payment of inheritance taxes is not listed and has never been characterized as a "cost of administration."

Adjustments Made to the Distributive Shares of Certain Beneficiaries

The Estate also objected to the adjustments made to the distributive shares of beneficiaries by the bequest of tax. The Department's adjustment of the bequests to reflect the "bequest of tax" prompts the third issue: whether a bequest, which is transmitted to the beneficiary with an Estate required to pay the beneficiary's the inheritance tax, requires the imposition of inheritance taxes on the value of the payment of the inheritance taxes. Simply put, the question is whether the "bequest of tax" is itself subject to inheritance tax.

To put the conflict in perspective, prior to the Department's audit and adjustment of the distributive shares to reflect the "bequest of tax," the Estate itself had calculated and reported an amount for the "bequest of tax" to the beneficiaries. The Department, however, ascertained that the Estate's calculation was incorrect

and assessed an additional inheritance tax of $10.00. After the Department's assessment that the Estate owed an additional tax of $10.00, the Estate altered its stance and now contends that no adjustment should have been made to the distributive shares for the "bequest of tax."

Again, the impact of Item I of Mrs. McVey's Will is at issue. Therein, the Will provides that "[a]ny death or inheritance taxes payable at my death . . . shall be paid out of my residuary estate . . . and shall not be charged in any way to any beneficiary or recipient of my estate." The immediate effect of this provision is to have death taxes, including inheritance taxes, paid out of the residuary estate and, thus, permit the bequests to pass as denominated in the Will but decrease the residuary estate by the payment of the inheritance taxes on the bequests.

Regardless of the Will, the inheritance taxes must be paid. Here, while the testator had the authority to direct that death and inheritance taxes be paid out of the residual estate, she did not and could not obviate a beneficiary's obligation to pay inheritance taxes. Since the Will's language allowed beneficiaries to have their inheritance tax paid out of the residual estate, the Department was authorized to adjust the distributive shares of certain beneficiaries to reflect the additional "bequest of tax." To establish the inheritance tax due on the "bequest of tax," the original amount of the bequests was increased by an amount equal to the inheritance tax, which was to be paid from the residual estate.

The Department asserts that, but for the language in the Will, the value of these bequests would have been taxable as additional gifts. In essence, the Department treated the provisions of the Will, which provided for the payment of inheritance taxes from the residuary estate, as an additional legacy, which is subject to inheritance tax. The circuit court agreed with the Department that the bequest of inheritance tax itself is subject to inheritance tax. Further, the circuit court and the Department noted that Kentucky follows the majority rule in the country that the tax-free aspect of the bequest is itself taxable. To support this conclusion, the circuit court also cited *Estate of Samuels v. Depart. of Revenue*, Order No. K-6766 (Ky. Bd. of Tax App. 1981), and *The Kentucky Trust Company, Executor for the Estate of Davis v. Department of Revenue*, Order No. K-258 (Ky. Bd. Tax App. 1966).

In contrast, the Estate and the KBTA proffered arguments disputing these positions. The KBTA, without mention of any of its previous cases such as the one case cited by the circuit court, opined that, pursuant to KRS 140.010, inheritance taxes are imposed by the receipt of property from a decedent by reason of his death. Then, it cites several cases to support the position that once a Will provides for the payment of death and inheritance taxes, the "bequest of tax" is not also taxable. (These cases are inapposite and discussed below.) Lastly, it proffers that the Department's reasoning suggests that a tax on a "bequest of tax" is a tax on the tax *ad infinitum*.

The Estate, which agrees with the KBTA's decision and cites many of the same cases, elucidates, too, that KRS 140.010 holds that the inheritance tax is measured by the receipt of property from a decedent. Accordingly, the Estate maintains that because the beneficiary has no entitlement, possession, or expectancy to receive the property used to pay the death taxes, no property is passed from the decedent and, therefore, no inheritance tax should be required on the "bequest of tax." Further, it also opines that a tax on the "bequest of tax" is a tax *ad infinitum*.

Both the Estate and the KBTA reference several of the same cases to support their position. First, we consider *Northcutt's Ex'x v. Farmers Nat. Bank*, 292 Ky. 628, 166 S.W.2d 971 (Ky. App. 1942). The Estate and KBTA claim that this case stands for the proposition that when sufficient residuary funds exist to pay an inheritance tax, then the recipients of bequests are no longer liable for the tax on the bequest. They also cited to *Brodie v. DeVatz*, 556 S.W.2d 444 (Ky. 1977), to support this interpretation.

Our reading of *Northcutt Ex'x* is somewhat different. In *Northcutt Ex'x*, the question was whether a lapsed devise should pass to the residue of the estate or pass pursuant to intestacy. *Id*. at 972. The Court found that the testator did not intend for this gift to pass to the residual legatees in the event of a lapse. *Id*. at 973. In this context, the Court discussed whether the lapsed gift should first be used to pay debts or cost of administration prior to paying these expenses from the residual estate. Therein, the Court merely states that if an Estate has sufficient

funds to pay its debts, recipients are not personally liable for the debts. *Id*. at 974. Significantly, it is completely silent on the issue of whether the "bequest of tax" is itself subject to inheritance tax. It is not relevant to the case at bar since the Estate has sufficient funds to pay its expenses and lapsed devises are not involved.

Additionally, we do not deem *Brodie v. DeVatz* on point, either. Somewhat similar to this case, the question was whether inheritance tax on non-probate property should be borne by the recipients or by the estate since the decedent's will provided that inheritance taxes were to be paid out of the estate. *Id*. at 444. The particular gifts were non-probate property but subject to inheritance tax because they were given in contemplation of death and joint property with right of survivorship. The Court, based on the testamentary language in the will, forgave collection of inheritance taxes from those who had received gifts in expectation of death or joint property with right of survivorship since the testator's will said that those taxes were to be paid by the estate. *Id*. at 445. However, just as in *Northcutt Ex'x*, this case is completely silent on whether the "bequest of tax" is subject to inheritance taxes. Again, *Brodie,* too, is not on point for purposes of our review. Keep in mind no one is suggesting that a testator is not permitted to write his or her will to allow for the payment of the inheritance tax out of the Estate. That is not the issue here.

Lastly, we observe that both the Estate and the KBTA discuss *Glessner's Estate v. Carman*, 146 W.Va. 282, 118 S.E.2d 873 (W.Va. 1961). Our first observation is based on the obvious – this case is not a Kentucky case.

Therefore, its relevance is automatically subject to diminution.

The Estate and KBTA rely on this case for its language that taxing authorities have no right to artificially increase bequests and that taxes cannot be imposed upon the transfer of property in amounts larger than the bequest. Additionally, the Estate points out that *Glessner* states that "[a]s heretofore noted our statute does not provide that every dollar of an estate shall be subjected to the inheritance tax." *Id*. at 290, 118 S.E.2d at 877.

The most notable distinction between *Glessner* and our case is that the West Virginia statute under discussion is not the same as the Kentucky statute. As explained in the Department's appellee brief, West Virginia's inheritance tax is computed upon a "market value" of the interest in the property transferred, and Kentucky's inheritance tax is calculated according to the "fair cash value" of the property. Appellee's Brief, page 19-20. The distinction between the methodologies for computing inheritance taxes in the respective states renders the holding in *Glessner* virtually without meaning in our Commonwealth.

The first inheritance tax was passed in 1906. *Kentucky Tax Commission v. Lincoln Bank & Trust Company*, 245 S.W.2d 950, 952 (Ky. 1952). Since its inception, an inheritance tax has not been considered a tax on property itself but an "excise [tax] or duty upon the right or privilege of taking property by will or by descent. . . ." *Booth's Ex'r v. Commonwealth*, 130 Ky. 88, 113 S.W.61, 64 (Ky. 1908). So, contrary to the arguments of the Estate and the KBTA, the Kentucky inheritance tax is not a tax on the property itself but a tax on the transfer

of the property. And, the tax is imposed for the privilege of becoming a beneficiary under the Will.

In *State Tax Commission v. Hughes Drug Co.*, 219 Ky. 432, 293 S.W. 944 (Ky. App. 1927), an excise tax is explained:

> The word has, however, come to have a broader meaning and includes every form of taxation which is not a burden laid directly upon persons or property; in other words, excise includes every form of charge imposed by public authority for the purpose of raising revenue upon the performance of an act, the enjoyment of a privilege, or the engaging in an occupation.

Id. at 945 (citation omitted). Thus, an excise tax is one that is based on "the enjoyment of a privilege" rather than a specific burden laid directly on persons or property. We previously recognized herein that an inheritance tax is an excise tax. *See Martin*, 126 S.W.2d at 447. In the case at hand, the Department and the circuit court properly upheld Kentucky jurisprudence by imposing the inheritance tax on the "bequest of tax." The imposition was not because of the transfer of property but represented the excise tax based on the privilege bestowed on the beneficiaries by the Will, which directed that their inheritance tax be paid out of the residual estate.

In essence, the effect of payment of the beneficiaries' inheritance taxes was not, as is the case when a will does not provide for inheritance taxes, off the top of the bequest itself but rather from the residual estate. Subsequently, when the inheritance taxes are computed for the residual estate, the residual estate will have been reduced by the amount paid for the death and inheritance taxes of

certain beneficiaries. This factor permits an accurate assessment of the inheritance tax obligation on the residual estate. This assessment will take place in conjunction with the relationship of the residual beneficiary to the decedent. *See* KRS 140.070.

The Estate argues that if this tax on the payment of inheritance tax is allowed "there would have to be a tax on the tax and then on *ad infinitum*." Appellant's brief at page 10. We disagree with the Estate's reasoning. If we accepted this argument, we would essentially be allowing double taxation. We do not interpret the statutes in this manner to allow this result.

> A statute will not be so construed as to embrace double taxation, unless the construction is required by its express words or necessary implication. The safe and sound rule of construction of levying laws is to hold, in the absence of express words plainly disclosing a different intent, that they were not intended to subject the same property to be twice charged for the same tax, nor the same business to be twice taxed for the exercise of the same privilege.

City of Newport v. Fitzer, 131 Ky. 544, 115 S.W. 742, 743 (Ky. App. 1909). This principle was more recently stated again by the Kentucky Supreme Court in *St. Ledger v. Commonwealth of Kentucky, Revenue Cabinet*, 942 S.W.2d 893 (Ky. 1997). "We addressed the dangers of double taxation in *Commonwealth v. Walsh's Trustee*, 133 Ky. 103, 117 S.W. 398, 399 (1909), a case involving an attempt to tax certain corporate stock, where we maintained:

> Throughout the whole scheme of taxation adopted by this state there is an evident purpose to avoid double taxation, not alone in not taxing the same property twice in the same year for the same purpose, but as well in not taxing

> the same thing, whatever its form, twice in the same year for the same purpose. . . ."

St. Ledger at 897.

In the case at bar there were two separate bequests which resulted in a tax on each bequest. There is now no additional bequest, transfer or conveyance of property or privilege, therefore there is no additional tax which could be imposed.

Violation of Section 2 of the Kentucky Constitution

The Estate argues that the Department's application of the inheritance tax statutes violates Section 2 of the Kentucky Constitution because the adjustment made by the Department to the distributive shares of the named beneficiaries to reflect the "bequest of tax" amounts to a "taking of property" in violation of Kentucky Constitution Section 2. In response, the Department, while disagreeing with this contention, observes that the Estate did not make this constitutional challenge in the lower court, and for that reason the issue is not properly preserved for our review.

Clearly, the argument was not raised below and is only being argued on appeal. Accordingly, it is not preserved for our review. *Taxpayer's Action Group of Madison County v. Madison County Bd. of Elections*, 652 S.W.2d 666 (Ky. App. 1983). In fact, before this Court may address a challenge to the constitutionality of a statute or regulation, the Attorney General must be notified. Kentucky Rules of Civil Procedure 24.03; KRS 418.075. The Estate did not do so. The Kentucky Supreme Court has held that the notification requirement is

mandatory and should be strictly enforced. *Maney v. Mary Chiles Hospital*, 785 S.W.2d 480 (Ky. 1990). Therefore, for both the failure to preserve and the failure to notify the Attorney General of a constitutional challenge, we must decline to address the constitutional question. It is not properly preserved for our review.

CONCLUSION

Having determined that the Department properly disallowed the deduction for inheritance taxes as a "cost of administration" and that its adjustment to the distributive shares of certain beneficiaries to reflect the "bequest of tax" was appropriate, we affirm the April 11, 2012 Opinion and Order of the Franklin Circuit Court.

ALL CONCUR.

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