Basic Federal and Kentucky Individual Income Tax

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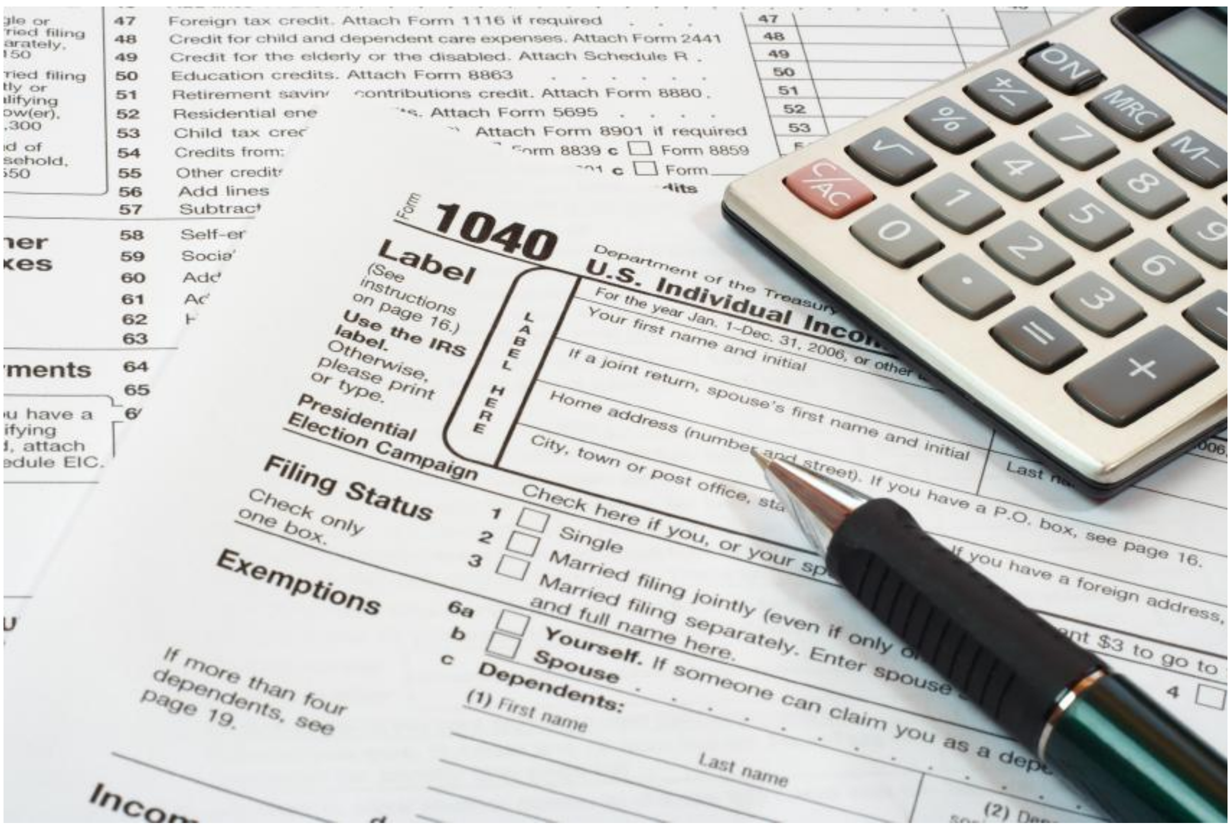
BASIC FEDERAL AND KENTUCKY INDIVIDUAL INCOME TAX



D I S C L A I M E R

Every effort and care has been taken in the preparation of this manual. However, the possibility of mechanical and/or human error does exist. The information provided is for educational purposes only and nothing herein constitutes the provision of legal advice or services.

In the event that any information in this manual is later determined to be in error, this manual cannot be used by taxpayers in supporting a specific position or issue before the Department of Revenue as it does not have the statutory and regulatory authority.

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INTRODUCTION

The Basics

The information in this manual has been designed to give you an overall understanding of the basics of both the federal and Kentucky Individual Income Tax return. Subjects covered in this class will include statutes and regulations as they apply to federal and Kentucky individual income tax, forms and schedules, filing status, exemptions, income and adjustments, deductions, tax computation, tax credits, and more. Examples will be presented to apply the tax concepts discussed and highlight federal/state differences.

The Objective

The purpose of this manual is to provide DOR employees with a basic working knowledge of both federal and Kentucky individual income tax and guidance on various tax issues. This manual is useful as a reference tool and should provide the employee with the knowledge to complete and review basic federal and Kentucky individual income tax returns.

The Material

The material in this manual is based on the tax laws in effect for federal and Kentucky purposes as they apply to the **2010** tax year. Generally, the foundation for laws that impact Kentucky income tax is based on the Internal Revenue Code (IRC). However, it is important to note that the IRC is subject to legislative changes and is updated annually, whereas Kentucky does not automatically adopt the IRC on a yearly basis. Consequently, one should know the tax year in question and the appropriate IRC in effect when applying income tax law.

Kentucky is presently under the IRC code date of December 31, 2006 with two exceptions – laws impacting depreciation are per the IRC date of December 31, 2001; and the provisions of the Military Family Tax Relief Act of 2003. Therefore, substantial tax law changes enacted for federal tax purposes in subsequent years are not in effect for Kentucky tax purposes, thus creating federal and Kentucky tax law differences.

Note: The bulk of the material in Part I of this manual is based on completing the federal Form 1040, which is the most comprehensive and commonly used form available for filing your federal individual income tax return.

Part I – Federal

Section 1

A) Who Should File?

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WHO SHOULD FILE?

You must file a federal income tax return if you are a citizen or resident of the United States or a resident of Puerto Rico and you meet the filing requirements for any of the following categories that apply to you. The filing requirements for each category apply even if you do not owe tax.

1. Individuals in general. (Note: There are special rules for surviving spouses, executors, administrators, legal representatives, U.S. citizens and residents living outside the United States, residents of Puerto Rico, and individuals with income from U.S. possessions.)

2. Dependents.

3. Certain children under age 19 or full-time students.

4. Self-employed persons.

5. Aliens.

Individuals—In General

If you are a U.S. citizen or resident, whether you must file a return depends on three basic factors:

1. Your gross income,

2. Your filing status, and

3. Your age.

To find out whether you must file, see Table 1-1, Table 1-2, and Table 1-3 (which follow in the material). Even if none of the tables show that you are required to file a return, it still may be necessary to file to request a refund in certain situations.

Gross income. This includes all income you receive in the form of money, goods, property, and services that is not exempt from tax. It also includes income from sources outside the United States or from the sale of your main home (even if you can exclude all or part of it) and may include part of your Social Security benefits in certain circumstances.

Note: Common types of income will be discussed later in this material.

Filing status. Your filing status depends on whether you are single or married and on your family situation. Your filing status is determined on the last day of your tax year, which is December 31 for most taxpayers.

Age. If you are age 65 or older at the end of the year, you generally can have a higher amount of gross income than other taxpayers before you must file. See Table 1-1. You are considered age 65 on the day before your 65th birthday. For example, if your 65th birthday is on January 1, 2011, you are considered age 65 for 2010.

Table 1-1. 2010 Filing Requirements for Most Taxpayers

IF your filing status is…	AND at the end of 2010 you were… *	THEN file a return if your gross income was at least… **
Single	Under age 65	$9,350
	Age 65 or older	$10,750
Married filing jointly ***	Under age 65 (both spouses)	$18,700
	Age 65 or older (one spouse)	$19,800
	Age 65 or older (both spouses)	$20,900
Married filing separately	Any age	$3,650
Head of household	Under age 65	$12,050
	Age 65 or older	$13,450
Qualifying widow(er) with dependent child	Under age 65	$15,050
	Age 65 or older	$16,150

* If you were born on January 1, 1946, you are considered to be age 65 at the end of 2010.
** Gross income means all income you received in the form of money, goods, property, and services that is not exempt from tax, including any income from sources outside the United States or from the sale of your main home (even if you can exclude part or all of it). Do not include any Social Security benefits unless (a) you are married filing a separate return and you lived with your spouse at any time during 2010 or (b) one-half of your Social Security benefits plus your other gross income and any tax-exempt interest is more than $25,000 ($32,000 if married filing jointly). If (a) or (b) applies, see the instructions for Form 1040 or 1040A or IRS Publication 915 to figure the taxable part of Social Security benefits you must include in gross income.
*** If you did not live with your spouse at the end of 2010 (or on the date your spouse died) and your gross income was at least $3,650, you must file a return regardless of your age.

Dependents

If you are a dependent (one who meets the dependency tests discussed later) see Table 1-2 to determine if you must file a return. You also must file if your situation is described in Table 1-3.

Responsibility of Parent. Generally, a child is responsible for filing his or her own tax return and for paying any tax on the return. But if a dependent child who must file an income tax return cannot file it for any reason, such as age, then a parent, guardian, or other legally responsible person must file it for the child. If the child cannot sign the return, the parent or guardian must sign the child’s name followed by the words “By (your signature), parent for minor child.”

Child’s Earnings. Amounts earned by a child for performing services are his or her gross income. This is true even if under local law the child’s parents have the right to the earnings and may actually have received them. If the child does not pay the tax due on this income, then the parent is liable for the tax.

Table 1-2. 2010 Filing Requirements for Dependents

If your parents (or someone else) can claim you as a dependent, and any of the situations below apply to you, you must file a return. (See Table 1-3 for other situations when you must file.)

In this table, earned income includes salaries, wages, tips, and professional fees. It also includes taxable scholarship and fellowship grants. Unearned income includes investment-type income such as taxable interest, ordinary dividends, and capital gain distributions. It also includes unemployment compensation, taxable Social Security benefits, pensions, annuities, cancellation of debt, and distributions of unearned income from a trust. Gross income is the total of your earned and unearned income.

Single dependents—Were you either age 65 or older or blind?

☐ **No.** You must file a return if any of the following apply.

- Your unearned income was more than $950.
- Your earned income was more than $5,700.
- Your gross income was more than the larger of:
  - $950, or
  - Your earned income (up to $5,400) plus $300.

☐ **Yes.** You must file a return if any of the following apply.

- Your unearned income was more than $2,350 ($3,750 if 65 or older and blind).
- Your earned income was more than $7,100 ($8,500 if 65 or older and blind).
- Your gross income was more than the larger of:
  - $2,350 ($3,750 if 65 or older and blind), or
  - Your earned income (up to $5,400) plus $1,700 ($3,100 if 65 or older and blind).

Married dependents—Were you either age 65 or older or blind?

☐ **No.** You must file a return if any of the following apply.

- Your unearned income was more than $950.
- Your earned income was more than $5,700.
- Your gross income was at least $5 and your spouse files a separate return and itemizes deductions.
- Your gross income was more than the larger of:
  - $950, or
  - Your earned income (up to $5,400) plus $300.

☐ **Yes.** You must file a return if any of the following apply.

- Your unearned income was more than $2,050 ($3,150 if 65 or older and blind).
- Your earned income was more than $6,800 ($7,900 if 65 or older and blind).
- Your gross income was at least $5 and your spouse files a separate return and itemizes deductions.
- Your gross income was more than the larger of:
  - $2,050 ($3,150 if 65 or older and blind), or
  - Your earned income (up to $5,400) plus $1,400 ($2,500 if 65 or older and blind).

Certain Children under Age 19 or Full-Time Students

If a child's only income is interest and dividends (including capital gain distributions and Alaska Permanent Fund dividends), the child was under age 19 at the end of 2010 or was a full-time student under age 24 at the end of 2010, and certain other conditions are met, then a parent can elect to include the child's income on the parent's return. If this election is made, the child does not have to file a return.

Self-Employed Persons

You are considered to be self-employed if you:

- Carry on a trade or business as a sole proprietor,
- Are an independent contractor,
- Are a member of a partnership, or
- Are in business for yourself in any other way.

Self-employment can include work in addition to your regular full-time business activities, such as certain part-time work that you do at home or in addition to your regular job.

You must file a return if your gross income is at least as much as the filing requirement amount for your filing status and age (shown in Table 1-1). Also, you must file Form 1040 and Schedule SE (Form 1040), Self-Employment Tax, if:

1. Your net earnings from self-employment (excluding church employee income) were $400 or more, or

2. You had church employee income of $108.28 or more. (See Table 1-3.)

Use Schedule SE (Form 1040) to figure your self-employment tax. Self-employment tax is comparable to the Social Security and Medicare tax withheld from an employee's wages. For more information about this tax, see IRS Publication 334, Tax Guide for Small Business.

Aliens

Your status as an alien—resident, nonresident, or dual-status—determines whether and how you must file an income tax return.

The rules used to determine your alien status are discussed in IRS Publication 519, U.S. Tax Guide for Aliens.

<u>Resident Alien</u>. If you are a resident alien for the entire year, you must file a tax return following the same rules that apply to U.S. citizens.

Nonresident Alien. If you are a nonresident alien, the rules and tax forms that apply to you are different from those that apply to U.S. citizens and resident aliens. See IRS Publication 519 to find out if U.S. income tax laws apply to you and which forms you should file.

Dual-Status Taxpayer. If you are a resident alien for part of the tax year and a nonresident alien for the rest of the year, you are a dual-status taxpayer. Different rules apply for each part of the year. For information on dual-status taxpayers, see IRS Publication 519.

Table 1-3. Other Situations When You Must File a 2010 Return

If any of the four conditions listed below applies, you must file a return, even if your income is less than the amount shown in Table 1-1 or Table 1-2.

1. You owe any special taxes, including any of the following.
   - Social Security or Medicare tax on tips you did not report to your employer.
   - Social Security or Medicare tax on wages you received from an employer who did not withhold these taxes.
   - Uncollected Social Security, Medicare, or railroad retirement tax on tips you reported to your employer.
   - Uncollected Social Security, Medicare, or railroad retirement tax on your group-term life insurance. This amount should be shown in box 12 of your Form W-2.
   - Alternative minimum tax.
   - Additional tax on a qualified retirement plan, including an individual retirement arrangement (IRA).
   - Additional tax on an Archer MSA or health savings account. (See IRS Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.)
   - Additional tax on a Coverdell ESA or qualified tuition program. (See IRS Publication 970, Tax Benefits for Education.)
   - Recapture of an investment credit or a low-income housing credit. (See the Instructions for Form 4255, Recapture of Investment Credit, or Form 8611, Recapture of Low-Income Housing Credit.)
   - Recapture tax on the disposition of a home purchased with a federally subsidized mortgage.
   - Recapture of the qualified electric vehicle credit.
   - Recapture of an education credit.
   - Recapture of the Indian employment credit. (See the Instructions for Form 8845, Indian Employment Credit.)
   - Recapture of the New Markets Credit. (See Form 8874, New Markets Credit.)
   - Recapture of Alternative Motor Vehicle Credit. (See Form 8910, Alternative Motor Vehicle Credit.)
   - Recapture of First-Time Homebuyer Credit.
   - Household employment taxes. (See Schedule H (Form 1040), Household Employment Taxes.)

2. You received any advance earned income credit (EIC) payments from your employer. This amount should be shown in box 9 of your Form W-2.

3. You had net earnings from self-employment of at least $400.

4. You had wages of $108.28 or more from a church or qualified church-controlled organization that is exempt from employer Social Security and Medicare taxes. (See IRS Publication 334.)

Finally, even if you do not have to file or owe any tax, you should file a federal income tax return to request a refund if any of the following conditions apply.

1. You had federal income tax withheld or made estimated tax payments.
2. You qualify for the Earned Income Credit.
3. You qualify for the Additional Child Tax Credit.
4. You qualify for the Health Coverage Tax Credit.
5. You qualify for the refundable credit for prior year minimum tax.
6. You qualify for the Making Work Pay Credit.
7. You qualify for the First-Time Homebuyer Credit.
8. You qualify for the American Opportunity Credit.
9. You qualify for the Credit for Federal Tax on Fuels.
10. You qualify for the Adoption Credit.

WHAT FORM SHOULD BE USED?

There are three basic options to choose from when filing your Federal Individual Income Tax Return – Form 1040, Form 1040A and Form 1040EZ.

Form 1040EZ

Form 1040EZ is the simplest form to use.

You can use Form 1040EZ if all of the following apply.

1. Your filing status is single or married filing jointly. If you were a nonresident alien at any time in 2010, your filing status must be married filing jointly.

2. You (and your spouse if married filing a joint return) were under age 65 and not blind at the end of 2010. If you were born on January 1, 1946, you are considered to be age 65 at the end of 2010.

3. You do not claim any dependents.

4. Your taxable income is less than $100,000.

5. Your income is only from wages, salaries, tips, unemployment compensation, Alaska Permanent Fund dividends, taxable scholarship and fellowship grants, and taxable interest of $1,500 or less.

6. You did not receive any advance earned income credit (EIC) payments.

7. You do not claim any adjustments to income, such as a deduction for IRA contributions or student loan interest.

Form 1040A

If you do not qualify to use Form 1040EZ, you may be able to use Form 1040A.

You can use Form 1040A if all of the following apply.

1. Your income is only from wages, salaries, tips, IRA distributions, pensions and annuities, taxable Social Security and railroad retirement benefits, taxable scholarship and fellowship grants, interest, ordinary dividends (including Alaska Permanent Fund dividends), capital gain distributions, and unemployment compensation.

2. Your taxable income is less than $100,000.

3. Your adjustments to income are for only the following items.
a. IRA deduction.
b. Student loan interest deduction.

4. You do not itemize your deductions.

5. Your taxes are from only the following items.
a. Tax Table.
b. Alternative minimum tax.
c. Advance earned income credit payments, if you received any.
d. Recapture of an education credit.
e. Form 8615, Tax for Certain Children Who Have Investment Income of More Than $1,900.
f. Qualified Dividends and Capital Gain Tax Worksheet.

Form 1040

If you cannot use Form 1040EZ or Form 1040A, you must use Form 1040. You can use Form 1040 to report all types of income, deductions, and credits.

You may pay less tax by filing Form 1040 because you can take itemized deductions, some adjustments to income, and credits you cannot take on Form 1040A or Form 1040EZ.

You must use Form 1040 if any of the following apply.

1. Your taxable income is $100,000 or more.

2. You itemize your deductions.

3. You had income that cannot be reported on Form 1040EZ or Form 1040A, including tax-exempt interest from private activity bonds issued after August 7, 1986.

4. You claim any adjustments to gross income other than the adjustments listed earlier under Form 1040A.

5. Your Form W-2, box 12, shows uncollected employee tax (Social Security and Medicare tax) on tips or group-term life insurance.

6. You received $20 or more in tips in any one month and did not report all of it to your employer.

7. You were a bona fide resident of Puerto Rico and exclude income from sources in Puerto Rico.

Form 1040EZ (cont.)

8. You do not claim any credits other than the earned income credit or the making work pay credit.

9. You do not owe any household employment taxes on wages you paid to a household employee.

10. You are not claiming the additional standard deduction.

You must meet all of these requirements to use Form 1040EZ. If you do not, you must use Form 1040A or Form 1040.

Figuring tax. On Form 1040EZ, you can use only the tax table to figure your tax. You cannot use Form 1040EZ to report any other tax.

Form 1040A (cont.)

6. You claim only the following tax credits.
a. The credit for child and dependent care expenses.
b. The credit for the elderly or the disabled.
c. The child tax credit.
d. The additional child tax credit.
e. The education credits.
f. The retirement savings contributions credit.
g. The earned income credit.
h. The making work pay credit.

7. You did not have an alternative minimum tax adjustment on stock you acquired from the exercise of an incentive stock option. (See IRS Publication 525, Taxable and Nontaxable Income.)

You must meet all of the above requirements to use Form 1040A. If you do not, you must use Form 1040.

Form 1040 (cont.)

8. You claim any credits other than the credits listed earlier under Form 1040A.

9. You owe the excise tax on insider stock compensation from an expatriated corporation.

10. Your Form W-2 shows an amount in box 12 with a code Z.

11. You had a qualified health savings account funding distribution from your IRA.

12. You are an employee and your employer did not withhold Social Security and Medicare tax.

13. You have to file other forms with your return to report certain exclusions, taxes, or transactions.

14. You are a debtor in a bankruptcy case filed after October 16, 2005.

15. You have a net disaster loss attributable to a federally declared disaster, even if you are claiming the standard deduction.

16. You must recapture the first-time homebuyer credit.

17. You received a refund or credit of certain taxes or net disaster loss you claimed as part of your standard deduction.

FEDERAL FILING STATUS

There are five options for filing status available to choose from when completing your federal individual income tax return. Your filing status is based on your marital status and family situation on the last day of your tax year, which is typically December 31 for most taxpayers.

Marital Status

In general, your filing status depends on whether you are considered unmarried or married. For federal tax purposes, a marriage means only a legal union between a man and a woman as husband and wife.

Unmarried persons. You are considered unmarried for the whole year if, on the last day of your tax year, you are unmarried or legally separated from your spouse under a divorce or separate maintenance decree. State law governs whether you are married or legally separated under a divorce or separate maintenance decree.

Married persons. You are considered married for the whole year if on the last day of your tax year you and your spouse meet any one of the following tests.

1. You are married and living together as husband and wife.

2. You are living together in a common law marriage that is recognized in the state where you now live or in the state where the common law marriage began.

3. You are married and living apart, but not legally separated under a decree of divorce or separate maintenance.

4. You are separated under an interlocutory (not final) decree of divorce. For purposes of filing a joint return, you are not considered divorced.

If you are considered married for the whole year, you and your spouse can file a joint return, or you can file separate returns.

Spouse died during the year. If your spouse died during the year, you are considered married for the whole year for filing status purposes.

If you did not remarry before the end of the tax year, you can file a joint return for yourself and your deceased spouse. For the next two years, you may be entitled to the special benefits described later under Qualifying Widow(er) With Dependent Child.

If you remarried before the end of the tax year, you can file a joint return with your new spouse. Your deceased spouse's filing status would then be married filing separately for that year.

Married persons living apart. If you live apart from your spouse for the last six months of the year and meet certain tests, you may be "considered unmarried." If this applies to you, you may qualify to file as head of household even though you are not divorced or legally separated. See Head of Household, later, for more information.

Note: Same–sex marriages are not recognized as marriages under the federal tax law.

Filing Status

Listed below are the five basic filing statuses:

- **Single –** Your filing status is single if, on the last day of the year, you are unmarried or legally separated from your spouse under a divorce or separate maintenance decree, and you do not qualify for another filing status.

  Widow(er). Your filing status may be single if you were widowed before January 1, 2010, and did not remarry before the end of 2010. However, you might be able to use another filing status that will give you a lower tax. See Head of Household and Qualifying Widow(er) With Dependent Child, later, to see if you qualify.

- **Married Filing Jointly –** You can choose married filing jointly as your filing status if you are married and both you and your spouse agree to file a joint return. On a joint return, you report your combined income and deduct your combined allowable expenses. You can file a joint return even if one of you had no income or deductions.

  If you and your spouse decide to file a joint return, your tax may be lower than your combined tax for the other filing statuses. Also, your standard deduction (if you do not itemize deductions) may be higher, and you may qualify for tax benefits that do not apply to other filing statuses.

- **Married Filing Separately –** You can choose married filing separately as your filing status if you are married. This filing status may benefit you if you want to be responsible only for your own tax or if it results in less tax than filing a joint return.

  If you and your spouse do not agree to file a joint return, you may have to use this filing status unless you qualify for head of household status, discussed next.

  If you choose married filing separately as your filing status, there are certain special rules that may apply (see IRS Publication 17 for more details). Example: You are excluded from claiming certain tax credits, such as the Earned Income Credit or the Education Tuition Tax Credit.

- **Head of Household –** You may be able to file as head of household if you meet all the following requirements.

  1. You are unmarried or "considered unmarried" on the last day of the year.
  2. You paid more than half the cost of keeping up a home for the year.
  3. A "qualifying person" lived with you in the home for more than half the year (except for temporary absences, such as school). However, if the "qualifying person" is your dependent parent, he or she does not have to live with you.

  (See IRS Publication 17 for specific details on each of these three tests.)

- **Qualifying Widow(er) With Dependent Child –** If your spouse died in 2010, you can use married filing jointly as your filing status for 2010 if you otherwise qualify to use that status. The year of death is the last year for which you can file jointly with your deceased spouse. See Married Filing Jointly, earlier.

  You may be eligible to use qualifying widow(er) with dependent child as your filing status for two years following the year your spouse died. For example, if your spouse died in 2009, and you have not remarried, you may be able to use this filing status for 2010 and 2011 tax years.

  This filing status entitles you to use joint return tax rates and the highest standard deduction amount (if you do not itemize deductions). This status does not entitle you to file a joint return.

Finally, remember if more than one filing status applies to you, then you will probably want to choose the one that will give you the lowest tax. You must first determine your filing status before you can determine your filing requirements, standard deduction (if you do not itemize deductions), and calculate the correct tax on your federal return. Also, your filing status is used in determining whether you are eligible to claim certain deductions and credits.

PERSONAL EXEMPTIONS AND DEPENDENTS

There are two types of exemptions that you may be able to claim on your federal return:

- Personal exemptions for yourself and your spouse, and
- Exemptions for dependents.

While each is worth the same amount ($3650 for 2010 tax year), different rules apply to each type.

Personal Exemptions

You are generally allowed one exemption for yourself. If you are married, you may also be allowed one exemption for your spouse (depending on which filing status you choose). These are called personal exemptions.

<u>Your Own Exemption</u>
You can take one exemption for yourself unless you can be claimed as a dependent by another taxpayer. If another taxpayer is entitled to claim you as a dependent, you cannot take an exemption for yourself even if the other taxpayer does not actually claim you as a dependent.

<u>Your Spouse's Exemption</u>
Your spouse is never considered your dependent.

- Joint return – On a joint return you can claim one exemption for yourself and one for your spouse.

- Separate return – If you file a separate return, you can claim an exemption for your spouse only if your spouse had no gross income, is not filing a return, and was not the dependent of another taxpayer. This is true even if the other taxpayer does not actually claim your spouse as a dependent. This is also true if your spouse is a nonresident alien.

- Death of spouse – If your spouse died during the year and you file a joint return for yourself and your deceased spouse, you generally can claim your spouse's exemption under the rules just explained under *Joint return*. If you file a separate return for the year, you may be able to claim your spouse's exemption under the rules just described in *Separate return*.

    - If you remarried during the year, you cannot take an exemption for your deceased spouse.

    - If you are a surviving spouse without gross income and you remarry in the year your spouse died, you can be claimed as an exemption on both the final separate return of your deceased spouse and the separate return of your new spouse for that year. If you file a joint return with your new spouse, you can be claimed as an exemption only on that return.

- Divorced or separated spouse – If you obtained a final decree of divorce or separate maintenance by the end of the year, you cannot take your former spouse's exemption. This rule applies even if you provided all of your former spouse's support.

Exemptions for Dependents

You are allowed one exemption for each person you can claim as a dependent. You can claim an exemption for a dependent even if your dependent files a return.

The term "dependent" means either:

- A qualifying child, or
- A qualifying relative.

Qualifying Child

There are five tests that must be met for a child to be your qualifying child. These five tests are:

1. Relationship,
2. Age,
3. Residency,
4. Support, and
5. Joint return.

Relationship – Your son, daughter, stepchild, foster child, or a descendent (for example, your grandchild) of any of them, or your brother, sister, half brother, half sister, stepbrother, stepsister, or a descendent (for example, your niece or nephew) of any of them.

Age – To meet this test, a child must be under age 19 at the end of the year, a full-time student under age 24 at the end of the year, or permanently and totally disabled at any time during the year, regardless of age.

Residency – To meet this test, your child must have lived with you for more than half of the year. Exceptions include temporary absences, children who were born or died during the year, kidnapped children, and children of divorced or separated parents.

Support – To meet this test, the child cannot have provided more than half of his or her own support.

Joint Return – To meet this test, the child cannot file a joint return for the year.

Qualifying Relative

There are four tests that must be met for a person to be your qualifying relative. These four tests are:

1. Not a qualifying child test,
2. Member of household or relationship test,
3. Gross income test, and
4. Support test.

Not a Qualifying Child – A child is not your qualifying relative if the child is your qualifying child or the qualifying child of any other taxpayer.

Member of Household or Relationship Test – To meet this test, a person must either live with you all year as a member of your household, or be related to you in one of the ways listed under "Relatives who do not have to live with you".

Gross Income – To meet this test, a person's gross income for 2010 must be less than $3650.

Support – To meet this test, you generally must provide more than half of a person's total support during the calendar year.

Finally, you can claim an exemption for a qualifying child or qualifying relative only if the following three tests are met.

1. Dependent taxpayer test.
2. Joint return test.
3. Citizen or resident test.

Dependent Taxpayer Test

If you could be claimed as a dependent by another person, you cannot claim anyone else as a dependent. Even if you have a qualifying child or qualifying relative, you cannot claim that person as a dependent.

If you are filing a joint return and your spouse could be claimed as a dependent by someone else, you and your spouse cannot claim any dependents on your joint return.

Joint Return Test

You generally cannot claim a married person as a dependent if he or she files a joint return.

Exception. An exception to the joint return test applies if your child and his or her spouse file a joint return merely as a claim for refund and no tax liability would exist for either spouse on separate returns.

Citizen or Resident Test

You cannot claim a person as a dependent unless that person is a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico. However, there is an exception for certain adopted children, as explained next.

Exception for Adopted Child. If you are a U.S. citizen or U.S. national who has legally adopted a child who is not a U.S. citizen, U.S. resident alien, or U.S. national, this test is met if the child lived with you as a member of your household all year. This exception also applies if the child was lawfully placed with you for legal adoption.

Child's Place of Residence. Children usually are citizens or residents of the country of their parents.

If you were a U.S. citizen when your child was born, the child may be a U.S. citizen even if the other parent was a nonresident alien and the child was born in a foreign country. If so, this test is met.

Foreign Student's Place of Residence. Foreign students brought to this country under a qualified international education exchange program and placed in American homes for a temporary period generally are not U.S. residents and do not meet this test. You cannot claim an exemption for them. However, if you provided a home for a foreign student, you may be able to take a charitable contribution deduction. See Expenses Paid for Student Living With You in chapter 24.

U.S. National. A U.S. national is an individual who, although not a U.S. citizen, owes his or her allegiance to the United States. U.S. nationals include American Samoans and Northern Mariana Islanders who chose to become U.S. nationals instead of U.S. citizens.

All the requirements for claiming an exemption for a dependent on the federal return are briefly summarized in Table 3-1 on the following page.

Table 3-1. Overview of the Rules for Claiming an Exemption for a Dependent (Note: This table is only a brief overview of the rules. For details on the dependency exemptions, see IRS Publication 17.)

- You cannot claim any dependents if you, or your spouse if filing jointly, could be claimed as a dependent by another taxpayer.
- You cannot claim a married person who files a joint return as a dependent unless that joint return is only a claim for refund and there would be no tax liability for either spouse on separate returns.
- You cannot claim a person as a dependent unless that person is a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico.[1]
- You cannot claim a person as a dependent unless that person is your qualifying child or qualifying relative.

Tests to Be a Qualifying Child	Tests to Be a Qualifying Relative
1. The child must be your son, daughter, stepchild, foster child, brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them.	1. The person cannot be your qualifying child or the qualifying child of any other taxpayer.
2. The child must be (a) under age 19 at the end of the year and younger than you (or your spouse, if filing jointly), (b) under age 24 at the end of the year, a full-time student, and younger than you (or your spouse, if filing jointly), or (c) any age if permanently and totally disabled.	2. The person either (a) must be related to you in one of the ways listed under Relatives who do not have to live with you, or (b) must live with you all year as a member of your household[2] (and your relationship must not violate local law).
3. The child must have lived with you for more than half of the year.[2]	3. The person's gross income for the year must be less than \$3,650.[3]
4. The child must not have provided more than half of his or her own support for the year.	4. You must provide more than half of the person's total support for the year.[4]
5. The child is not filing a joint return for the year (unless that return is filed only as a claim for refund)	
If the child meets the rules to be a qualifying child of more than one person, only one person can actually treat the child as a qualifying child. See the Special Rule for Qualifying Child of More Than One Person to find out which person is the person entitled to claim the child as a qualifying child.	

[1]There is an exception for certain adopted children.
[2]There are exceptions for temporary absences, children who were born or died during the year, children of divorced or separated parents or parents who live apart, and kidnapped children.
[3]There is an exception if the person is disabled and has income from a sheltered workshop.
[4]There are exceptions for multiple support agreements, children of divorced or separated parents or parents who live apart, and kidnapped children.

Part I – Federal

Section 2

A) Income

- Wages, Salary, Tips, etc.
- Interest
- Dividends
- Taxable Refunds
- Alimony Received
- Business Income/Schedule C
- Capital Gains/Schedule D
- Other Gains & Losses
- Retirement Income
- Schedule E
- Farm Income/Schedule F
- Unemployment Income
- Social Security
- Other Income

INCOME

Items of income are reported on lines 7 – 22 on the federal Form 1040. The following material is presented in a line-by-line format explaining the different types of income and how it should be reported on the federal individual income tax return.

LINE 7 – Wages, Salaries, Tips, etc.

Report the total of all wages, salaries, tips, etc. on this line. For taxpayers who file a joint return, include both spouses income on this line. For most people, the amount to enter on this line should be shown in box 1 of Form W-2 Wage and Income Statement. Other types of income may also be reported on line 7, *within certain limitations*. This includes:

- Wages received as a household employee for which a W-2 was not issued
- Tip income not reported to your employer
- Allocated tips shown in box 8 of Form W-2
- Some dependent care benefits
- Employer-provided adoption benefits if unable to exclude per Form 8839
- Scholarship and fellowship grants
- Excess salary deferrals
- Disability pension income shown on Form 1099-R
- Corrective distributions from a retirement plan shown on Form 1099-R

LINE 8a – Taxable Interest

Include amounts of interest earned reported on Form 1099-INT or Form 1099-OID. If the total taxable interest is over $1500 a federal Schedule B must be completed and attached. Schedule B must also be attached if any of the following apply:

- You received interest from a seller-financed mortgage and the buyer used the property as a personal residence.
- You have accrued interest from a bond.
- You are reporting original issue discount (OID) in an amount less than the amount shown on Form 1099-OID.

- You are reducing your interest income on a bond by the amount of amortizable bond premium.
- You are claiming the exclusion of interest from series EE or I U.S. savings bonds issued after 1989.
- You received interest or ordinary dividends as a nominee.
- You had a financial interest in, or signature authority (or other authority that is comparable to signature authority) over, a financial account in a foreign country or you received a distribution from, or were a grantor of or transferor to a foreign trust.

LINE 8b – Tax-Exempt Interest

Report tax-exempt interest, such as from municipal bonds, that is shown on Form 1099-INT.

TIP: Refer to IRS Publication 550 for additional information on interest income.

LINE 9a – Ordinary Dividends

Enter total ordinary dividends as reflected on Form 1099-DIV. You may be required to attach Schedule B. See information above for line 8a.

LINE 9b – Qualified Dividends

Enter any qualified dividends received on this line. Qualified dividends are also included on line 9a. Generally, qualified dividends are shown on Form 1099-DIV in box 1b.

Qualified dividends are a type of dividend to which capital gains tax rates are applied. These tax rates are usually lower than regular income tax rates.

In order to qualify:

- The dividend must have been paid by an American company or a qualifying foreign company.
- The dividends are not listed with the IRS as dividends that do not qualify.
- The required dividend holding period has been met.

LINE 10 – Taxable Refunds, Credits, or Offsets of State and Local Income Taxes

If a state or local income tax refund is received during the tax year, the refund must generally be included in income if the taxpayer deducted the tax in an earlier year. None of your refund is taxable if, in the year you paid the tax, you either (a) did not itemize deductions, or (b) elected to deduct state and local general sales tax instead of state and local income taxes.

However, under the tax benefit rule, the taxpayer must only include the refund up to the amount by which the deduction taken for the refunded amount, reduced tax in the earlier year. Due to this rule, a state or local income tax refund may not be entirely taxable if the taxpayer claimed unused tax credits, or was subject to the alternative minimum tax in the earlier year.

Refer to the section on Recoveries in IRS Publication 525 Taxable and Nontaxable Income to determine the taxability of your state refund if certain conditions apply. For example, refer to Publication 525 if your refund is for a tax year other than the one previous to receiving it or if the refund is for a tax other than income tax.

Example of the Tax Benefit Rule

When completing your 2009 tax return, you can choose to claim either an $11,000 state income tax deduction or a $10,000 state general sales tax deduction. You choose to deduct the state income tax. In 2010 you receive a $2,500 state income tax refund.

The maximum refund that you may have to include in income the following year is $1,000, since you could have deducted $10,000 in state general sales tax. In other words, you benefitted by an additional $1,000 because you chose the state income tax deduction.

If you claimed unused tax credits, or were subject to the alternative minimum tax in the prior year, complete the State and Local Income Tax Refund Worksheet, included with the instructions for federal Form 1040, to determine the taxable amount. A copy of the worksheet can be found on the following page.

State and Local Income Tax Refund Worksheet—Line 10 *Keep for Your Records*

Before you begin: √ Be sure you have read the **Exception** above to see if you can use this worksheet instead of Pub. 525 to figure if any of your refund is taxable.

1. Enter the income tax refund from **Form(s) 1099-G** (or similar statement). But **do not** enter more than the amount of your state and local income taxes shown on your 2009 Schedule A, line 5 . . . . 1. ______
2. Enter your total allowable itemized deductions from your 2009 Schedule A, line 29 . . . . 2. ______

Note. If the filing status on your 2009 Form 1040 was married filing separately and your spouse itemized deductions in 2009, skip lines 3 through 10, enter the amount from line 2 on line 11, and go to line 12.

3. Enter the amount shown below for the filing status claimed on your **2009** Form 1040.
   - Single or married filing separately—$5,700
   - Married filing jointly or qualifying widow(er)—$11,400
   - Head of household—$8,350

   3. ______
4. Did you fill in line 39a on your 2009 Form 1040?
   - ☐ **No.** Enter -0-.
   - ☐ **Yes.** Multiply the number in the box on line 39a of your 2009 Form 1040 by $1,100 ($1,400 if your 2009 filing status was single or head of household).

   4. ______
5. Enter any state or local real estate taxes shown on your 2009 Schedule A, line 6. **Do not** include foreign real estate taxes . . . . 5. ______
6. Enter $500 ($1,000 if married filing jointly) . . . . 6. ______
7. Enter the smaller of line 5 or line 6 . . . . 7. ______
8. Enter any net disaster loss from your 2009 Form 4684, line 18 . . . . 8. ______
9. Enter any new motor vehicle taxes shown on your 2009 Schedule A, line 7 . . . . 9. ______
10. Add lines 3, 4, 7, 8, and 9 . . . . 10. ______
11. Is the amount on line 10 less than the amount on line 2?
    - ☐ **No.** STOP None of your refund is taxable.
    - ☐ **Yes.** Subtract line 10 from line 2 . . . . 11. ______
12. **Taxable part of your refund.** Enter the **smaller** of line 1 or line 11 here and on Form 1040, line 10 . . 12. ______

LINE 11 – Alimony Received

Enter amounts received as alimony or separate maintenance. Alimony is generally taxable to the person receiving it and generally deductible to the person who pays the alimony. For additional information on alimony issues refer to IRS Publication 17 or IRS Publication 504.

LINE 12 – Business Income or Loss (Schedule C or C-EZ)

If you operate a business or practice your profession as a sole proprietor, report income and expenses on Schedule C Profit or Loss from Business or Schedule C-EZ Net Profit from Business and report net profit or loss on this line. In addition, if your business income reflects a profit, you must also complete Schedule SE, which is reported as an adjustment to income on federal Form 1040.

Note: The starting point for the Kentucky tax return is federal adjusted gross income, which includes Schedule C or C-EZ income; therefore, Kentucky does not have a Kentucky Schedule C or C-EZ. However, there may be federal/state differences which would require filing a Kentucky Schedule M with the Kentucky return to reconcile those differences.

Schedule C Overview

If you operate a business as a sole proprietor you must complete Schedule C or C-EZ and attach to federal Form 1040. Schedule C should be used by most taxpayers to report their income and expenses.

Schedule C is composed of five distinct parts:

- Part I Income
    - Used to report gross receipts, sales, returns and allowances, cost of goods, etc. to arrive at gross profit and report any other income to arrive at gross income.
- Part II Expenses
    - Used to claim various expenses such as advertising, employee benefits paid, legal services, labor, office expense, supplies, taxes, utilities, etc., and arrive at net profit or (loss).
- Part III Cost of Goods Sold
    - For businesses with inventory this section is used to determine beginning inventory, subtract purchases and costs to determine ending inventory and calculate the cost of goods sold.
- Part IV Information on Your Vehicle
    - This part must be completed only if you are claiming car or truck expenses on Part II, line 9 and not required to file federal Form 4562 Depreciation and Amortization for the business.
- Part V Other Expenses
    - This part is used to manually enter a description and amount of business expense (e.g. certain business start-up costs) not included in Part II Expenses.

Schedule C-EZ Overview

Schedule C-EZ is a shorter version that can be used if you meet certain requirements.

Taxpayers who qualify to file Schedule C-EZ include those who:

- Had no employees during the year,
- Are not required to file federal Form 4562,
- Do not deduct expenses for business use of home,
- Do not have prior year unallowed passive activity losses from the business,

AND

- Had business expenses of $5,000 or less,
- Use the cash method of accounting,
- Did not have an inventory any time during the year,
- Did not have a net loss from the business,
- Had only one business as either a sole proprietor, qualified joint venture, or statutory employee.

Schedule C-EZ is composed of three parts:

- Part I General Information
    - Used to enter demographics and business code.
- Part II Net Profit
    - Used to enter gross receipts and total expenses to arrive at net profit.
- Part III Information on Your Vehicle
    - Complete this part only if you are claiming car or truck expenses as part of total expenses in Part II.

If you realize a profit from your business you must also complete Schedule SE Self-Employment Tax and include as an adjustment to income on federal Form 1040, line 27. For additional information regarding Schedule C or C-EZ refer to the instructions for these forms or IRS Publication 17.

LINE 13 – Capital Gain or Loss (Schedule D)

This line is used for reporting capital gains or losses. If you had a capital gain or loss, including any capital gain distributions or a capital loss carryover from the previous year, you must complete and attach Schedule D.

You do not have to file Schedule D if both of the following apply:

- The only amounts you have to report on Schedule D are capital gain distributions from Form(s) 1099-DIV, box 2a, or substitute statements.
- None of the Form(s) 1099-DIV or substitute statements have an amount in box 2b or 2d.

Schedule D Overview

Schedule D Capital Gains and Losses is composed of three parts:

Part I Short-Term Capital Gains and Losses – Assets Held One Year or Less

- Use this section for short-term gains and losses and any carryover to arrive at net short-term capital gain or loss.

Part II Long-Term Capital Gains and Losses – Assets Held More Than One Year

- Use this section for long-term gains and losses and any carryover to arrive at net long-term capital gain or loss.

Part III Summary

- This section combines Part I and Part II to arrive at allowable net gain or loss.

Taxpayers are limited on the amount of loss they may claim. You may only claim the lesser of the actual loss or $3,000, or if married filing separately the lesser of the actual loss or $1500. Unused losses may be carried forward. In some instances you may also have to complete a Schedule D Tax Worksheet or Qualified Dividends and Capital Gain Tax Worksheet. Refer to the instructions for Schedule D for additional information.

LINE 14 – Other Gains or Losses

If you have an ordinary gain or loss from sale or exchange of assets used in a business you must file federal Form 4797 Sales of Business Property. For individuals, the amount of gain or loss reported on Form 4797 flows to line 14 on Form 1040. Refer to the instructions for Form 4797 for additional information on gains or losses from sale of business property.

LINE 15a – Individual Retirement Account (IRA) Distributions

Except as noted in the information below, leave line 15a blank and enter the total distribution received on line 15b. Enter the total on line 15a if any of the following apply:

- You are rolling over all or part of the IRA into another qualified plan
- You received a distribution from an IRA (other than a Roth IRA) and you made nondeductible contributions
- You received a distribution from a Roth IRA, unless code T or Q is shown in box 7 of Form 1099-R
- You converted all or part of a traditional, SEP, or SIMPLE IRA to a Roth IRA
- You had a 2009 or 2010 IRA contribution returned to you
- You made excess contributions to your IRA for an earlier year and had them returned to you in 2010
- You recharacterized part or all of a contribution to a Roth IRA as a traditional IRA, or vice versa
- The distribution is a qualified charitable distribution (QCD)
- The distribution is a qualified health savings account (HSA) funding distribution (HFD)

LINE 15b – Individual Retirement Account Distributions (IRA) – taxable amount

Enter taxable amounts received from individual retirement accounts as shown on Form 1099-R. Some situations may require completing federal Form 8606 to determine the amount to report as taxable. See the instructions for this form and also refer to IRS Publication 590 for additional information.

LINE 16a – Pensions and Annuities

Report total amounts of pension and annuity income as reported on Form 1099-R.

LINE 16b – Pensions and Annuities – taxable amount

Report taxable amounts of pension and annuity income received as reported on Form 1099-D. If your Form 1099-D does not show the taxable amount, you must use the General Rule for pension and annuity income as explained in IRS Publication 939 to determine the taxable amount.

Do not include the following pension and annuity income on lines 16a and 16b:

- Disability pensions received before you reach the minimum retirement age set by your employer.
- Corrective distributions (including any earnings) of excess salary deferrals or excess contributions to retirement plans. The plan must advise you of the year(s) the distributions are includible in income.

The above income should be reported on line 7 of federal Form 1040.

Attach a copy of Form 1099-R to Form 1040 if any federal income tax was withheld. For additional information on pension and annuity income refer to IRS Publication 575.

LINE 17 – Rental Real Estate, Royalties, Partnerships, S Corporations, Trusts, etc. (Schedule E)

Complete Schedule E Supplemental Income and Loss and report income or loss from rental real estate, royalties, partnerships, S corporations, estates, trusts, and residual interests in Real Estate Mortgage Investment Conduits (REMICs) and enter totals on this line.

Schedule E Overview

Schedule E Supplemental Income and Loss is composed of five parts:

Part I Income or Loss from Rental Real Estate and Royalties

- Use this section of Schedule E to report rents and royalties received, various related expenses, and depreciation from rental real estate to arrive at total income or loss. Note: rental real estate loss may be limited. See instructions for Schedule E.

Part II Income or Loss from Partnerships and S Corporations

- This section is used to determine total partnership and S corporation income or loss. Amounts may flow from Schedule K-1s received and federal Form 8582 may be required to support allowable passive losses.

Part III Income or Loss from Estates and Trusts

- This section is used for reporting income from an estate or trust.

Part IV Income or Loss from Real Estate Mortgage Investment Conduits (REMICs)

- Report income from REMICs in this section.

Part V Summary

- The summary combines income amounts from the other sections plus any net farm rental income from Form 4835 to arrive at total income or loss from Schedule E activities, which is then entered on federal Form 1040, line 17.

LINE 18 – Farm Income or Loss (Schedule F)

This line is used to report farm income or loss. Schedule F Profit or Loss from Farming must be completed and attached. Net farm income or loss is determined by subtracting expenses from income. In addition, if your farm income reflects a profit, you must also complete Schedule SE, which is reported as an adjustment to income on federal Form 1040.

Schedule F Overview

Schedule F Profit or Loss from Farming reflects farm income and expenses and is composed of four parts:

Part I Farm Income – Cash Method

- This section is used to determine gross farm income from sales of livestock, agricultural payment programs and other related farm income.

Part II Farm Expenses – Cash and Accrual Method

- This section is used to claim farm expenses such as chemicals used, feed, repairs and maintenance, veterinary bills, etc.

Part III Farm Income – Accrual Method

- If you use the accrual method of accounting, use this part to report income when you earn it, not when you receive the income.

Part IV Principal Agricultural Activity Codes

- This section contains a listing of six-digit codes based on the North American Industry Classification System (NAICS). These codes are used by the IRS to classify farms by their primary activity.

Note: In some instances, farm income can be reported on Schedule C, instead of Schedule F, if the income is from providing agricultural services, management fees on a contract basis or you are in the business of breeding or raising and caring for pet animals.

LINE 19 – Unemployment Compensation

You should receive a Form 1099-G showing in box 1 the total unemployment compensation paid to you. Generally, you should report this amount on line 19.

LINE 20a – Social Security Benefits

Report total Social Security benefits received on this line as shown on Form SSA-1099 issued by the Social Security Administration. Railroad retirement benefits treated as Social Security will be reflected on Form RRB-1099.

LINE 20b – Social Security Benefits – taxable amount

Some Social Security benefits may be taxable based on other income and factors. Taxable benefits are reported on this line. To determine if any benefits are taxable, complete the Social Security Benefits Worksheet.

LINE 21 – Other Income

Use line 21 to report any taxable income you received that is not reported elsewhere on the return or other schedules. Examples of other income to report are prizes and awards, jury duty, director fees, etc.

LINE 22 – Total Income

Combine the amounts reported as taxable on lines 7 through 21 to arrive at total income.

TIP: Refer to IRS Publication 525 Taxable and Nontaxable Income for additional information about income. This publication discusses various types of income and explains whether the income is taxable or nontaxable.

Part I – Federal

Section 3

A) Adjustments to Income

- Educator Expenses
- Certain Business Expenses of Reservists, Performing Artists, and Fee-Basis Government Officials
- Health Savings Account (HSA) Deduction
- Moving Expenses
- One-half of Self Employment Tax
- Self-Employed SEP, SIMPLE and Qualified Plans
- Self-Employed Health Insurance Deduction
- Penalty on Early Withdrawal of Savings
- Alimony Paid
- IRA Deduction
- Student Loan Interest Deduction
- Tuition and Fees Deduction
- Domestic Production Activities Deduction

ADJUSTMENTS TO INCOME

Adjustments to income are often referred to as “above the line” deductions because they are claimed on lines 23 – 36 of the federal Form 1040 prior to the computation of the federal adjusted gross income (line 37). Similar to the previous section, this material is presented in a line-by-line format explaining the different adjustments to income and where they are claimed on the federal individual income tax return.

LINE 23 – Educator Expenses

If you were an eligible educator in 2010, you can deduct on line 23 of the Form 1040 up to $250 of qualified expenses you paid in 2010. If you and your spouse are filing jointly and both of you were eligible educators, the maximum deduction allowed is $500. However, neither spouse can deduct more than $250 of his or her qualified expenses on line 23.

An eligible educator is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide who worked in a school for at least 900 hours during a school year.

Qualified expenses include ordinary and necessary expenses paid in connection with books, supplies, equipment (including computer equipment, software, and services), and other materials used in the classroom. An ordinary expense is one that is common and accepted in your educational field. A necessary expense is one that is helpful and appropriate for your profession as an educator. An expense does not have to be required to be considered necessary. Qualified expenses do not include expenses for home schooling or for nonathletic supplies for courses in health or physical education.

Note: If you itemize your deductions, you may be able to claim educator expenses greater than the $250 (or $500) limit on Schedule A, line 21. However, this deduction would be subject to a limitation of two percent (2%) of your federal AGI.

LINE 24 – Certain Business Expenses of Reservists, Performing Artists, and Fee-Basis Government Officials

If you are one of the following individuals – Armed Forces reservist, fee-basis state or local government official or a qualified performing artist – then special rules apply to deducting your employee business expenses. The following are business expenses that would not be included on federal Form 2106 (or 2106-EZ), but instead claimed on line 24 of the federal Form 1040:

- Certain business expenses of National Guard and reserve members who traveled more than 100 miles from home to perform services as a National Guard or reserve member.

- Performing-arts-related expenses as a qualified performing artist.
- Business expenses of fee-basis state or local government officials.

For more specific details, see the instructions for federal Form 2106 or 2106-EZ.

LINE 25 – Health Savings Account (HSA) Deduction

You may be able to claim this deduction if contributions (other than employer contributions, rollovers, and qualified HSA funding distributions from an IRA) were made to your Health Savings Account for 2010. You must complete federal Form 8889 to claim this deduction. See IRS Publication 969 for more information.

LINE 26 – Moving Expenses

<u>Who Can Deduct Moving Expenses</u>? You can deduct your moving expenses if you meet all three of the following requirements.

• Your move is closely related to the start of work.

• You meet the distance test – your new principal workplace must be at least 50 miles farther from your old home than your old workplace was.

• You meet the time test – if you are an employee, you must work full time in the general area of your new workplace for at least 39 weeks during the 12 months right after you move.

<u>Deductible Moving Expenses</u>. Provided you meet all three requirements discussed earlier, you can deduct the reasonable expenses of:

• Moving your household goods and personal effects (including in-transit or foreign-move storage expenses), and

• Traveling (including lodging but not meals) to your new home.

For more information regarding the qualifying tests or what specific moving expenses are considered deductible, please see IRS Publication 521 – Moving Expenses.

You cannot claim a moving expense deduction for any expenses covered by reimbursements, unless it is part of a non-accountable reimbursement plan and reimbursement payments are also included as income.

<u>Determining the Moving Expense Deduction</u>. Complete federal Form 3903 to figure your moving expense deduction and then claim the amount on line 26 of the federal Form 1040.

LINE 27 – One-Half of Self-Employment Tax

If you had net earnings from self-employment from other than church employee income that was $400 or more, or you had church employee income of $108.28 or more, then you should have paid self-employment tax. You can generally deduct one-half of your self-employment tax on federal Form 1040, line 27.

LINE 28 – Self-Employed SEP, SIMPLE and Qualified Plans

If you were self-employed or a partner, you may be able to take a deduction for contributions made to Self-Employed Retirement Plans such as a SEP (Simplified Employee Pension) or SIMPLE (Savings Incentive Match Plan for Employees) IRA, or a qualified 401(k) retirement plan.

<u>Qualifications to Take the Deduction</u>. You must have self-employment income. Self-employment income for the purpose of this deduction means net profits from a Schedule C (or C-EZ) or Schedule F, self-employed income from a partnership, or wages as a shareholder-employee in an S-corporation. Additionally, you must set up and fund a qualified retirement plan by the required deadline.

<u>Claiming the Deduction</u>. You must use the worksheets found in IRS Publication 560 for figuring your allowable tax deduction for SEP, SIMPLE, and 401(k) contributions.

For more details, see IRS Publication 560, or if you are a clergy member, see IRS Publication 517.

LINE 29 – Self-Employed Health Insurance Deduction

If you were self-employed and had a net profit for the year, you may be able to deduct, as an adjustment to income, amounts paid for medical and qualified long-term care insurance on behalf of yourself, your spouse, your dependents, and, effective March 30, 2010, your children who were under age 27 at the end of 2010. For this purpose, you were self-employed if you were a general partner (or a limited partner receiving guaranteed payments) or you received wages from an S corporation in which you were more than a two percent (2%) shareholder. The insurance plan must be established under your trade or business and the deduction cannot be more than your earned income from that trade or business.

If you qualify to take the deduction, generally you would use the Self-Employed Health Insurance Deduction Worksheet in the federal Form 1040 instructions to figure the amount you can deduct.

Note: If you itemize your deductions, you cannot also include the same amount in your medical and dental expenses deduction on Schedule A.

LINE 30 – Penalty on Early Withdrawal of Savings

If you withdrew money from a certificate of deposit or other time-deposit savings account prior to your certificate maturing, you may have incurred a penalty for early withdrawal. This penalty is charged by the bank and typically withheld directly from your proceeds from the certificate. You should receive a Form 1099-INT or Form 1099-OID that will show the amount of any penalty that you were charged. Enter this figure on line 30 of the federal Form 1040 to claim this deduction.

LINE 31a – Alimony Paid

Alimony is a payment to or for a spouse or former spouse under a divorce or separation instrument. It does not include voluntary payments that are not made under a divorce or separation instrument. Alimony is deductible by the payer and must be included in the spouse's or former spouse's income.

How to Deduct Alimony Paid. You can deduct alimony you paid, whether or not you itemize deductions on your return. You must file federal Form 1040. You cannot use federal Form 1040A or federal Form 1040EZ. Enter the amount of alimony you paid on Form 1040, line 31a.

Payments Considered Alimony. To be considered alimony, a payment must meet certain requirements. Different requirements generally apply to payments under instruments executed after 1984 and to payments under instruments executed before 1985. This section discusses the specific rules for payments under instruments executed after 1984. If you need the rules for payments under pre-1985 instruments, refer to the 2004 version of IRS Publication 504. Please use Table 18-1 on the following page as a guide to determine whether certain payments are considered alimony.

Table 18-1. Alimony Requirements (Instruments Executed After 1984)

Payments ARE alimony if all of the following are true:	**Payments are NOT alimony if any of the following are true:**
Payments are required by a divorce or separation instrument.	Payments are not required by a divorce or separation instrument.
Payer and recipient spouse do not file a joint return with each other.	Payer and recipient spouse file a joint return with each other.
Payment is in cash (including checks or money orders).	Payment is: • Not in cash • A noncash property settlement. • Spouse's part of community income, or • To keep up the payer's property.
Payment is not designated in the instrument as not alimony.	Payment is designated in the instrument as not alimony.
Spouses legally separated under a decree of divorce or separate maintenance are not members of the same household.	Spouses legally separated under a decree of divorce or separate maintenance are members of the same household.
Payments are not required after death of the recipient spouse.	Payments are required after death of the recipient spouse.
Payment is not treated as child support.	Payment is treated as child support.
These payments are deductible by the payer and includible in income by the recipient.	These payments are neither deductible by the payer nor includible in income by the recipient.

Cash Payment Requirement. Only cash payments, including checks and money orders, qualify as alimony. The following do not qualify as alimony:

- Transfers of services or property (including a debt instrument of a third party or an annuity contract).
- Execution of a debt instrument by the payer.
- The use of the payer’s property.

Payments to a Third Party. Cash payments, checks, or money orders to a third party on behalf of your spouse under the terms of your divorce or separation instrument can be considered alimony, if they otherwise qualify. These may include payments for your spouse's medical expenses, housing costs (rent, utilities, etc.), taxes, tuition, etc. The payments are treated as received by your spouse and then paid to the third party.

Child Support. A payment that is specifically designated as child support or treated as specifically designated as child support under your divorce or separation instrument is not alimony. Child support payments are not deductible by the payer and are not taxable to the recipient.

LINE 31b – Recipient of Alimony

In the space provided on line 31b, enter your spouse's Social Security number. If you paid alimony to more than one person, enter the Social Security number of one of the recipients. Show the Social Security number and amount paid to each other recipient on an attached statement. Enter your total payments on line 31a.

LINE 32 – IRA Deduction

An individual retirement account (IRA) is a personal savings plan that gives you tax advantages for setting aside money for your retirement. There are generally two different types of IRAs – Traditional IRAs and Roth IRAs.

Two advantages of a traditional IRA are:

- You may be able to deduct some or all of your contributions to it, depending on your circumstances, and
- Generally, amounts in your IRA, including earnings and gains, are not taxed until they are distributed.

In contrast to that, the Roth IRA, features nondeductible contributions and tax-free distributions.

Who Can Open a Traditional IRA? You can open and make contributions to a traditional IRA if:

- You (or, if you file a joint return, your spouse) received earned income during the year, and
- You were not age 70½ by the end of the year.

For IRA purposes, earned income includes alimony and separate maintenance payments reported on line 11 of the federal Form 1040. Also, if you were a member of the U.S. Armed Forces, earned income includes any nontaxable combat pay you received.

When Can Contributions Be Made? You can open a traditional IRA at any time and contributions can be made immediately to it through your chosen sponsor (trustee or other administrator). However, contributions must be made by due date – that is, contributions can be made to your traditional IRA for a year at any time during the year or by the due date for filing your return for that year not including extensions.

How Much Can Be Contributed? There are limits and other rules that affect the amount that can be contributed to a traditional IRA. For 2010, the most that can be contributed to your traditional IRA generally is the smaller of the following amounts:

- $5,000 ($6,000 if you are 50 or older).
- Your taxable compensation (defined earlier) for the year.

Spousal IRA Limit. For 2010, if you file a joint return and your taxable compensation is less than that of your spouse, the most that can be contributed for the year to your IRA is the smaller of the following amounts:

- $5,000 ($6,000 if you are 50 or older).
- The total compensation includible in the gross income of both you and your spouse for the year, reduced by the following two amounts.
    - Your spouse's IRA contribution for the year to a traditional IRA.
    - Any contribution for the year to a Roth IRA on behalf of your spouse.

This means that the total combined contributions that can be made for the year to your IRA and your spouse's IRA can be as much as $10,000 ($11,000 if only one of you is 50 or older, or $12,000 if both of you are 50 or older).

How Much Can You Deduct? Generally, you can deduct the lesser of:

- The contributions to your traditional IRA for the year, or
- The general limit (or the spousal IRA limit, if it applies).

However, if you or your spouse was covered by an employer retirement plan, you may not be able to deduct this amount. See Tables 17-1 and 17-2 on the following page for further details.

Note: If you, or your spouse, are covered by an employer retirement plan, your deduction may be limited or disallowed, but you may be eligible for the retirement savings contribution credit instead.

Table 17-1. Effect of Modified AGI on Deduction if You Are Covered by Retirement Plan at Work

IF your filing status is...	AND your modified AGI is...	THEN you can take...
single	$56,000 or less	a full deduction.
or	more than $56,000 but less than $66,000	a partial deduction.
head of household	$66,000 or more	no deduction.
married filing jointly	$89,000 or less	a full deduction.
or	more than $89,000 but less than $109,000	a partial deduction.
qualifying widow(er)	$109,000 or more	no deduction.
married filing	less than $10,000	a partial deduction.
separately	$10,000 or more	no deduction.

Table 17-2. Effect of Modified AGI on Deduction if You Are NOT Covered by Retirement Plan at Work

IF your filing status is...	AND your modified AGI is...	THEN you can take...
single, head of household or **qualifying widow(er)**	any amount	a full deduction.
married filing jointly or **separately** with a spouse who ***is not*** covered by a plan at work	any amount	a full deduction.
married filing jointly with a spouse who ***is*** covered by a plan at work	$167,000 or less	a full deduction.
	more than $167,000 but less than $177,000	a partial deduction.
	$177,000 or more	no deduction.
married filing separately with a spouse who ***is*** covered by a plan at work	less than $10,000	a partial deduction.
	$10,000 or more	no deduction.

Roth IRAs. Regardless of your age, you may be able to establish and make nondeductible contributions to an individual retirement plan called a Roth IRA. Unlike a traditional IRA, you cannot deduct contributions to a Roth IRA. But, if you satisfy the requirements, qualified distributions (discussed later) are tax free. Contributions can be made to your Roth IRA after you reach age 70½ and you can leave amounts in your Roth IRA as long as you live.

Who Can Contribute to a Roth IRA? Generally, you can contribute to a Roth IRA if you have taxable compensation and your modified AGI is less than:

- $177,000 for married filing jointly or qualifying widow(er),
- $120,000 for single, head of household, or married filing separately and you did not live with your spouse at any time during the year, or
- $10,000 for married filing separately and you lived with your spouse at any time during the year.

When Can You Make Contributions? You can open a Roth IRA at any time and can make contributions to a Roth IRA for a year at any time during the year or by the due date of your return for that year (not including extensions).

How Much Can Be Contributed? The contribution limit for Roth IRAs generally depends on whether contributions are made only to Roth IRAs or to both traditional IRAs and Roth IRAs.

- Roth IRAs only – If contributions are made only to Roth IRAs, your contribution limit generally is the lesser of the following amounts.
    - $5,000 ($6,000 if you are 50 or older in 2010)
    - Your taxable compensation.
- Roth IRAs and Traditional IRAs – If contributions are made to both Roth IRAs and Traditional IRAs established for your benefit, your contribution limit for Roth IRAs generally is the same as your limit would be if contributions were made only to Roth IRAs, but then reduced by all contributions for the year to all IRAs other than Roth IRAs.

Qualified Distributions. You do not include in your gross income qualified distributions or distributions that are a return of your regular contributions from your Roth IRA(s). A qualified distribution is any payment or distribution from your Roth IRA that meets the following requirements:

1. It is made after the five-year period beginning with the first taxable year for which a contribution was made to a Roth IRA set up for your benefit, and

2. The payment or distribution is:

    a. Made on or after the date you reach age 59½,

    b. Made because you are disabled,

c. Made to a beneficiary or to your estate after your death, or

d. To pay up to $10,000 (lifetime limit) of certain qualified first-time homebuyer amounts.

For more information, see IRS Publication 590 – Individual Retirement Accounts.

LINE 33 – Student Loan Interest Deduction

Generally, personal interest you pay, other than certain home mortgage interest, is not deductible on your individual income tax return. However, if your modified adjusted gross income (MAGI) is less than $75,000 ($150,000 if filing a joint return) there is a special deduction allowed for paying interest on a qualified student loan (also known as an education loan) used for higher education. This deduction can reduce the amount of your income subject to tax by up to $2,500 in 2010.

Qualified Student Loan. A qualified student loan is any loan you took out solely to pay the qualified higher education expenses that were:

- For you, your spouse, or a person who was your dependent when you took out the loan,
- Paid or incurred within a reasonable period of time before or after you took out the loan, and
- For education provided during an academic period for an eligible student.

Loans from the following sources are not considered qualified student loans.

- A related person.
- A qualified employer plan.

Exceptions. For purposes of the student loan interest deduction, the following are exceptions to the general rules for dependents.

- An individual can be your dependent even if you are the dependent of another taxpayer
- An individual can be your dependent even if the individual files a joint return with a spouse.
- An individual can be your dependent even if the individual had gross income for the year that was equal to or more than the exemption amount for the year ($3,650 for 2010).

Eligible Student. An eligible student is a person who was enrolled in a degree, certificate or other program (including a program of study abroad that was approved for credit by the institution at which the student was enrolled) leading to a recognized educational credential at an eligible educational institution, and carried at least half the normal full-time workload for the course of study he or she was pursuing.

Qualified Higher Education Expenses. For purposes of the student loan interest deduction, qualified higher education expenses are the total costs of attending any eligible educational institution, including graduate school. An eligible educational institution includes most colleges, universities, and certain vocational schools. Qualified expenses include amounts paid for the following items:

- Tuition and fees.
- Room and board.
- Books, supplies, and equipment.
- Other necessary expenses (such as transportation).

The cost of room and board qualifies only to the extent that it is not more than the greater of:

- The allowance for room and board, as determined by the eligible educational institution, that was included in the cost of attendance (for federal financial aid purposes) for a particular academic period and living arrangement of the student, or
- The actual amount charged if the student is residing in housing owned or operated by the eligible educational institution.

Note: You must make adjustments or reduce your qualified higher education expenses by certain tax-free items (such as the tax-free part of scholarships and fellowships).

Claiming the Deduction. Your student loan interest deduction for 2010 is generally the smaller of $2,500 -or- the interest you paid in 2010. However, that amount is phased out (gradually reduced) if your MAGI is between $60,000 and $75,000 ($120,000 and $150,000 if you file a joint return). You cannot take a student loan interest deduction if your MAGI is $75,000 or more ($150,000 or more if you file a joint return).

To determine the allowable deduction, use the Student Loan Interest Deduction Worksheet in the Form 1040 or Form 1040A instructions. To help you figure your student loan interest deduction, you should receive a Form 1098-E, Student Loan Interest Statement from the lending institution.

For more details on Student Loan Interest Deductions, please see IRS Publication 970.

LINE 34 – Tuition and Fees Deduction

The tuition and fees deduction can reduce the amount of your income subject to tax by up to $4,000 for qualified education expenses paid during the year for yourself, your spouse, or your dependent(s).

Generally, you can claim the tuition and fees deduction if all three of the following requirements are met:

1. You pay qualified education expenses of higher education.
2. You pay the education expenses for an eligible student.
3. The eligible student is yourself, your spouse, or your dependent for whom you claim an exemption on your tax return.

You cannot claim the tuition and fees deduction if any of the following apply:

- Your filing status is married filing separately.
- Another person can claim an exemption for you as a dependent on his or her tax return. You cannot take the deduction even if the other person does not actually claim that exemption.
- Your modified adjusted gross income (MAGI) is more than $80,000 ($160,000 if filing a joint return).
- You (or your spouse) were a nonresident alien for any part of 2010 and the nonresident alien did not elect to be treated as a resident alien for tax purposes. More information on nonresident aliens can be found in IRS Publication 519, U.S. Tax Guide for Aliens.
- You or anyone else claims an American Opportunity or Lifetime Learning Credit in 2010 with respect to expenses of the student for whom the qualified education expenses were paid.

<u>Qualified Education Expenses</u>. For purposes of the tuition and fees deduction, qualified education expenses are tuition and certain related expenses required for enrollment or attendance at an eligible educational institution.

<u>Eligible Educational Institution</u>. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

TIP: You should generally choose the education benefit that will give you the lowest tax. You may want to compare the tuition and fees deduction to the education credits. You cannot claim both the tuition and fees deduction and the education credits for the same student.

LINE 35 – Domestic Production Activities Deduction

You may be able to deduct up to nine percent (9%) of your qualified production activities income from the following domestic manufacturing activities:

1. Construction of real property performed in the United States.

2. Engineering or architectural services performed in the United States for construction of real property in the United States.

3. Any lease, rental, license, sale, exchange, or other disposition of:
   a. Tangible personal property, computer software, and sound recordings that you manufactured, produced, grew, or extracted in whole or in significant part in the United States;
   b. Any qualified film you produced; or
   c. Electricity, natural gas, or potable water you produced in the United States.

Note: In certain cases, the references above to the United States include Puerto Rico.

Your deduction may be reduced if you had oil-related qualified production activities income.

The deduction does not apply to income derived from:

- The sale of food and beverages you prepared at a retail establishment;
- Property you leased, licensed, or rented for use by any related person;
- The transmission or distribution of electricity, natural gas, or potable water; or
- The lease, rental, license, sale, exchange, or other disposition of land.

For more details, please see federal Form 8903 and its instructions.

LINE 36 – Total Adjustments to Income

Combine the amounts reported as adjustments on lines 22 through 35 to arrive at a total.

Part I – Federal

Section 4

A) Federal Standard Deduction vs. Itemized Deductions

- Standard Deduction Eligibility
- Who Should Itemize
- Schedule L
- Claiming Itemized Deductions

B) Schedule A Breakdown

- Medical and Dental Expenses
- Taxes You Paid
- Interest You Paid
- Gifts to Charity
- Theft and Casualty Losses
- Job Expenses and Certain Miscellaneous Deductions
- Other Miscellaneous Deductions Not Subject to 2% Limit
- Limitation of Itemized Deductions (Prior Years)

FEDERAL STANDARD DEDUCTION AND ITEMIZED DEDUCTIONS

Once you have computed your federal adjusted gross income, then you generally have the option of claiming the standard deduction or itemizing your deductions to reduce the amount of income on which you are taxed.

Standard Deduction – Eligibility

In some situations, you may not qualify for the standard deduction and only be allowed to itemize your deductions. You must itemize your deductions if:

- Your filing status is married filing separately, and your spouse itemizes deductions,
- You are filing a tax return for a short tax year because of a change in your annual accounting period, or
- You are a nonresident or dual-status alien during the year.

Note: If you can be claimed as a dependent on another person's return (such as your parents' return), your standard deduction may be limited.

Standard Deduction – Allowable Amount for 2010

Your allowable standard deduction for 2010 depends on your filing status, whether you are 65 or older or blind, whether an exemption can be claimed for you by another taxpayer, or if you qualify to use Schedule L , Standard Deduction for Certain Filers, discussed later in this material.

Generally, your standard deduction is:

- $5,700 if single or married filing separately,
- $11,400 if married filing jointly or qualifying widow(er), or
- $8,400 if head of household.

If you may be claimed by someone else as a dependent or are 65 or older or blind, you must complete a Standard Deduction Worksheet to determine your allowable standard deduction; if you qualify for certain deductions you may wish to use Schedule L to determine your allowable standard deduction.

Itemized Deductions – Who Should Itemize

You should itemize deductions if your total allowable deductions exceed the standard deduction for your filing status. You must itemize deductions if you do not qualify for the standard deduction.

Schedule L

For 2010, Schedule L may be an option if you don't have enough deductions to itemize, but have deductions that are allowed on Schedule L. Schedule L allows you to increase your standard deduction by certain net disaster losses or new motor vehicle taxes paid in 2010 for certain vehicles purchased in 2009.

Claiming Itemized Deductions

To claim itemized deductions, you must complete federal Schedule A and attach to your return. Schedule A allows you to deduct allowable medical and dental expenses, certain taxes and interest you paid, charitable contributions, unreimbursed employee business expenses, miscellaneous deductions and other deductions. A breakdown of Schedule A and an overview of those deductions follows.

SCHEDULE A DEDUCTION BREAKDOWN

Medical and Dental Expenses

Medical expenses are the costs of diagnosis, cure, mitigation, treatment, or the prevention of disease, and the costs for treatments affecting any part or function of the body. They must be primarily to alleviate or prevent a physical or mental defect or illness. You may not deduct expenses that are merely beneficial to general health, such as vitamins or a vacation.

You can generally deduct medical expenses you pay for yourself as well as those you pay for someone who was your spouse or dependent either when the services were provided or when you paid for them. To compute your allowable medical deduction, you must multiple your federal adjusted gross income (AGI) by 7.5 percent (7.5%). This amount may be referred to as a "7.5 percent limit". Only the medical expenses in excess of that amount are allowed to be claimed as an itemized deduction.

Example: Your AGI is $80,000. Multiply that by 7.5 percent and your 7.5 percent limit is $6,000. Thus, only your medical expenses in excess of $6,000 would qualify as an itemized deduction.

Table 21-1, on the following page, summarizes most medical expenses that you may claim as a deduction and lists medical expenses that are not an allowable deduction.

Table 21– 1. Medical and Dental Expenses Checklist (See IRS Publication 502 for more detailed information.)

You Can Include:	You Cannot Include:
● Bandages ● Birth control pills prescribed by your doctor ● Body scan ● Capital expenses for equipment or improvements to your home needed for medical care (see the worksheet in IRS Publication 502) ● Diagnostic devices ● Expenses of an organ donor ● Eye surgery— to promote the correct function of the eye ● Fertility enhancement, certain procedures ● Guide dogs or other animals aiding the blind, deaf, and disabled ● Hospital service fees (lab work, therapy, nursing services, surgery, etc.) ● Lead-based paint removal ● Legal abortion ● Legal operation to prevent having children such as a vasectomy or tubal ligatIon ● Long-term care contracts, qualified ● Meals and lodging provided by a hospital during medical treatment ● Medical service fees (from doctors, dentists, surgeons, specialists, and other medical practitioners ● Medicare Part D premiums ● Medical and hospital insurance premiums ● Oxygen equipment and oxygen ● Part of life-care fee paid to retirement home designated for medical care. ● Physical examination ● Pregnancy test kit ● Prescription medicine and insulin (prescribed by a doctor) ● Psychiatric and psychological treatment ● Social Security tax, Medicare tax, FUTA, and state employment tax for worker providing medical care (see "Wages for nursing services" below) ● Special items (artificial limbs, false teeth, eye glasses, contact lenses, hearing aids, crutches, wheelchair, etc.) ● Special education for mentally or physically disabled persons ● Stop-smoking programs ● Transportation for needed medical care ● Treatment at a drug or alcohol center (includes meals and lodging provided by the center) ● Wages for nursing services ● Weight-loss, certain expenses for obesity	● Babysitting and childcare ● Bottled water ● Contributions to Archer MSAs (see IRS Publication 969) ● Diaper service ● Expenses for your general health (even if following your doctor's advice) such as— —Health club dues —Household help (even if recommended by a doctor) —Social activities, such as dancing or swimming lessons —Trip for general health improvement ● Flexible spending account reimbursements for medical expenses (if contributions were on a pre-tax basis) ● Funeral, burial, or cremation expenses ● Health savings account payments for medical expenses ● Illegal operation or treatment ● Life insurance or income protection policies, or policies providing payment for loss of life, limb, sight, etc. ● Maternity clothes ● Medical insurance included in a car insurance policy covering all persons injured in or by your car ● Medicine you buy without a prescription ● Nursing care for a healthy baby ● Prescription drugs you brought in (or ordered, shipped) from another country, in most cases ● Nutritional supplements, vitamins, herbal supplements, "natural medicines," etc., unless recommended by a medical practitioner as a treatment for a specific medical condition diagnosed by a physician ● Surgery for purely cosmetic reasons ● Toothpaste, toiletries, cosmetics, etc. ● Teeth whitening ● Weight-loss expenses not for the treatment of obesity or other disease

Taxes You Paid

When itemizing your deductions, a variety of taxes you paid may be claimed on Schedule A. Two tests must be met for you to deduct taxes you paid:

- The tax must be imposed on you,
- You must pay the tax during your tax year.

Refer to Table 22-1 Which Taxes Can You Deduct, below to determine which taxes you may claim as an itemized deduction.

Table 22–1. Which Taxes Can You Deduct?

Type of Tax	You Can Deduct	You Cannot Deduct
Fees and Charges	Fees and charges that are expenses of your trade or business or of producing income.	Fees and charges that are not expenses of your trade or business or of producing income, such as fees for driver's licenses, car inspections, parking, or charges for water bills. Fines and penalties.
New Motor Vehicle Taxes	State or local sales or excise taxes you paid for the purchase of any new motor vehicle purchased after February 16, 2009, and before January 1, 2010, including certain fees charged to purchase new motor vehicles in states that do not have a sales tax.	State or local sales or excise taxes you paid on a vehicle purchased after December 31, 2009.
Income Taxes	State and local income taxes. Foreign income taxes. Employee contributions to state funds listed under Contributions to state benefit funds.	Federal income taxes. Employee contributions to private or voluntary disability plans.
Other Taxes	Taxes that are expenses of your trade or business. Taxes on property producing rent or royalty income. Occupational taxes. One-half of self-employment tax paid.	Federal excise taxes, such as tax on gasoline, that are not expenses of your trade or business or of producing income. Per capita taxes.
Personal Property Taxes	State and local personal property taxes.	Customs duties that are not expenses of your trade or business or of producing income.
Real Estate Taxes	State and local real estate taxes. Foreign real estate taxes. Tenant's share of real estate taxes paid by cooperative housing corporation.	Foreign real estate taxes, if you take the standard deduction and the real property is not used in your trade or business or does not produce rental income. Real estate taxes that are treated as imposed on someone else. Taxes for local benefits (with exceptions). Trash and garbage pickup fees (with exceptions). Rent increase due to higher real estate taxes. Homeowners' association charges.

Interest You Paid

Certain types of interest expense may be deducted on Schedule A. Interest is the amount you pay for the use of borrowed money. Examples of types of interest you pay that can be deducted include:

- Home mortgage expense
- Points
- Mortgage insurance premiums
- Investment interest

Personal interest is not deductible. Personal interest includes interest expense on car loans, finance charges on credit cards, late payment charges by a public utility, etc.

For additional information on deducting interest expenses, refer to the chart below.

Table 23–1. Where To Deduct Your Interest Expense

IF you have ...	THEN deduct it on ...	AND for more information go to ...
deductible student loan interest	Form 1040, line 33, or Form 1040A, line 18	IRS Publication 970.
deductible home mortgage interest and points reported on Form 1098	Schedule A (Form 1040), line 10	IRS Publication 936.
deductible home mortgage interest not reported on Form 1098	Schedule A (Form 1040), line 11	IRS Publication 936.
deductible points not reported on Form 1098	Schedule A (Form 1040), line 12	IRS Publication 936.
deductible mortgage insurance premiums	Schedule A (Form 1040), line 13	IRS Publication 936.
deductible investment interest (other than incurred to produce rents or royalties)	Schedule A (Form 1040), line 14	IRS Publication 550.
deductible business interest (non-farm)	Schedule C or C-EZ (Form 1040)	IRS Publication 535.
deductible farm business interest	Schedule F (Form 1040)	IRS Publications 225 and 535.
deductible interest incurred to produce rents or royalties	Schedule E (Form 1040)	IRS Publications 527 and 535.
personal interest	Not deductible.	

Gifts to Charity

Generally, you can deduct contributions of money or property that you make to, or for the use of, a qualified organization. Qualified organizations include the following examples:

- Churches, temples, synagogues,
- Most nonprofit charitable organizations such as the Red Cross,
- Most nonprofit educational organizations, including the Boy Scouts and the Girl Scouts,
- Nonprofit hospitals and medical research organizations, and
- Nonprofit volunteer fire departments and more.

See Table 24-1 Examples of Charitable Contributions below for a general overview of what contributions you may claim as a deduction on Schedule A.

Table 24–1. Examples of Charitable Contributions—A Quick Check
Use the following list as a quick check of contributions you can or cannot deduct on Schedule A. Information on additional rules and limits that may apply can be found later in this chapter.

Deductible as Charitable Contributions	**Not Deductible as Charitable Contributions**
Money or property you give to: • Churches, synagogues, temples, mosques, and other religious organizations • Federal, state, and local governments, if your contribution is solely for public purposes (for example, a gift to reduce the public debt) • Nonprofit schools and hospitals • Public parks and recreation facilities • Salvation Army, Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts, Girl Scouts, Boys and Girls Club of America, etc. • War veterans groups • Charitable organizations listed in IRS Publication 78 • Expenses paid for a student living with you, sponsored by a qualified organization • Out-of-pocket expenses when you serve a qualified organization as a volunteer	Money or property you give to: • Civic leagues, social and sports clubs, labor unions, and chambers of commerce • Foreign organizations (except certain Canadian, Israeli, and Mexican charities) • Groups that are run for personal profit • Groups whose purpose is to lobby for law changes • Homeowners' associations • Individuals • Political groups or candidates for public office • Cost of raffle, bingo, or lottery tickets • Dues, fees, or bills paid to country clubs, lodges, fraternal orders, or similar groups • Tuition • Value of your time or services • Value of blood given to a blood bank

Contributions You Cannot Deduct

There are certain contributions which are not allowed as a deduction on Schedule A. These include the following:

- Contributions to individuals
- Contributions to nonqualified organizations
- Contributions from which you benefit
- Value of time or service
- Personal expenses

Cash and Noncash Contributions

Cash contributions include those paid by cash, check, electronic funds transfer, credit card or payroll deductions. You cannot deduct a cash contribution, regardless of the amount, unless you keep one of the following records:

- Bank record showing name of organization, date and amount
- Canceled check
- Credit card statement
- Receipt or letter from the organization
- Payroll deduction record

For noncash contributions, such as property, household goods, etc. the records you must keep depend on whether your deduction for the contribution is:

- Less than $250,
- At least $250 but not more than $500,
- Over $500 but not more than $5,000, or
- Over $5,000

Further information about the necessary records to keep for noncash contributions may be found in the IRS Publication 17.

Limitations and Carryovers

Typically, the amount claimed as a deduction for charitable contributions is limited to 50 percent of your Adjusted Gross Income (AGI) for the year and, in some cases, may be limited to 30 percent or even 20 percent of the AGI, depending on the type of property given and the type of organization receiving it.

- 50 Percent Limit – The 50 percent limit applies to the total of all charitable contributions you make during the year. This means that your deduction for charitable contributions cannot exceed 50 percent of your adjusted gross income for the year. Generally, the 50 percent limit is the only limit that applies to gifts to organizations listed as "50 percent limit organizations." But there is one exception – a special 30 percent limit also applies to these gifts if they are gifts of capital gain property for which you figure your deduction using fair market value without reduction for appreciation.

- 50 Percent Limit Organizations – You can generally ask any organization whether it is considered a "50 percent limit organization" and most will be able to tell you. However, for further clarification, you can always either contact the IRS or check the IRS Publication 78.

- 30 Percent Limit – A 30 percent limit applies to the following gifts:

    - Gifts to all qualified organizations other than 50 percent limit organizations. This includes gifts to veterans' organizations, fraternal societies, non-profit cemeteries, and certain private non-operating foundations.

    - Gifts for the use of any organization. However, if these gifts are of capital gain property, they are subject to the 20 percent limit, described later, rather than the 30 percent limit.

- Student living with you – Amounts you spend on behalf of a student living with you are also subject to the 30 percent limitation. These amounts are considered a contribution for the use of a qualified organization. (See Expenses Paid for Student Living With You, earlier.)

- 20 Percent Limit – The 20 percent limit applies to all gifts of capital gain property to or for the use of qualified organizations (other than gifts of capital gain property to 50 percent limit organizations).

- Qualified Conservation Contribution – The special 30 percent limit does not apply to qualified conservation contributions (QCCs). Instead, a 50 percent limit applies. For qualified farmers and ranchers, QCCs are deductible up to 100 percent of adjusted gross income. (See IRS Publication 526 for more details.)

Contribution Carryovers

Charitable contributions that you are unable to deduct in the current tax year because it exceeds your adjusted-gross-income limits may be carried over to the following tax year. You can claim the excess deduction in each of the next five years until it is used up, but not beyond that time. Your total contributions deduction for the year to which you carry your contributions cannot exceed 50 percent of your adjusted gross income for that year.

Also, contributions that you carry over are still subject to the same percentage limits in the year to which it is carried. For example, contributions subject to the 20 percent limit in the year in which it is made are 20 percent limit contributions in the year to which it is carried.

Theft and Casualty Losses

If you have been the victim of a theft, accident, fire, flood, or some other casualty during the year, you may be able to claim some of your unreimbursed losses as an itemized deduction.

Casualty and theft losses are treated somewhat differently depending on whether the loss occurred to property used in your trade or business, property used to generate investment income, or property used for personal or family purposes. However, regardless of the type of property, the loss must first be reported on IRS Form 4684, *Casualties and Thefts.*

TIP: Use Schedule L instead of Schedule A if you are deducting a net disaster loss as part of your standard deduction.

Casualty Defined

A casualty is the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.

- A sudden event is one that is swift, not gradual or progressive.
- An unexpected event is one that is ordinarily unanticipated and unintended.
- An unusual event is one that is not a day-to-day occurrence and that is not typical of the activity in which you were engaged.

Theft Defined

A theft is the taking and removing of money or property with the intent to deprive the owner of it. The taking of property must be illegal under the law of the state where it occurred and it must have been done with criminal intent. You do not need to show a conviction for theft.

Other Losses

Many other types of losses can qualify to be deducted as a casualty and theft loss. Examples of other losses that might be claimed as a casualty and theft include:

- Losses on business or income-producing property
- Losses on leased property
- Loss of inventory
- Loss on deposits

Losses You May Deduct

Deductible casualty losses can result from a number of different causes, including the following:

- Car accidents
- Earthquakes
- Fires
- Floods
- Government-ordered demolition or relocation of a home that is unsafe to use
- Mine cave-ins
- Shipwrecks
- Sonic booms
- Storms, including hurricanes and tornadoes
- Terrorist attacks
- Vandalism
- Volcanic eruptions

Deductible theft losses include the taking of money or property by the following means:

- Blackmail
- Burglary

- Embezzlement
- Extortion
- Kidnapping for ransom
- Larceny
- Robbery

The taking of money or property through fraud or misrepresentation is theft if it is illegal under state or local law. Losses from fraud are deductible. For example, when a contractor disappears after taking a down payment for a repair he never performs, the victim is allowed a deduction.

Losses You May NOT Deduct

A casualty loss is not deductible if the damage or destruction is caused by the following:

- Accidentally breaking articles such as glassware or china under normal conditions;
- A fire if you willfully set it, or pay someone else to set it;
- A car accident if your willful negligence or willful act, such as the result of drunk driving;
- A willful act or willful negligence of someone acting for you caused the accident;
- Progressive deterioration; or
- A family pet.

Required Proof

To deduct a casualty or theft loss, you must be able to show that there was a casualty or theft. You also must be able to support the amount you take as a deduction.

For a **casualty loss,** you should be able to show all the following:

- The type of casualty (car accident, fire, storm, etc.) and when it occurred;
- That the loss was a direct result of the casualty;
- That you were the owner of the property, or if you leased the property from someone else, that you were contractually liable to the owner for the damage; and
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery.

For a **theft loss**, you should be able to show all the following:

- When you discovered that your property was missing;
- That your property was stolen;
- That you were the owner of the property; and
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery.

Determining Your Loss

To determine your deduction for a casualty or theft loss, you must first compute the amount of your loss.

Determine the amount of your loss using the following steps:

- Determine your adjusted basis in the property before the casualty or theft;
- Determine the decrease in fair market value (FMV) of the property as a result of the casualty or theft; and
- From the smaller of the amounts you determined in (1) and (2), subtract any insurance or other reimbursement you received or expect to receive.

For personal-use property and property used in performing services as an employee, apply the deduction limits, discussed later, to determine the amount of your deductible loss.

Insurance and Other Reimbursements

If you receive an insurance or other type of reimbursement, you must subtract the reimbursement when you figure your loss. You do not have a casualty or theft loss to the extent you are reimbursed.

If you expect to be reimbursed for part or all of your loss, you must subtract the expected reimbursement when you figure your loss. You must reduce your loss even if you do not receive payment until a later tax year.

Limits on Your Deduction

Generally, each personal casualty or theft loss is limited to the excess of the loss over $100 for federal purposes. In addition, the 10 percent of adjusted gross income (AGI) limit continues to apply to the net loss.

Additional Theft and Casualty Loss Issues

There are many additional issues associated with claiming, reporting and computing casualty and theft losses beyond the scope of this material. Those issues include:

- Determining fair market value (FMV),
- Timing of reimbursements,
- Basis of property,
- Single casualty on multiple properties,
- Disaster areas, and
- More.

For information about these issues, refer to IRS Publication 17 and IRS Publication 547.

Job Expenses and Certain Miscellaneous Deductions

As an employee, it is possible that you may incur some expenses that are related to your job. If your employer did not pay you back for those expenses, they would be considered unreimbursed job expenses; you may be able to deduct those expenses as miscellaneous deductions on Schedule A. Because they are considered a miscellaneous deduction, you will only be allowed to deduct the amount that exceeds two percent (2%) of your adjusted gross income.

Example: If your federal AGI is $50,000 you must have unreimbursed job expenses of more than $1000 ($50,000 x 2% = $1000) before the expenses are deductible. And even then, only the amount over $1000 can be deducted.

Eligible Expenses

Your expenses must have been required for you to carry out the job for which you were hired and must be ordinary and necessary. This means the item or service is common and accepted in your line of work and is appropriate and helpful to your job.

Federal Form 2106

You will need to complete federal Form 2106, Employee Business Expenses, or federal Form 2106-EZ, Unreimbursed Employee Business Expenses, whenever you are deducting unreimbursed job expenses. For further information on how these expenses should be reported on the form, please see IRS Publication 463. For a complete listing of unreimbursed job expenses and their descriptions, refer to IRS Publication 529. Examples of some expenses you may be entitled to claim include the following:

- Travel expenses
- Meal expenses
- Educator expenses that are more than you can deduct as an adjustment to income
- Business related entertainment expenses
- Licenses and regulatory fees
- Malpractice insurance premiums
- Medical examinations required by an employer
- Gifts
- Business use of home
- Subscriptions to professional journals and trade magazines related to your work
- Tools and supplies used in your work
- Home office expense
- Union dues and expenses
- Work clothes and uniforms if required and not suitable for everyday use
- Work-related education.

Information about many of these deductions follows.

Travel Expenses

Although commuting costs are not deductible, some local transportation expenses are. Deductible local transportation expenses include the expenses of going from one workplace (away from your place of residence) to another workplace.

Travel expenses are the ordinary and necessary expenses of traveling away from home for your business, profession, or job. You cannot deduct expenses that are lavish or extravagant or that are for personal purposes.

Travel expenses paid or incurred in connection with a temporary work assignment away from home are deductible. However, travel expenses paid in connection with an indefinite work assignment are not deductible. Any work assignment in excess of one year is considered indefinite. Also, you may not deduct travel expenses at a work location if it is realistically expected that you will work there for more than one year, whether or not you actually work there that long.

Deductible travel expenses while away from home include, but are not limited to, the costs of:

- Travel by airplane, train, bus, or car between your home and your business destination;
- Using your car while at your business destination;
- Fares for taxis or other types of transportation between the airport or train station and your hotel, the hotel and the work location, and from one customer to another, or from one place of business to another;
- Meals and lodging;
- Tips you pay for services related to any of these expenses;
- Dry cleaning and laundry;
- Business calls while on your business trip; and
- Other similar ordinary and necessary expenses related to your business travel.

Meal Expenses

Instead of keeping records of your meal expenses and deducting the actual cost, you can generally use a standard meal allowance, which varies depending on where you travel. The deduction for business meals is generally limited to 50 percent of the unreimbursed cost.

Entertainment Expenses

Entertainment expenses that are both ordinary and necessary in carrying on a trade or business may be deductible if they meet one of two tests: the expenses must be directly related to the business or the entertainment is associated with the active conduct of your trade or business, and directly before or after a substantial business discussion.

Gifts

If you give gifts in the course of your trade or business, you can deduct all or part of the cost. You can deduct no more than $25 for business gifts you give directly or indirectly to each person during your tax year.

Business Use of Your Car

If you use your car in your job or business and you use it only for that purpose, you may deduct its entire cost of operation. However, if you use the car for both business and personal purposes, you may deduct only the cost of its business use. Transportation expenses do not include expenses you have while traveling away from home overnight.

Transportation expenses include the ordinary and necessary costs of all of the following:

- Getting from one workplace to another in the course of your business or profession when you are traveling within the city or general area that is your tax home;
- Visiting clients or customers;
- Going to a business meeting away from your regular workplace; and
- Getting from your home to a temporary workplace when you have one or more regular places of work. These temporary workplaces can be either within the area of your tax home or outside that area.

You generally can use one of the two following methods to figure your deductible expenses.

- Standard mileage rate; or
- Actual car expenses.

To use the standard mileage rate, you must own or lease the car; the car must not be used to transport persons or property for compensation or hire, for example as a taxi.
Further, to use the standard mileage rate for a car you own, you must choose to use it in the first year the car is available for use in your business.

Home Office

Whether you are self-employed or are an employee, you may be able to deduct certain expenses for the part of your home you use for business despite the general denial of business expense deductions for the home. To deduct expenses for business use of the home, part of your home must be used regularly and exclusively as one of the following:

- The principal place of business for your trade or business
- The place where you meet and deal with your patients, clients, or customers in the normal course of your trade or business; or
- In connection with your trade or business, if you use a separate structure that is not attached to your home.

Work Related Education Expenses

You may be able to deduct work-related educational expenses paid during the year as an itemized deduction. To be deductible, your expenses must be:

- For education that maintains or improves your job performance, or
- Is required by your employer or by law to keep your salary, status or job.

The education cannot be part of a program that will qualify you for a new trade or business. Although the education must relate to your present work, educational expenses incurred during temporary absence from your job may be deductible. However, after your temporary absence, you must return to the same kind of work. Usually, absence from work for one year or less is considered temporary.

Allowable Education Expenses

If your education meets the requirements described earlier you can generally deduct your education expenses as business expenses. If you are not self-employed, you can deduct business expenses only if you itemize your deductions. You cannot deduct expenses related to tax-exempt and excluded income.

The following education expenses can be deducted:

- Tuition, books, supplies, lab fees, and similar items;
- Certain transportation and travel costs; and
- Other education expenses, such as costs of research and typing when writing a paper as part of an educational program.

You cannot deduct personal or capital expenses. For example, you cannot deduct the dollar value of vacation time or annual leave you take to attend classes. This amount is a personal expense.

Union Dues and Expenses

You can deduct dues and initiation fees you pay for union membership. You can also deduct assessments for benefit payments to unemployed union members. However, you cannot deduct the part of the assessments or contributions that provides funds for the payment of sick, accident, or death benefits. Also, you cannot deduct contributions to a pension fund even if the union requires you to make the contributions.

Work Clothes and Uniforms

You can deduct the cost and upkeep of work clothes if the following two requirements are met:

- You must wear them as a condition of your employment; and
- The clothes are not suitable for everyday wear.

Certain Miscellaneous Deductions

You can deduct certain expenses as miscellaneous itemized deductions on Schedule A. Just like the unreimbursed job expenses, you may only claim the amount of expenses that exceed two percent (2%) of your adjusted gross income.

Job Search Expenses

You can deduct certain expenses you have in looking for a new job in your present occupation, even if you do not get a new job. You cannot deduct these expenses if:

- You are looking for a job in a new occupation;
- There was a substantial break between the ending of your last job and your looking for a new one; or
- You are looking for a job for the first time.

You can deduct certain other expenses as miscellaneous itemized deductions subject to the two percent (2%) of adjusted gross income limit. On Schedule A, you can deduct expenses that you pay:

- To produce or collect income that must be included in your gross income;
- To manage, conserve, or maintain property held for producing such income; or
- To determine, contest, pay, or claim a refund of any tax.

You can deduct expenses you pay for the purposes in (1) and (2) above only if they are reasonable and closely related to these purposes. Examples of these other expenses include the following items:

- Appraisal fees for a casualty loss or charitable contribution;
- Casualty and theft losses from property used in performing services as an employee;
- Clerical help and office rent in caring for investments;
- Depreciation on home computers used for investments;

- Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust;
- Fees to collect interest and dividends;
- Hobby expenses, but generally not more than hobby income;
- Indirect miscellaneous deductions of pass-through entities;
- Investment fees and expenses;
- Legal fees related to producing or collecting taxable income or getting tax advice;
- Loss on deposits in an insolvent or bankrupt financial institution;
- Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed to you;
- Repayments of income;
- Repayments of Social Security benefits;
- Safe deposit box rental;
- Service charges on dividend reinvestment plans;
- Tax advice fees; and
- Trustee's fees for your IRA, if separately billed and paid.

Other Miscellaneous Deductions – Not Subject to the Two Percent (2%) Limit

You can deduct the items listed below as miscellaneous itemized deductions. They are not subject to the two percent (2%) limit.

- Amortizable premium on taxable bonds;
- Casualty and theft losses from income-producing property;
- Federal estate tax on income in respect of a decedent;
- Gambling losses up to the amount of gambling winnings;
- Impairment-related work expenses of persons with disabilities;
- Losses from Ponzi-type investment schemes;
- Repayments of more than $3,000 under a claim of right; and
- Unrecovered investment in an annuity.

Examples of expenses you may **not** deduct include the following:

- Adoption expenses
- Burial or funeral expenses, including the cost of a cemetery lot
- Campaign expenses
- Check-writing fees
- Club dues
- Fines and penalties, such as parking tickets
- Health spa expenses
- Hobby losses—but see *Hobby expenses,* earlier
- Home repairs, insurance, and rent
- Illegal bribes and kickbacks
- Life insurance premiums
- Lobbying expenses
- Losses from the sale of your home, furniture, personal car, etc.
- Lost or misplaced cash or property
- Lunches with co-workers
- Personal disability insurance premiums
- Personal legal expenses
- Personal, living, or family expenses
- Political contributions
- Professional accreditation fees
- Professional reputation, expenses to improve
- Residential telephone line
- Tax-exempt income, expenses of earning or collecting
- The value of wages never received or lost vacation time
- Travel expenses for another individual
- Voluntary unemployment benefit fund contributions
- Wristwatches

FYI – Limit on Itemized Deductions (Prior Years)

For tax year 2010 there is no limit on itemized deductions. However, you should be aware that in previous years, taxpayers could be subject to a limit on certain itemized deductions, based on their adjusted gross income. In 2009 the limitation threshold amount was adjusted gross income that exceeded $83,400 for taxpayers using married filing separate status and $166,800 for all other taxpayers. The limitation calculation was included as a part of Schedule A.

Part I – Federal

Section 5

A) Computing Taxable Income and Tax Liability

B) Federal Tax Credits Overview
- Foreign Tax Credit
- Child and Dependent Care Expenses Credit
- Education Credit(s)
- Retirement Savings Contributions Credit
- Child Tax Credit
- Residential Energy Credits
- Making Work Pay Credit
- Earned Income Tax Credit (EIC)
- First-time Homebuyer Credit
- Adoption Credit

C) Child and Dependent Care Expenses Credit

D) Education Credit(s)

E) Child Tax Credit

F) Residential Energy Credits

G) Earned Income Tax Credit (EIC)

COMPUTING TAXABLE INCOME AND TAX LIABILITY

After you have figured your federal adjusted gross income (FAGI) and determined whether you should claim the standard deduction or itemize your deductions, the next step is to calculate your taxable income and how much tax you owe.

Taxable Income

Determining your taxable income – line 43 of the federal Form 1040 – essentially involves nothing more than some simple math calculations. First, you would either subtract the standard deduction or amount of itemized deductions from your federal adjusted gross income (line 41). Next, multiply the exemption amount ($3650 for 2010 tax year) by the number of exemptions claimed on line 6d of the federal Form 1040 (line 42). Finally, subtract the line 42 from line 41 to arrive at your total taxable income and enter this figure on line 43.

Example: George and Beverly Hendricks are married and have one child. Their filing status is married filing joint and they claim three exemptions on line 6d. The Hendricks have an FAGI of $65,000 and claimed the standard deduction.

$65,700 (Federal Adjusted Gross Income) (line 38)
– $11,400 (Standard Deduction, Married Filing Joint) (line 40)
$54,300 (line 41)

$3,650 (Exemption Amount)
X 3 (Total # of Exemptions) (line 6d)
$10,950 (line 42)

$54,300 (line 41)
– $10,950 (line 42)
$43,350 (Taxable Income) (line 43)

Tax Liability

Generally, the amount of tax owed is reported on line 44 of the federal Form 1040. Most taxpayers use either the Tax Table or the Tax Computation Worksheet to figure their income tax. If your taxable income is less than $100,000, you must use the Tax Table that is included in the instructions of the federal Form 1040. If your taxable income is $100,000 or more, instead use the Tax Computation Worksheet (also provided in the instructions).

However, there are also special methods for calculating tax if your income includes any of the following items:

- A net capital gain (complete Schedule D Tax Worksheet);
- Qualified dividends taxed at the same rates as a net capital gain;
- Lump-sum distributions (complete federal form 4972, check appropriate box);
- Farming or fishing income (complete Schedule J – Income Averaging for Farmers and Fishermen);
- Investment income over $1,900 for certain children (complete federal Form 8615);
- Parents' election to report child's interest and dividends (complete federal form 8814, check appropriate box); and
- Foreign earned income exclusion or the housing exclusion (complete Foreign Earned Income Tax Worksheet or federal Form 2555 or 2555-EZ).

For more details on calculating tax in each of these situations, please see IRS Publication 17.

Alternative Minimum Tax

The tax law gives special treatment to some kinds of income and allows special deductions and credits for some kinds of expenses. Taxpayers who benefit from the law in these ways may have to pay at least a minimum amount of tax through an additional tax. This additional tax is called the alternative minimum tax (AMT).

You may have to pay the AMT if your taxable income for regular tax purposes, combined with certain adjustments and tax preference items, is more than a certain amount. For more information on the Alternative Minimum Tax for individuals, see federal Form 6251.

FEDERAL TAX CREDITS OVERVIEW

Once you have completed your tax computation, the following is a list (and brief description) of some of the tax credits available on the federal individual income tax return that can then be applied to help reduce your tax liability. For a complete list of all available credits and more information on the applicable rules for specific credits, please see IRS Publication 17.

- **Foreign Tax Credit –** You generally can choose whether to take the amount of any qualified foreign taxes paid or accrued during the year as a credit against your U.S. income tax. Or, you can choose to deduct them as an itemized deduction. To claim the Foreign Tax Credit you must complete federal Form 1116, attach it to your federal Form 1040 and enter the amount of the credit on Form 1040, line 47. See IRS Publication 514 for exceptions.

- **Child and Dependent Care Expenses Credit –** If you paid someone to care for a child or a dependent so you could work, you may be able to reduce your tax by claiming the credit for child and dependent care expenses on your federal income tax return. This credit is available to people who, in order to work or to look for work, have to pay for child care services for dependents under age 13, or if you paid for care of a spouse or a dependent of any age who is physically or mentally incapable of self-care. To determine this credit, you must complete federal Form 2441.

- **Education Credit(s) –** The American Opportunity Credit and Lifetime Learning Credit are both available to students attending a post-secondary educational institution, such as a college or university. These education credits may be claimed by those who incur qualifying educational expenses, such as tuition and fees, books, supplies and equipment. To determine the correct amount of these credits, you must complete federal Form 8863.

- **Retirement Savings Contributions Credit –** A nonrefundable tax credit up to $1,000 ($2,000 for joint filers) that can be claimed by taxpayers who make an eligible contribution to a qualified retirement plan, such as an IRA, SEP, 401(k), 403(b), SIMPLE, or 457 plan. To be eligible, the contribution must be made by a person born before January 2, 1993 who is not claimed as a dependent on another tax return and whose modified adjusted gross income is $27,750 or less ($41,625 if head of household; $55,500 if married filing jointly). To claim this credit you must complete federal Form 8880.

- **Child Tax Credit –** The Child Tax Credit is a credit that may reduce your tax by as much as $1,000 for each of your qualifying children. To be eligible, your child must be 16 years old or younger, must be claimed as a dependent, and must be related to you by blood, marriage, adoption, or foster arrangement. The child must also be a US citizen or resident alien. If your Child Tax Credit is more than your tax liability, you may take the excess as additional Child Tax Credit. To claim this additional Child Tax Credit, complete federal Form 8812 to calculate the excess amount you can claim.

- **Residential Energy Credits –** There are two types of home energy credits available to claim on the federal return if you made energy saving improvements to your main home or residence – the Nonbusiness Energy Property Credit and the Residential Energy Efficient Property Credit. Both credits are generally 30 percent of the cost of qualified improvements made to your main home or residence, and the Nonbusiness Energy Property Credit is limited to $1,500 over a two year period. To claim the energy credits, you must complete federal Form 5695.

- **Making Work Pay Credit –** A provision of the American Recovery and Reinvestment Act of 2009 provided a refundable tax credit of up to $400 for working individuals and up to $800 for married taxpayers filing joint returns. To claim this credit, you must complete federal Schedule M. This credit was only available for two years and expired in the 2010 tax year.

- **Earned Income Tax Credit (EIC) –** A tax credit for certain people who work, meet certain requirements, and have earned income that does not exceed a specified limit. The Earned Income Credit is determined based on the following factors: age, residency, filing status, income earned, and qualifying children.

- **First-time Homebuyer Credit –** A refundable tax credit that was originally made available to Americans who qualified as first-time homebuyers and made home purchases between April 9, 2008, and July 1, 2009. However, recent legislation extended the original timeframe (not once, but twice) and also expanded the credit to allow some long-term resident homebuyers to qualify. To claim this credit, qualifying individuals must have purchased their home after April 9, 2008, and before May 1, 2010 and must complete federal Form 5405. The First-time Homebuyer Credit expired in the 2010 tax year and (pending further legislation) will no longer be available in the future. For further details, please see IRS Publication 17.

- **Adoption Credit –** A federal tax credit of up to $13,170 for qualified expenses paid to adopt an eligible child. This credit may be allowed for the adoption of a child with special needs even if you do not have any qualified expenses. If your modified adjusted gross income (AGI) is more than $182,520, your credit will be reduced. If your modified AGI exceeds $222,520, you cannot take the credit. To claim the Adoption Credit, you must complete federal Form 8839 and attach it and along with your adoption-related documents to your federal Form 1040. Include the credit in your total for Form 1040, line 71, and check box b on that line.

CHILD AND DEPENDENT CARE CREDIT

You may be able to claim a Child and Dependent Care Credit on your federal income tax return if you pay someone to care for your dependent who is under the age 13 or for your spouse or dependent who is physically or mentally not able to care for himself or herself. To qualify, you must pay these expenses so you can work or look for work. This credit is nonrefundable and is limited to your tax liability.

Tests to Claim the Credit

To be able to claim the credit for child and dependent care expenses, you must file federal Form 1040 or Form 1040A, not federal Form 1040EZ, and meet all the following tests.

1. The care must be for one or more qualifying persons who are identified on the form you use to claim the credit.
2. You (and your spouse if filing jointly) must have earned income during the year.
3. You must pay child and dependent care expenses so you (and your spouse, if filing jointly) can work or look for work.
4. You must make payments for child and dependent care to someone you (and your spouse) cannot claim as a dependent. If you make payments to your child, he or she cannot be your dependent and must be age 19 or older by the end of the year. You cannot make payments to:
    a. Your spouse, or
    b. The parent of your qualifying person, if your qualifying person is your child and under the age 13.
5. Your filing status must be single, head of household, qualifying widow(er) with dependent child, or married filing jointly. You must file a joint return if you are married, unless an exception applies to you.
6. You must identify the care provider on your tax return.
7. If you exclude or deduct dependent care benefits provided by a dependent care benefits plan, the total amount you exclude or deduct must be less than the dollar limit for qualifying expenses (generally, $3,000 if one qualifying person was cared for or $6,000 if two or more qualifying persons were cared for). (If two or more qualifying persons were cared for, the amount you exclude or deduct will always be less than the dollar limit, since the amount you can exclude or deduct is limited to $5,000.

Qualifying Person Test

Your child and dependent care expenses must be for the care of one or more qualifying persons. A qualifying person is:

1. Your qualifying child who is your dependent and who was under age 13 when the care was provided;

2. Your spouse who was not physically or mentally able to care for himself or herself and lived with you for more than half the year; or

3. A person who was not physically or mentally able to care for himself or herself, lived with you for more than half the year, and either:

   a. Was your dependent, or

   b. Would have been your dependent except that:

      i. He or she received gross income of $3,650 or more;

      ii. He or she filed a joint return; or

      iii. You, or your spouse if filing jointly could be claimed as a dependent on someone else's 2010 return.

Provider Identification Test

You must identify all persons or organizations that provide care for your child or dependent. Use Part I of federal Form 2441 to show the information.

To identify the care provider, you must give the provider's:

1. Name;

2. Address; and

3. Taxpayer identification number.

If the care provider is an individual, the taxpayer identification number is his or her Social Security number or individual taxpayer identification number. If the care provider is an organization, then it is the employer identification number (EIN).

You do not have to show the taxpayer identification number if the care provider is a tax-exempt organization (such as a church or school). In this case, enter "Tax-exempt" in the space where the tax form calls for the number.

Calculating the Credit

To figure the correct amount of the Child and Dependent Care Credit you are allowed to claim, you must complete federal Form 2441. You cannot claim more than $3,000 in expenses for one qualified person and more than $6,000 for two or more qualified persons (even if your total expenses exceed these limits). Depending on your adjusted gross income, a credit percentage of 20% to 35% applies to your expenses to determine the amount of allowable credit.

Note: You may have to pay employment taxes. If you pay someone to come to your home and care for your dependent or spouse, you may be a household employer who has to pay employment taxes. Usually, you are not considered a household employer if the person who cares for your dependent or spouse does so at his or her home place of business. For more details on paying employment taxes as a household employer, see IRS Publication 17.

EDUCATION CREDITS

For the 2010 tax year, there are two tax credits available on the federal return to persons who pay expenses for higher (postsecondary) education. They are:

- The American Opportunity Credit, and
- The Lifetime Learning Credit.

Note: The Hope Credit is no longer available for 2010 tax year because the special rules for students attending school in a Midwestern disaster area have expired.

In order to claim either of the education credits, you must complete the federal Form 8863.

For a detailed comparison of the American Opportunity Credit and the Lifetime Learning Credit, please see Table 35-1 on page 75.

Who Can Claim an Education Credit?

You may be able to claim an education credit if you, your spouse, or a dependent you claim on your tax return was a student enrolled at or attending an eligible educational institution. The credits are based on the amount of qualified education expenses paid for the student in 2010 for academic periods beginning in 2010 and in the first three months of 2011.

Academic period. An academic period includes a semester, trimester, quarter, or other period of study (such as a summer school session) as reasonably determined by an educational institution.

Eligible Educational Institution. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions.

Who Can Claim a Dependent's Expenses?

If a student is claimed as a dependent on another person's tax return, only the person who claims the student as a dependent can claim a credit for the student's qualified education expenses. If a student is not claimed as a dependent on another person's tax return, only the student can claim a credit.

Who Cannot Claim a Credit?

You cannot take an education credit if any of the following apply.

1. You are claimed as a dependent on another person's tax return, such as your parent's return.

2. Your filing status is married filing separately.

3. You (or your spouse) were a nonresident alien for any part of 2010 and did not elect to be treated as a resident alien for tax purposes.

4. Your modified adjust gross income (MAGI) is one of the following:

    a. American Opportunity Credit: $180,000 or more if married filing jointly, or $90,000 or more if single, head of household, or qualifying widow(er).

    b. Lifetime learning credit: $120,000 or more if married filing jointly, or $60,000 or more if single, head of household, or qualifying widow(er).

Table 35-1. Comparison of Education Credits

	American Opportunity Credit	**Lifetime Learning Credit**
Maximum credit	Up to $2,500 credit per **eligible student**	Up to $2,000 credit per **return**
Limit on modified adjusted gross income (MAGI)	$180,000 if married filling jointly; $90,000 if single, head of household, or qualifying widow(er)	$120,000 if married filling jointly; $60,000 if single, head of household, or qualifying widow(er)
Refundable or nonrefundable	40% of credit may be refundable	Credit limited to the amount of tax you must pay on your taxable income
Number of years of postsecondary education	Available **ONLY** for the first **4** years of postsecondary education	Available for all years of postsecondary education and for courses to acquire or improve job skills
Number of tax years credit available	Available **ONLY** for **4** tax years per eligible student	Available for an unlimited number of years
Type of degree required	Student must be pursuing an undergraduate degree or other recognized education credential	Student does not need to be pursuing a degree or other recognized education credential
Number of courses	Student must be enrolled at least half time for at least one academic period beginning during the tax year	Available for one or more courses
Felony drug conviction	No felony drug convictions on student's records	Felony drug convictions are permitted
Qualified expenses	Tuition and required enrollment fees. Course-related books, supplies, and equipment **do not** need to be purchased from the institution in order to qualify.	Tuition and required enrollment fees, including amounts required to be paid to the institution for course-related books, supplies, and equipment.
Payments for academic periods	Payments made in 2010 for academic periods beginning in 2010 and in the first 3 months of 2011	

TIP: You can claim both the American Opportunity Credit and the Lifetime Learning Credit on the same return—but not for the same student.

Qualified Education Expenses

Generally, qualified education expenses are amounts paid in 2010 for tuition and fees required for the student's enrollment or attendance at an eligible educational institution. It does not matter whether the expenses were paid in cash, by check, by credit or debit card, or with borrowed funds.

Only certain expenses for course-related books, supplies, and equipment qualify.

- American Opportunity Credit: Qualified education expenses include amounts spent on books, supplies, and equipment needed for a course of study, whether or not the materials are purchased from the educational institution as a condition of enrollment or attendance.
- Lifetime Learning Credit: Qualified education expenses include **only** amounts for books, supplies, and equipment required to be paid to the institution as a condition of enrollment or attendance.

Qualified education expenses **do not** include amounts paid for any of the following:

- Room and board, insurance, medical expenses (including student health fees), transportation, or other similar personal, living, or family expenses.
- Any course or other education involving sports, games, or hobbies, or any non-credit course, unless such course or other education is part of the student's degree program or (for the Lifetime Learning Credit only) helps the student acquire or improve job skills.
- Nonacademic fees, such as student activity fees, athletic fees, insurance expenses, or other expenses unrelated to the academic course of instruction.

<u>Expenses Paid with Borrowed Funds</u>. You can claim an education credit for qualified education expenses paid with the proceeds of a loan. Use the expenses to figure the credit for the year in which the expenses are paid, not the year in which the loan is repaid.

No Double Benefits Allowed

You cannot do any of the following:

- Deduct higher education expenses on your income tax return (as, for example, a business expense) and also claim an education credit based on those same expenses.
- Claim more than one education credit based on the same qualified education expenses.
- Claim an education credit based on the same expenses used to figure the tax-free portion of a distribution from a Coverdell education savings account (ESA) or qualified tuition program (QTP).

- Claim an education credit based on qualified education expenses paid with educational assistance, such as a tax-free scholarship, grant, or employer-provided educational assistance.

Adjustments to Qualified Education Expenses

If you pay qualified education expenses with certain tax-free funds, you cannot claim an education credit for those amounts. You must reduce the total amount of qualified education expenses by the amount of any tax-free educational assistance and refund(s) you received when computing any education credits.

CHILD TAX CREDIT

The Child Tax Credit is a credit that may reduce your tax liability by as much as $1,000 for each of your qualifying children. The additional child tax credit is a credit you may be able to take if you are not able to claim the full amount of the Child Tax Credit.

Qualifying Child

A qualifying child for purposes of claiming the Child Tax Credit is a child who:

1. Is your son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, your grandchild, niece, or nephew);
2. Was under age 17 at the end of 2010;
3. Did not provide over half of his or her own support for 2010;
4. Lived with you for more than half of 2010;
5. Is claimed as a dependent on your return; and
6. Was a U.S. citizen, a U.S. national, or a resident of the United States.

For each qualifying child you must check the box on the federal Form 1040 or federal Form 1040A, line 6c, column (4).

<u>Qualifying Child of More Than One Person</u>. A special rule applies if your qualifying child is the qualifying child of more than one person. For details, please see IRS Publication 17.

Claiming the Credit

To claim the Child Tax Credit, you must file federal Form 1040 or federal Form 1040A. You cannot claim the Child Tax Credit on federal Form 1040EZ. You must provide the name and identification number (usually a Social Security number) on your tax return for each qualifying child. Depending on your circumstances, you would either use the Child Tax Credit Worksheet or IRS Publication 972 to calculate the amount of your credit.

Amount of Credit

The maximum amount you can claim for the Child Tax Credit is $1,000 for each qualifying child.

Limits on the Credit

You must reduce your child tax credit if either of the following situations apply:

1. The amount on line 46, federal Form 1040 is less than the credit. If this amount is zero, you cannot take this credit because there is no tax to reduce. However, you may be able to take the additional Child Tax Credit; or

2. Your modified adjusted gross income (AGI) exceeds the amount shown below for your filing status.

   a. Married filing jointly - $110,000;

   b. Single, head of household, or qualifying widow(er) - $75,000; or

   c. Married filing separately - $55,000.

Additional Child Tax Credit

This credit is available for certain individuals who get less than the full amount of the Child Tax Credit. The additional child tax credit may give you a refund even if you do not owe any tax. To claim the additional child tax credit, you must complete federal Form 8812 to determine the credit, and then carry that amount to federal Form 1040, line 65.

RESIDENTIAL ENERGY CREDITS

You may be able to take one or both of the following credits if you made energy saving improvements to your home located in the United States in 2010.

- Nonbusiness Energy Property Credit.
- Residential Energy Efficient Property Credit.

If you are a member of a condominium management association for a condominium you own or a tenant-stockholder in a cooperative housing corporation, you are treated as having paid your proportionate share of any costs of such association or corporation for purposes of these credits.

Nonbusiness Energy Property Credit

You may be able to take a credit of 30 percent of the costs paid or incurred in 2010 for any qualified energy efficiency improvements and any residential energy property. The credit is limited to a total of $1,500 over tax years 2009 and 2010.

Qualified Energy Efficiency Improvements. Qualified energy efficiency improvements are the following improvements to your main home located in the Unites States in 2010 if they are new, can be expected to remain in use at least five years, and meet certain requirements for energy efficiency.

- Any insulation material or system specifically and primarily designed to reduce heat gain or loss in your home;
- Exterior windows (including certain storm windows) and skylights;
- Exterior doors (including certain storm doors); or
- A metal roof or asphalt roof with pigmented coatings or cooling granules that are specifically and primarily designed to reduce the heat gain in your home.

Residential Energy Property Costs. Residential energy property costs are costs of new qualified energy property that is installed on or in connection with your main home that you owned during 2010 located in the United States. Include any labor costs properly allocable to the onsite preparation, assembly, or original installation of the energy property. Qualified residential energy property is any of the following:

- Certain electric heat pump water heaters; electric heat pumps; central air conditioners; natural gas, propane, or oil water heaters; and stoves that use biomass fuel;
- Qualified natural gas, propane, or oil furnaces and qualified natural gas, propane, or oil hot water boilers; or
- Certain advanced main air circulating fans used in natural gas, propane, or oil furnaces.

Residential Energy Efficient Property Credit

You may be able to take a credit of 30 percent of the costs paid or incurred in 2010 for any of the following:

- Qualified solar electric property for use in your home located in the United States;
- Qualified solar water heating property for use in your home located in the United States;

- Qualified fuel cell property installed on or in connection with your main home located in the United States;
- Qualified small wind energy property for use in connection with your home located in the United States; or
- Qualified geothermal heat pump property installed on or in connection with your home located in the United States.

Note: The credit amount for costs paid for qualified fuel cell property is limited to $500 for each one-half kilowatt of capacity of the property.

Home. A home is where you lived in 2010 and can include a house, houseboat, mobile home, cooperative apartment, condominium, and a manufactured home that conforms to Federal Manufactured Home Construction and Safety Standards.

Main Home. Your main home is generally the home where you live most of the time. A temporary absence due to special circumstances, such as illness, education, business, military service, or vacation will not change your main home.

Joint Occupancy. If you owned your home jointly with someone other than your spouse, each owner must complete his or her own federal Form 5695. Your credit is limited to the smaller of:

1. The amount you paid; or

2. $1,500 multiplied by a fraction. The numerator is the amount you paid and the denominator is the total amount paid by you and all other owners.

Joint Ownership of Qualified Property. If you and a neighbor shared the cost of qualifying property to benefit each of your main homes, both of you can take the Nonbusiness Energy Property Credit. You figure your credit on the part of the cost you paid. The limit on the amount of the credit applies to each of you separately.

Claiming the Credit

To claim either of the Residential Energy Credits, you need to complete federal Form 5695 and attach it to your federal Form 1040. Enter the allowable credit amount on line 52 of federal Form 1040.

Note: Also use federal Form 5695 to take any residential energy efficient property credit carryforward from 2009 or to carry the unused portion of the credit to 2011.

For more details on the Residential Energy Credits, please see the instructions for federal Form 5695.

EARNED INCOME CREDIT

The Earned Income Credit (EIC) is a tax credit for certain people who work and have less than $48,362 of earned income. A tax credit usually means more money in your pocket. It reduces the amount of tax you owe. The EIC may also give you a refund.

Claiming the Earned Income Credit

To claim the EIC, you must:

1. Qualify by meeting certain rules; and
2. File a tax return, even if you:
    a. Do not owe any tax;
    b. Did not earn enough money to file a return; or
    c. Did not have income taxes withheld from your pay.

Who Can Qualify for the Earned Income Credit?

To qualify to claim the Earned Income Credit, you must first meet all of the rules (*) listed in *Part A, Rules for Everyone.* Then you must meet the rules in *Part B, Rules If You Have a Qualifying Child*, or *Part C, Rules If You Do Not Have a Qualifying Child*. There is one final rule you must meet in *Part D, Figuring and Claiming the EIC*. You qualify for the credit if you meet all the rules in each part that applies to you.

- If you have a qualifying child, the rules in *Parts A, B,* and *D must* apply to you.
- If you do not have a qualifying child, the rules in *Parts A, C,* and *D must* apply to you.

* Refer to Table 36-1 on the following page as a guide to *Parts A, B, C,* and *D*. The table is a summary of all the rules in each part.

<u>Do You Have a Qualifying Child?</u> Your child is considered a qualifying child only if your child meets the following four tests described below:

1. Relationship,
2. Age,
3. Residency, and
4. Joint return.

These four tests are similar to the standards (defined earlier) that are used to determine if someone is a qualifying child when claiming exemptions for dependents on the federal return.

Table 36-1. Earned Income Credit in a Nutshell.

<table>
<tr><th colspan="2">First, you must meet all the rules in this column.</th><th colspan="2">Second, you must meet all the rules in one of these columns, whichever applies.</th><th>Third, you must meet the rule in this column.</th></tr>
<tr><th colspan="2">Part A.
Rules for Everyone</th><th>Part B.
Rules If You Have a Qualifying Child</th><th>Part C.
Rules If You Do Not Have a Qualifying Child</th><th>Part D.
Figuring and Claiming the EIC</th></tr>
<tr><td>1. Your adjusted gross income (AGI) must be less than:
• $43,352 ($48,362 for married filing jointly) if you have three or more qualifying children,
• $43,352 ($48,362 for married filing jointly) if you have three or more qualifying children,
• $35,535 ($40,545 for married filing jointly) if you have one qualifying child, or
• $13,460 ($18,470 for married filing jointly) if you do not have a qualifying child.</td><td>2. You must have a valid Social Security number.

3. Your filing status cannot be “Married filing separately.”

4. You must be a U.S. citizen or resident alien all year.

5. You cannot file Form 2555 or Form 2555-EZ (relating to foreign earned income).

6. Your investment income must be $3,100 or less.

7. You must have earned income.</td><td>8. Your child must meet the relationship, age, residency, and joint return tests.

9. Your qualifying child cannot be used by more than one person to claim the EIC.

10. You cannot be a qualifying child of another person.</td><td>11. You must be at least age 25 but under age 65.

12. You cannot be the dependent of another person.

13. You cannot be a qualifying child of another person.

14. You must have lived in the United States more than half of the year.</td><td>15. Your earned income must be less than:
• $43,352 ($48,362 for married filing jointly) if you have three or more qualifying children,
• $43,352 ($48,362 for married filing jointly) if you have three or more qualifying children,
• $35,535 ($40,545 for married filing jointly) if you have one qualifying child, or
• $13,460 ($18,470 for married filing jointly) if you do not have a qualifying child.</td></tr>
</table>

How to Figure the Earned Income Credit

To calculate the correct amount for the Earned Income Credit, complete the Schedule EIC Worksheet provided in the instructions for the federal Form 1040. Claim the allowable credit amount on line 64a of the federal Form 1040.

Maximum Available Credit

The following are the maximum available amounts for the Earned Income Credit in the 2010 tax year:

- $5,666 with three or more qualifying children
- $5,036 with two qualifying children
- $3,050 with one qualifying child
- $457 with no qualifying children

Part I – Federal

Section 6

A) Calculating Tax Due and the Bottom Line

- Other Taxes
- Payments
- The Bottom Line

CALCULATING TAX DUE AND THE BOTTOM LINE

Other Taxes

Once you have taken all credits into consideration, you must determine if you are liable for any additional tax under the Other Taxes section of the federal Form 1040.

Self-Employment Tax. You must figure this tax if either of the following applies to you or your spouse if you file a joint return:

- Your net earnings from self-employment from other than church employee income were $400 or more. The term "earnings from self-employment" may include certain nonemployee compensation and other amounts reported to you on Form 1099-MISC; or
- You had church employee income of $108.28 or more.

Self-employment tax is reported on line 56 of the federal Form 1040. Schedule SE should be completed and attached to your return.

Unreported Social Security and Medicare Tax. If you have any unreported Social Security and Medicare tax, you need to enter it on line 57 of the federal Form 1040. Complete and attach either federal Form 4137 or federal Form 8919 (depending on your situation) and check the appropriate box(es).

- Federal Form 4137 – Employees who receive tip income are supposed to report tips of over $20 per month to their employer. If you did not report such tips, you are still required to report the tip income to the IRS using federal Form 4137. To calculate the Social Security and Medicare Tax on your unreported tips use Form 4137. You must also pay this tax if you have any amount shown on your W-2 statement, box 8, "Allocated Tips" that you are including in your income on federal Form 1040, line 7.
- Federal Form 8919 – If you are an employee who received wages from an employer who did not withhold Social Security and Medicare tax from your wages, use federal Form 8919 to figure your share of the unreported tax. Include on line 57 of federal Form 1040 the amount from line 13 of federal Form 8919. Also, include the amount from line 6 of federal Form 8919 on line 7 of federal Form 1040.

Additional Tax on IRAs, Other Qualified Retirement Plans, Etc. If you have an IRA or other qualified retirement plan, you may incur additional taxes for any of the following activities:

- Taking early distributions from (a) an IRA or other qualified retirement plan, (b) an annuity, or (c) a modified endowment contract entered into after June 20, 1988, and the total distribution was not rolled over in a qualified rollover contribution;

- Making excess contributions to your IRAs, Coverdell education savings accounts (ESAs), Archer MSAs, or health savings accounts (HSAs);
- Receiving taxable distributions from Coverdell ESAs or qualified tuition programs; or
- Allowing excess amounts to accumulate in a qualified retirement plan (i.e. failing to take required distributions).

Generally, you must complete federal Form 5329 and attach it to federal Form 1040 to report the tax on excess contributions, early distributions, and excess accumulations. Enter the total additional taxes due on line 58 of the federal Form 1040.

Note: If you must file federal Form 5329, you cannot use federal Form 1040A or Form 1040EZ.

Payments

Tax payments are reported on lines 61 through 72 of the federal Form 1040. The payments are applied to your total tax (line 60) and result in either an overpayment (tax refund) or underpayment (balance due). Tax payments include several of the refundable credits discussed in the previous section (ex. Earned Income Credit) as well as the following:

- **LINE 61 – Federal Withholding on W-2 and 1099**
    - Your Federal Withholding generally is reported on any Forms W-2, W-2G and/or 1099 statements that you may receive. Add the amounts reported as Federal Withholding in Box 2 of your W-2 statements and in Box 4 of your 1099 statements and claim the total amount on line 61 of the federal Form 1040.
    - Remember to attach a copy of your W-2 statement(s) to the front of the federal Form 1040. If you have any 1099 statements showing withholding, you should also attach a copy of that 1099 as well.
- **LINE 62 – Estimated Tax Payments**
    - If you made estimated tax payments throughout the year, add up your estimated payments and report the total on line 62 of the federal Form 1040. Also be sure to include any credit forward amounts from your 2009 Individual Income tax return overpayment (if applicable).
- **LINE 72 – Total Payments**
    - Add the amounts on Form 1040, lines 61 through 71. Report the total amount on line 72. This amount represents your total tax payments throughout the year.

The Bottom Line

When completing your federal individual income tax return, the federal Form 1040 is typically filled with all kinds of facts and figures… but the most important number can usually be found on "the bottom line" and indicates whether you owe any additional taxes or whether you have an overpayment and should expect a refund.

- **LINE 74a or 76 – Refund or Amount You Owe**
  - Determining whether you should expect a refund or have a balance due again involves nothing more than a few simple math calculations. Enter your total payments from line 72, and then subtract your total tax from line 60.
    - → If the result is less than zero (a negative number), then you have a tax refund. Put the answer (ignoring the negative sign) on line 74a.
    - → If the result is greater than zero (a positive number), then you have a balance due. Enter the answer on line 76.
    - → However, if the result is equal to zero, then put "0" (zero) on both lines 74a and 76. Your payments exactly met your tax liability, and you have no refund and no balance due.
  - If you are getting a tax refund, you can choose how much of the amount on line 74a you want refunded to you, and how much you want to be applied to next year's estimated tax payments (line 75).

> **TIP:** If you expect your tax liability to be higher next year, or if you are making estimated tax payments, you should consider applying some of your refund amount towards next year. If you choose this option, enter the amount of your estimated payment on line 75. Then enter the remainder of your refund amount on line 74a. However, if you do not want to make any estimated payments at this time, then enter the full amount of your refund on line 74a.

Part II – Kentucky

Section 1

A) Filing Requirements

- Who Must File
- Filing Charts
- Additional Filing Issues

B) Forms Used

- Residents
- Nonresidents

D) Filing Status

- Options
- Legal Liability

E) Exemptions/Dependents

- Qualifying Child
- Qualifying Relative
- Kentucky Tax Credits
- Dividing Credits

WHO MUST FILE A KENTUCKY RETURN?

Full-Year Residents - If you were a Kentucky resident for the entire year, your filing requirements depend upon your family size, modified gross income, Kentucky adjusted gross income and income from self-employment. You must file a return if your modified gross income exceeds the amount in Chart A **and** your Kentucky adjusted gross income exceeds the amount in Chart B (see next page).

Full-year Nonresidents and Part-year Residents must file a Kentucky return if:

- They had any gross income from Kentucky sources and gross income from **all** sources in excess of modified gross income for their family size, or
- Kentucky gross receipts from self-employment in excess of modified gross income for their family size.

Residents of a Reciprocal State - must file a Kentucky return in order to get a refund of any Kentucky withholding. Kentucky has **reciprocal agreements** with specific states. These agreements provide that taxpayers be taxed on certain types of income by their state of residence, and not the state where income is earned. Kentucky residents are conversely provided the same exemption in each state.

The type of exemptions and states are as follows:

- Wages and Salaries – Illinois, Ohio, West Virginia.
- Wages, Salaries and Commissions – Indiana.
- Income (including salaries and wages) From Personal Services – Michigan, Wisconsin.
- Salaries and Wages, Commuting Daily – Virginia.
- **Ohio Residents** – Effective for calendar years beginning on or after January 1, 2007, the reciprocity agreement with Ohio shall not apply with respect to wages which an S Corporation pays to a shareholder-employee if the shareholder-employee is a "twenty (20) percent or greater" direct or indirect equity investor in the S corporation. Those wages referenced will be taxable to Kentucky and not eligible to be exempted under the reciprocal agreement.

Note: Persons who live in Kentucky for more than 183 days during the tax year are considered residents for tax purposes and reciprocity does not apply.

Gambling Income and Distributive Share Income (Schedule K-1) - are not exempt_from Kentucky tax under reciprocal agreements. A Kentucky Form 740-NP return must be filed if filing requirements are met.

Please use the following charts to determine if a 2010 Kentucky tax return is required to be filed. Use Chart B **if** your Modified Gross Income is **greater** than the amounts in Chart A.

Chart A

If Your **Family Size** is:		Your **Modified Gross Income** is greater than:
One	**and**	$10,830
Two	**and**	$14,570
Three	**and**	$18,310
Four or More	**and**	$22,050

Chart B

If Your **Filing Status** is:		Your **Kentucky Adjusted Gross Income** is greater than:
Single Person — Under age 65	**and**	$3,250
Single Person — Age 65 or over or blind	**and**	$5,250
Single Person — Age 65 or over and blind	**and**	$6,520
Husband and Wife — Both under age 65	**and**	$4,250
Husband and Wife — One age 65 or over	**and**	$5,920
Husband and Wife — Both age 65 or over	**and**	$7,020

ADDITIONAL FILING ISSUES

Excess or Erroneous Withholding – In some cases part-time or part-year workers have income taxes withheld from their paychecks. In many instances, a taxpayer who qualifies for the Family Size Tax Credit will be entitled to a refund, but not be required to file. Even though the filing requirements are not met, an income tax return **must** be filed to claim a refund of the Kentucky taxes withheld.

Children's Responsibility to File – A child meeting the filing requirements must file a return even though being claimed as a dependent by the parent. Kentucky income tax law, as opposed to federal income tax law, contains no special provisions for taxing the income nor reporting the income of a child on the parent's return.

Self-Employed Taxpayers – Any person with gross receipts (before cost of goods sold) from self-employment in excess of modified gross income for their family size in Chart A, must file a **Form 740 - Kentucky Individual Income Tax Return** regardless of the amount of Kentucky adjusted gross income. This may be considered self-employment income, that is, the taxpayer may file federal **Schedule SE - Self-Employment Tax** and actually pay self-employment tax. Shareholders in S-Corporations & Partners in Partnerships must consider the distributive share of gross receipts from the S Corporation or Partnership.

Due Date – The due date of Kentucky Individual Income Tax returns is set by KRS 141.160, which is referenced below:

> **141.160 When returns for income tax are due – Forms – Copy of federal return may be required.**
> (1) All returns of income for the preceding taxable year shall be made by April 15 in each year, **except** returns made on the basis of a fiscal year, which shall be made by the fifteenth day of the fourth month following the close of the fiscal year. Blank forms for returns of income shall be supplied by the department.

A **fiscal year** is defined as a 12-month period at the end of which all accounts are completed in order to provide a statement of a company's, organization's or government's financial condition, or for tax purposes. A fiscal year does not necessarily correspond to a calendar year. In general, individuals filing on a fiscal year basis do so because of business related income, farm income, etc.

> **Tip:** The threshold for a husband and wife living together is the combined modified gross income and combined adjusted gross income of **both** spouses**.** This rule also applies to computations for determining any allowable Family Size Tax Credit.

WHAT FORM SHOULD BE USED?

Full-Year Kentucky Residents should use either Form 740 or Form 740-EZ to file their return, depending on certain criteria, such as filing status, type of income, etc.

Form 740 should be used by taxpayers who:

- Have farm, business, rental and/or capital gain income or losses;
- Itemize deductions;
- Have adjustments to federal adjusted gross income;
- Report on an accrual basis;
- Claim estimated tax payments;
- Have pension income; or
- Members of the military that list Kentucky as their state of residence.

Form 740-EZ may be used if all of the following apply:

- You were a Kentucky resident for the full year
- You are filing Federal Form 1040-EZ;
- Your filing status is single;
- You have no dependents or additional credits; and
- You had only wages, salaries, tips, unemployment compensation, taxable scholarships or fellowship grants, and your taxable interest was $1500 or less.

Part-Year Residents use Form 740-NP to file their return to report income to Kentucky.

Form 740-NP should be used by part-year residents who:

- Move into or out of Kentucky during the year; and
- Earn or receive income while a resident of Kentucky.

Full-Year Nonresidents should use Form 740-NP or Form 740-NP-R to file their return, depending on their tax situation.

Form 740-NP-R should be used by nonresidents that:

- Reside in a reciprocal state (Illinois, Indiana, Michigan, Ohio, Virginia, West Virginia and Wisconsin) and their only Kentucky income is from wages that had Kentucky state tax withheld.

KENTUCKY FILING STATUS

Taxpayers filing **Kentucky Form 740** have four possible choices of filing status for their return. Depending upon the circumstances, taxpayers may choose to file using a <u>different</u> filing status than the filing status chosen for federal purposes. The four Kentucky filing status options are:

Filing Status 1 - Single - Use this filing status if you are unmarried, divorced, widowed, legally separated by court decree, or if you filed as "Head of Household" or "Qualifying Widow(er)" on your federal return. It should be noted that the spouse, if still legally married, that is unable to claim "Head of Household" status for federal purposes will have to utilize Filing Status 4.

Filing Status 2 - Married Filing Separately on a Combined Return - Use this filing status to report your incomes individually but on only one tax form. You may file separately on this combined return regardless of whether you filed jointly or separately for federal purposes if both you and your spouse have income. This filing status usually results in a lower tax than Filing Status 3.

Filing Status 3 - Married Filing Joint Return - Use this filing status if you and your spouse choose to file a joint return even if one spouse had no income. Jointly means that you and your spouse add your incomes together and report in Column B.

Filing Status 4 - Married Filing Separate Returns - If using this filing status, you and your spouse must file two separate tax forms. The husband's income is reported on one tax form, the wife's on the other. When filing separate returns, the name and Social Security number of each spouse must be entered on both returns.

Note: When filing a **Kentucky Form 740-NP**, a taxpayer has only three possible choices for filing status:

- Single,
- Married Filing Joint Return, or
- Married Filing Separate Returns.

Legal Liabilities

Legal liabilities are affected by the choice of filing status. Married persons who file joint or combined returns are jointly and severally liable for all income taxes due for the period covered by the return. That is, each spouse may be held legally responsible for payment of taxes on income earned by the other. If spouses want to credit the refund of one against the liability of the other or combine their tax liabilities or refunds, they must file a combined return. Offsets to outstanding liabilities may also be affected by choice of filing status. If spouses want to keep their tax liabilities and/or refunds separate, each must file a separate tax form.

EXEMPTIONS/DEPENDENTS

As is the case for federal income tax purposes, taxpayers may be entitled to exemptions (tax credits for Kentucky income tax purposes) for themselves and others. Each personal and dependency exemptions (tax credits) is worth the same amount for Kentucky (a $20 tax credit); however, different rules apply to each type.

Kentucky follows federal guidelines as to who qualifies for these exemptions (tax credits).

KRS 141.010(4)

> **141.010 Definitions for chapter.**
>
> As used in this chapter, unless the context requires otherwise:
>
> (4) "Dependent" means those persons defined as dependents in the Internal Revenue Code;

Exemptions for Dependents

You are allowed one exemption/credit for each person you can claim as a dependent. You can claim an exemption/credit for a dependent even if your dependent files a return. The term "dependent" includes:

- A qualifying child, or
- A qualifying relative

Qualifying Child

To qualify, five tests must be met. These tests are:

- Relationship
- Age
- Residency
- Support, and
- Special tests for qualifying child of more than one person

Relationship. Your son, daughter, stepchild, foster child, or a descendent (for example, your grandchild) of any of them, or your brother, sister, half brother, half sister, stepbrother, stepsister, or a descendent (for example, your niece or nephew) of any of them.

Age. To meet this test, a child must be under age 19 at the end of the year, a full-time student under age 24 at the end of the year, or permanently and totally disabled at any time during the year, regardless of age.

Residency. To meet this test, your child must have lived with you for more than half of the year. Exceptions include temporary absences, children who were born or died during the year, kidnapped children, and children of divorced or separated parents.

Support. To meet this test, the child cannot have provided more than half of his or her own support.

Qualifying Child of More Than One Person. If you and another person have the same qualifying child, you and the other person(s) can decide which of you will treat the child as a qualifying child. If you and the other person(s) cannot agree on who will claim the child and more than one person files a return claiming the same child, the IRS will disallow all but one of the claims using a tie-breaker rule.

Qualifying Relative

There are four tests that must be met for a person to be your qualifying relative. The four tests are:

- Not a qualifying child,
- Member of household or relationship,
- Gross income, and
- Support test

Not a Qualifying Child. A child is not your qualifying relative if the child is your qualifying child or the qualifying child of any other taxpayer.

Member of Household Or Relationship Test. To meet this test, a person must either live with you all year as a member of your household, or be related to you in one of the ways listed under "Relatives you do not have to live with you".

Gross Income. To meet this test, a person's gross income for 2010 must be less than $3,650.

Support. To meet this test, you generally must provide more than half of a person's total support during the calendar year.

Kentucky Tax Credits – Overview

Status			Amount of Credit(s)
a.	Single (unmarried individual) **KRS 141.020(3)(a)**		$20
b.	Married (filing separate) Spouse (no Ky. income and not a dependent of another taxpayer) **KRS 141.020(3)(b)** $20 for self and $20 for spouse		$40
c.	Married (filing joint) (Neither Spouse dependent of someone else) **KRS 141.020(3)(c)**		$40
d.	Dependent (each) (Not allowed for any dependent who has made a joint return with his spouse) **KRS 141.020(3)(c)**		$20
e.	Age 65 **KRS 141.020(3)(d)**	**Additional**	$40
f.	Married (filing separate) but Spouse is 65, has no Ky. gross income and not a dependent of another taxpayer **KRS 141.020(3)(e)** **Additional** $40 for spouse being age 65		$40
g.	Blind **KRS 141.020(3)(f)**	**Additional**	$40
h.	Married (filing separate) Spouse is blind, has no Ky. gross income and not a dependent of another taxpayer. **KRS 141.020(3)(g)** $40 for spouse being blind	**Additional**	$80
i.	Nonresidents **KRS 141.020(3)(h)**		Prorated
j.	Part-year Resident **KRS 141.020(3)(i)**		Prorated
k.	Member of Ky. National Guard **KRS 141.020(3)(1)**	**Additional**	$20

Tax Credits - Specific

Yourself – You are always allowed to claim a tax credit for yourself (even if your parent(s) can claim a credit for you on their return). On Form 740, Section B, line 1(a), there are five boxes under three separate headings. First, check the box under "Check Regular" to claim a tax credit for yourself. If you are 65 or older, then check the next two boxes on the line. If you are legally blind, then check the last two boxes on the line.

Your Spouse – Do not fill in Section B, line 1(b) if (1) you are single; (2) you are married and you and your spouse are filing two separate returns; or (3) your spouse received more than half of his or her support from another taxpayer. However, if your spouse died during the taxable year, you may claim a credit for the deceased on line 2(b).

- Fill in Section B, line 1(b), Form 740, if you are married and (1) you and your spouse are filing a joint or combined return, or (2) if your spouse had no income or is not required to file a return. If you meet these criteria, check the first box on line 1(b) for your spouse. If your spouse is 65 or older, check the next two boxes. If your spouse was legally blind at the end of the taxable year, check the last two boxes on line 1(b).

Dependents – You are allowed to claim a tax credit for each person defined as a dependent in the Internal Revenue Code. Generally, dependents who qualify for federal purposes also qualify for Kentucky.

- Use Section B, line 2, Form 740, to claim tax credits for your dependent children, including stepchildren and legally adopted children, who lived with you during the taxable year, dependents who did not live with you and to claim tax credits for other persons who qualify as dependents. You must include the dependent’s Social Security number, along with the dependent’s relationship to you. You must also check the box at the end of line 2 if the dependent qualifies to be counted to determine family size credit.

- Children of Divorced or Separated Parents - Attach a copy of federal Form 8332 filed with your federal return.

- Tax Credits for Individuals Supported by More than One Taxpayer - Attach a copy of federal Form 2120 - Multiple Support Declaration filed with your federal return.

National Guard Members – Persons, who are members of the Kentucky National Guard on December 31, may claim an additional credit in Section B, line 2. Designate this credit with the initials "N.G." Kentucky law specifically restricts this credit to Kentucky National Guard members; military reserve members are not eligible.

Dividing Credits

Each taxpayer must claim all of his or her own tax credits including the credits for age and blindness. Therefore, if married, each spouse must claim at least one credit.

Please note that spouses may choose how to divide tax credits for dependents, or one spouse may claim all dependent credits and the other none.

Example 1 – A husband who is 65 and a wife who is 60 are filing a combined return. The husband must claim three credits (one regular and two for being 65 or older), and the wife must claim one.

Example 2 – A husband and wife have two dependents. The husband must claim his regular credit, and the wife must claim hers. However, the two dependent credits may be claimed by either spouse, or each spouse may claim one.

Example 3 – A husband and wife elect to file separate returns. The wife does not have any Kentucky income. The wife is also 65 and is blind. The husband must claim his regular credit in Section B, line 1a and is also able to claim his spouse's regular credit plus the extra for being 65 and blind. The wife's credits are not considered dependency credits, but personal and consequently reflected on Section B, line 1(b).

Part II – Kentucky

Section 2

A) Kentucky Starting Point

- Federal Adjusted Gross Income

B) Allocation of Income

- Income Items
- Adjustments to Income

C) Sample Allocation Worksheet

COMPLETING KENTUCKY FORM 740

Since 1990, Kentucky tax returns have started with Federal Adjusted Gross Income (FAGI). As is the case with many tax laws, there are often exceptions to the rule. In this case the exception is the taxpayer who qualifies to file a reciprocal return. This situation will be addressed later in the material.

Statutory Authority

Portions of KRS 141.010 (9) and (10) are listed for reference. See the entire statute for complete information.

> *(9) "Gross income," in the case of taxpayers other than corporations, means "gross income" as defined in Section 61 of the Internal Revenue Code;*
>
> *(10) "Adjusted gross income," in the case of taxpayers other than corporations, means gross income as defined in subsection (9) of this section minus the deductions allowed individuals by Section 62 of the Internal Revenue Code and as modified by KRS 141.0101 and adjusted as follows, except that deductions shall be limited to amounts allocable to income subject to taxation under the provisions of this chapter, and except that nothing in this chapter shall be construed to permit the same item to be deducted more than once*

For single taxpayers or a taxpayer who is married filing a joint return, begin the Kentucky return by entering the amount from **federal Form 1040-EZ, 1040-A** or **1040** identified as federal adjusted gross income as appropriate on line 1, **Kentucky Form 740-EZ** or line 5, **Kentucky Form 740.**

However, if taxpayers are married and filing separate returns or filing separately on a combined return, Federal AGI must be divided among each respective spouse. In addition, each spouse must claim his or her own income and/or deductions. The simplest way to divide the income is to prepare a worksheet reflecting each income and adjustment item. Simply take each income and adjustment item reflected on the federal return and list on the worksheet in the appropriate column for the appropriate taxpayer.

ALLOCATION OF INCOME

Income Items

- **Wages** from **Form W-2 (Form K-2)** must be claimed by the taxpayer earning income.
- **Interest** is credited to the spouse earning such income. If the instrument providing the interest is in both names, then the income is considered to have been earned jointly. Accordingly, in this situation, interest would be divided 50% to each spouse.
- **Tax exempt** interest, for Federal purposes, is divided the same way.

  Note: Exempt interest for federal purposes is not included in federal adjusted income, thus, it would be an addition on the Kentucky return.

- **Ordinary dividend** income is divided in the same manner as interest income.
- **Tax Refunds** are prorated based on the year's income which generated the refund.

  Example – A couple's 2009 federal AGI was $50,000 of which $30,000 (or 60 percent) was attributable to the wife. They jointly received a $100 Kentucky refund that should be reported on their 2010 federal return. The wife would be allocated $60 (60% x $100) and the husband allocated $40 (40% x $100).

- **Alimony income** is reported by the spouse who receives same.
- **Business income** (Schedule C, F, or E) is reported by the individual which is earning the income. If both husband and wife have capital contributed and both are actively involved in the production of income, they can prorate the business income accordingly. For rental property, which is held in joint names, the income can be reported 50% to each spouse.
- **Capital gains and losses** (Schedule D) should be reported by the individual who owned the asset. If the asset was jointly owned, then the gain/loss should be divided equally.
- **Pensions and annuities** should be reported by the individual who is receiving the income.
- **Unemployment compensation** is reported by the person receiving the compensation.
- **Social Security income** that is reported as taxable is allocated to each spouse if both receive Social Security benefits.

- **Other income** such as lottery winnings, jury duty pay, etc. is reported by the spouse who receives the income.

Adjustments to Income

Adjustments to gross income are similar to income in that each spouse must claim their own adjustments. Adjustments are deducted from total income to arrive at the federal adjusted gross income.

Common adjustments include items such as allowable contributions to an Individual Retirement Account (IRA), alimony you pay and student loan interest you pay. Please refer to material earlier in this manual for additional information on adjustments to income. Some, but not all, additional adjustments to income include the following:

- Educator expenses
- Health savings account deductions
- Moving expenses
- One-half of self employment tax
- Payments to SEP, SIMPLE & qualified plans
- Self-employed health insurance
- Penalty on early withdrawal of savings
- Tuition and fees deduction
- Domestic production activities deduction

Note: In some instances, an allowable adjustment for federal income purposes may not be allowed for Kentucky. In that situation, a Schedule M adjustment would be necessary to arrive at the correct Kentucky adjusted gross income.

For additional information on adjustments to income, please see IRS Publication 17.

Sample Worksheet for Allocating Federal Adjusted Gross Income

Name: ____ SSN: ____

____ ____

Income	Spouse	Yourself or Joint	Total
Wages, salaries, tips, etc.			
Taxable interest			
Tax exempt interest			
Ordinary dividends			
Taxable refunds, credits or offsets of state & local income taxes			
Alimony received			
Business income or (loss)			
Capital gain or (loss)			
Other gains or (losses) - Attach Form 4797			
Taxable IRA distributions			
Taxable pensions and annuities			
Rents, royalties, partnerships, estates, trusts, etc.			
Farm income or (loss)			
Unemployment compensation (insurance)			
Taxable Social Security benefits			
Other income - Specify (prizes & awards)			
Add the amounts — **Total Income**			

Adjustments to Income	Spouse	Yourself or Joint	Total
Educator expenses ……………………………………….			
Certain business expenses or reservists, performing			
IRA deduction ………………………………………………			
Student loan interest deduction ……………………			
Tuition and fees deduction ……………………………			
Health savings account deduction …………………			
Moving expenses ……………………………………………			
One-half of self-employment tax …………………..			
Self-employed health insurance deduction …….			
Self-employed SEP, SIMPLE, and qualified plans			
Penalty on early withdrawal of savings ………….			
Alimony paid ………………………………………………..			
Domestic production activities deduction ………			
Additional federal allowable adjustments* …..			
Add total adjustments …………………………………..			
Subtract total adjustments from total income. This is your federal adjusted gross income. ……..			

* Adjustments may vary due to legislation specific to tax year involved.

TOTAL OF COLUMNS MUST EQUAL FEDERAL ADJUSTED GROSS INCOME

Part II – Kentucky

Section 3

A) Federal/State Differences

- IRC Code
- Provisions Adopted after Code Date

B) Schedule M

- Additions
- Subtractions

C) Schedule P

- When to Use
- Exclusion Amount
- Public Pension
- Private Pension
- Eligible Distributions
- Computation

FEDERAL/STATE DIFFERENCES

IRC Code – The foundation for Kentucky income tax law has always been grounded in the Internal Revenue Code as of a certain date. The 2007 General Assembly, through House Bill 258, amended KRS 141.010(3) to advance the Internal Revenue Code (IRC) reference date for state individual and corporation income tax purposes to **December 31, 2006**, exclusive of any amendments made subsequent to that date, other than amendments which extend provisions in effect on December 31, 2006.

Exceptions – For Kentucky purposes there are currently two notable exceptions to the December 31, 2006 IRC Code Date:

- Depreciation & Section 179 expense deductions are subject to the IRC Code as of December 31, 2001

- The provisions of the Military Family Tax Relief Act of 2003 – Kentucky has adopted these provisions, but each part has a different effective date

Provisions of the Code Enacted after December 31, 2006

The IRC code is constantly changing through the legislative process. New laws are created that impact individual income tax by various means including creating new taxes, new deductions or credits or changing existing tax laws. Often changes include extending effective dates or changing dollar threshold amounts.

Federal legislation enacted after the IRC code date of December 31, 2006 will not apply to the 2010 Kentucky individual income tax returns. One example of this type of legislation is the American Recovery and Reinvestment Act of 2009, which was passed by Congress and signed into law on February 17, 2009.

Note: Remember each year is subject to the tax laws in effect for Kentucky at that time for the year involved. If you have questions about any changes that might impact the Kentucky tax treatment reference the appropriate Kentucky Income Tax Seminar for Practitioners workbook used in the University of Kentucky tax schools or utilize the IRS website for updates and new legislation.

Transitional Differences – Are differences that only exist until the next time the General Assembly updates the Internal Revenue Code date in **KRS 141.010(3)** to the current Internal Revenue Code or any exceptions to the code. Depreciation is an example of a transitional difference.

Traditional Differences – Are differences that will always exist between the Kentucky and Federal tax returns regardless of whether or not there is a code update. An example of this is Kentucky's pension exclusion.

ADJUSTING FOR DIFFERENCES BETWEEN KENTUCKY & FEDERAL LAW

Schedule M Kentucky Federal Adjusted Gross Income Modifications

Individuals should use Kentucky Schedule M to adjust for differences between federal and Kentucky income. This schedule is designed to accommodate the necessary changes to convert federal adjusted gross income (FAGI) to Kentucky adjusted gross income (KAGI).

Depending on the type of income involved, it may be necessary to either add or subtract amounts from federal adjusted gross income to arrive at the correct Kentucky adjusted gross income. Information on both types of adjustments follows.

Additions to Federal Adjusted Gross Income

Part 1 of Schedule M is used to report additions to FAGI. They include:

- Line 1 Other States Municipal Bond Interest Income
- Line 2 Self-Employed Health Insurance Deduction (federal Form 1040, line 29)
- Line 3 Resident Adjustment- Kentucky Schedule K-1
- Line 4 Federal Depreciation (amount from federal Form 4562)
- Line 5 Federal Net Operating Loss (NOL)
- Line 6 Federal Domestic Production Activities Deduction (amount from federal Form 8903)
- Line 7 Other Additions which includes:
    - Lump-sum distributions,
    - Differences in pension and IRA bases,
    - Passive activity loss adjustments,
    - Differences in gains or losses from the sale of intangible assets amortized under the provision of the Revenue Reconciliation act of 1993,
    - Differences in gains (losses) from the sale of depreciable property placed in service after September 10, 2001.

Subtractions from Federal Adjusted Gross Income

Part 2 of Schedule M is used to report subtractions to FAGI. They include:

- Line 9 State income tax refund or credit reported as income
- Line 10 Interest income from U.S. Government bonds and securities
- Line 11 Excludable amount of retirement income. Schedule P must be attached if greater than $41,110. *(Note: Schedule P will be discussed later in this material.)*
- Line 12 Taxable amount of Social Security and Railroad Retirement Board benefits
- Line 13 Long-term care insurance premiums
- Line 14 Health insurance premiums not previously deducted from your income. Do not include premiums paid with pretax dollars (cafeteria plans)
- Line 15 Resident adjustment from partnerships, fiduciaries and S corporations, Schedule K-1
- Line 16 Kentucky Depreciation from revised Form 4562, and
- Line 17 Kentucky Net Operating Loss (NOL)
- Line 18 Kentucky Domestic Production Activities Deduction
- Line 19 Other Subtractions include:
    - Capital gains on sales of Kentucky Turnpike bonds,
    - Capital gains on property taken by eminent domain,
    - Income for training or working at an election booth,
    - Income from the Tobacco Master Settlement, Tobacco Loss Assistance Program (TLAP), Tobacco Quota Buy down exemption,
    - Wage expense from the Work Opportunity Credit,
    - Child's income reported on a parent's return,
    - Differences in gains or losses from the sale of intangible assets amortized under the provision of the Revenue Reconciliation act of 1993,
    - Differences in gains (losses) from the sale of depreciable property placed in service after September 10, 2001, at-risk limitations,
    - Passive activity loss adjustment, and
    - Income of military personnel killed in the line of duty.

SCHEDULE M

Form 740
42A740-M
Department of Revenue ➤ Attach to Form 740.

2010

KENTUCKY
FEDERAL ADJUSTED GROSS INCOME
MODIFICATIONS

Enter name(s) as shown on tax return. | Your Social Security Number

PART I **ADDITIONS TO FEDERAL ADJUSTED GROSS INCOME**

		A. Spouse (Use if Filing Status 2 is checked.)		B. Yourself (or Joint)
1 Enter interest income from bonds issued by other states and their political subdivisions	1	00	1	00
2 Enter self-employed health insurance deduction from federal Form 1040, line 29	2	00	2	00
3 Enter resident adjustment from partnerships, fiduciaries and S corporations, Schedule K-1	3	00	3	00
4 Enter federal depreciation from Form 4562	4	00	4	00
5 Enter federal Net Operating Loss	5	00	5	00
6 Enter federal domestic production activities deduction from federal Form 8903, line 25	6	00	6	00
7 Other additions (list and enter total): (a) ______ (b) ______ (c) ______	7	00	7	00
8 Total Additions. Enter here and on Form 740, page 1, line 6	8	00	8	00

PART II **SUBTRACTIONS FROM FEDERAL ADJUSTED GROSS INCOME**

		A. Spouse		B. Yourself
9 Enter state income tax refund or credit **reported** as income on federal Form 1040	9	00	9	00
10 Enter interest income from U.S. government bonds and securities	10	00	10	00
11 Enter excludable amount of retirement income (attach Schedule P if more than $41,110)	11	00	11	00
12 Enter taxable amount of Social Security and Railroad Retirement Board benefits from federal Form 1040, line 20(b) (1040A, line 14(b))	12	00	12	00
13 Enter long-term care insurance premiums	13	00	13	00
14 Enter health insurance premiums not previously deducted from income. Do not include premiums paid with pretax dollars (cafeteria plan)	14	00	14	00
15 Enter resident adjustment from partnerships, fiduciaries and S corporations, Schedule K-1	15	00	15	00
16 Enter Kentucky depreciation from revised Form 4562	16	00	16	00
17 Enter Kentucky Net Operating Loss	17	00	17	00
18 Enter Kentucky domestic production activities deduction (see instructions)	18	00	18	00
19 Other subtractions (list and enter total): (a) ______ (b) ______ (c) ______	19	00	19	00
20 Total Subtractions. Enter here and on Form 740, page 1, line 8	20	00	20	00

2010 FEDERAL/KENTUCKY INDIVIDUAL INCOME TAX DIFFERENCES

Kentucky income tax law is based on the federal income tax law in effect on December 31, 2006. The Department of Revenue generally follows the administrative regulations and rulings of the Internal Revenue Service in those areas where no specific Kentucky law exists.

The chart below provides a quick reference guide to the major federal/Kentucky differences. It is not intended to be all inclusive. Items not listed may be referred to the Department of Revenue to determine Kentucky tax treatment.

PROVISION	FEDERAL TAX TREATMENT	KENTUCKY TAX TREATMENT
1. Interest from Federal Obligations	Taxable	Exempt
2. Retirement Income from:		Partially exempt if retired after December 31, 1997; exempt if retired before January 1, 1998; Schedule P may be required
Commonwealth of Kentucky Retirement Systems	Taxable	
Kentucky Local Government Retirement Systems	Taxable	
Federal and Military Retirement Systems	Taxable	
3. Pensions and Annuities Starting After 7/1/86 and Before 1/1/90	3-year recovery rule eliminated	3-year recovery rule retained
4. Other Pension and Annuity Income	Taxable	100% excludable up to $41,110; Schedule P may be required
5. Benefits from U.S. Railroad Retirement Board	May be taxable	Exempt; Schedule P may be required
6. Social Security Benefits	May be taxable	Exempt
7. Capital Gains on Sale of Kentucky Turnpike Bonds	Taxable	Exempt
8. Other States' Municipal Bond Interest Income	Exempt	Taxable
9. Kentucky Local Government Lease Interest Payments	Taxable	Exempt
10. Long-Term Care Insurance Premiums Paid With After-Tax Dollars	Limited deduction as self-employed health insurance	100% adjustment to gross income
11. Medical and Dental Insurance Premiums Paid With After-Tax Dollars	Limited deduction as self-employed health insurance	100% adjustment to gross income
12. Capital Gains on Property Taken by Eminent Domain	Taxable	Exempt
13. Election Workers—Income for Training or Working at Election Booths	Taxable	Exempt
14. Artistic Contributions	Noncash contribution allowed as itemized deduction	Appraised value allowed as itemized deduction or adjustment to income
15. State Income Taxes	Deductible	Nondeductible
16. Leasehold Interest—Charitable Contribution	May be deductible	Deductible; Schedule HH required
17. Kentucky Unemployment Tax Credit	No credit allowed	$100 per certified employee; Schedule UTC required
18. Work Opportunity Credit (federal Form 5884)	Tax credit allowed; wage expense reduced by amount of credit	No credit allowed; entire wage expense is deductible
19. Welfare to Work Credit (federal Form 8861)	Tax credit allowed; wage expense reduced by amount of credit	No credit allowed; wage expense reduced by amount of federal credit
20. Child and Dependent Care Credit	Tax credit based on expenses	20% of federal credit
21. Family Size Tax Credit	No credit allowed	Decreasing tax credit allowed
22. Education Tuition Tax Credit	Tax credit based on expenses	Credit allowed Form 8863-K required
23. Taxpayer Who May be Claimed as Dependent on Another's Return (i.e., full-time student)	May not claim self	May claim self
24. Child's Income Reported by Parent	Permitted; taxed at parent's rate	Not permitted
25. National Tobacco Settlement TLAP Income Quota Buyout (including imputed interest)	Taxable	Exempt
26. Bonus Depreciation/Additional Section 179 Expense	Deductible	Nondeductible
27. Mortgage Debt Forgiveness	Exempt	Taxable
28. Domestic Production Activities Deduction	Deductible	Deductible; may be limited
29. Active Duty Military Pay	Taxable	Exempt

SCHEDULE P KENTUCKY PENSION INCOME EXCLUSION

Kentucky offers taxpayers the pension exclusion, which is also a federal/state difference. This means that for Kentucky purposes, pension income, within certain limitations, may be excluded from Kentucky tax.

Schedule P should be used in the following situations:

- Your taxable pension and retirement income from all sources is **greater** than $41,110; and you are retired from **the federal government, the Commonwealth of Kentucky** or **a Kentucky local government**; or,
- You receive supplemental U.S. Railroad Retirement Board benefits; or,
- You file Form 4972-K – Tax on Lump-Sum Distributions.

Exclusion Amount

The allowable pension exclusion amount for 2010 has been set at $41,110. However, some taxpayers may qualify to exclude amounts above that amount depending on their pension circumstances.

Note: The pension income exclusion applies to each taxpayer separately.

Exempt Retirement Benefits That Do Not Reduce the Pension Exclusion

The following types of retirement benefits are exempt and may be deducted from federal adjusted gross income without reducing the pension exclusion:

- Social Security and U.S. Railroad Retirement Board Benefits
- Supplemental Annuities from the U.S. Railroad Retirement Board
- Commonwealth of Kentucky Retirement Systems – **All** benefits **if** retired before January 1, 1998, and benefits accruing for service before January 1, 1998, if retired after December 31, 1997.
- Kentucky Local Government Retirement and Federal and U.S. Military Retirement Systems – **All** benefits **if** retired before January 1, 1998, and benefits accruing for service before January 1, 1998, if retired after December 31, 1997.

Public Pension Income

Public pension income is considered income from plans established for public employees by the federal government and Kentucky and its political subdivisions (includes Kentucky Teachers' Retirement System, Kentucky State Employees' Retirement System, County Employees' Retirement System (KY), Kentucky State Police Retirement System, Kentucky Judicial Retirement Plan, Kentucky Legislators' Retirement Plan, Kentucky State - Supported Institutions of Higher Education Retirement Plans (institution-sponsored), Kentucky Local Government Retirement Systems, Federal and Military Retirement Systems, and any other plans authorized by the Kentucky Revised Statutes). This income is generally reported on Federal Form 1040, line 16b or Federal Form 1040-A, line 12b.

Private Pension Income

Private pension income includes income from all pension plans, including private disability pensions and annuities, profit-sharing plans, retirement plans, employee savings plans, stock bonus plans, IRAs, or any other plan created or organized under a **written retirement plan** for the exclusive benefit of employees. Deferred compensation benefits (457 and 401(k) plans) paid to federal, state and local retirees will always be considered private pension income.

As a general rule, private pension incomes are reported on the federal income tax return as IRA income or as pension or annuity income (Federal Form 1040 lines 15b and/or 16b, or Federal Form 1040A lines 11b and/or 12b).

Pension Income Included in Wages

Pension income from disability pension and annuities or some deferred compensation distributions may also be reflected on line 7 of the Federal Form 1040 or 1040A (Wages, Salaries, Tips, etc.), because such income is reflected on a W-2 wage statement. These private disability pension and annuity incomes, deferred compensation distributions and death benefits are eligible for the 100 percent pension income exclusion up to $41,110 for 2010.

If the private pension income is from a lump-sum distribution and reported for income averaging on **Federal Form 4972**, the individual will still be eligible for the pension income exclusion. **Kentucky Form 4972-K - Kentucky Tax on Lump-Sum Distributions** and **Kentucky Schedule P – Pension Income Exclusion** must be completed.

Statutory Authority

KRS 141.010 (10) (i) excludes the applicable amount of pension distributions. In the case of private pensions, the exclusion amount is determined by **KRS 141.0105** which allows for annual indexing and is set for 2010 at $41,110. Private pensions are the Department's designation of pensions that were not exempt from taxation prior to enactment of **KRS 141.010(10) (i)**. The exclusion for public pension is determined by **KRS 141.0215**.

Change in Pension Law

Public pension income earned **before** 12/31/1997 and earned **after** 1/1/1998 is subject to different tax treatment. Previously, exempt public pensions continued to be fully exempt through 1997. In other words, Kentucky law provides that any pension payments received from public sources (federal, Kentucky state and Kentucky local) for work performed **prior** to 1/1/98, are not to be reflected in taxable income and do not infringe on the excludable amount. However, for persons who have retired subsequent to December 31, 1997, a portion of their public pension attributable to work performed **after** 1997 must be included with all other retirement income to determine the excludable amount.

Eligible Distributions

In accordance with **KRS 141.010(10)(i)** the exclusion extends to the applicable amount of total distributions from pension plans, annuity contracts, profit-sharing plans, retirement plans, or employee savings plans. Consider the following:

"Distributions" includes but is not limited to any lump-sum distribution from pension or profit-sharing plans qualifying for the income tax averaging provisions of **IRC Section 402**; any distribution from an individual retirement account as defined in **Section 408** of the Internal Revenue Code; and any disability pension; **KRS 141.010(10)(i)(3)a**;

"Annuity Contract" has the same meaning as set forth in **IRC Section 1035**; **KRS 141.010(10)(i)(3)b** and "Pension plans, profit-sharing plans, retirement plans or employee savings plans" means any trust or other entity created or organized under a written retirement plan and forming part of a stock bonus, pension, or profit-sharing plan of a public or private employer for the exclusive benefit of employees or their beneficiaries and includes plans qualified or unqualified under **Section 401** of the Internal Revenue Code and individual retirement accounts as defined in **Section 408** of the Internal Revenue Code. **KRS 141.010(10) (i)(3)c**

KRS 141.010(10)(i)(3)a exempts "Disability Pensions". These benefits are distributions received before the minimum retirement age set by the plan and must be reported and taxed as wages on line 7, federal Form 1040.

The following list depicts the eligibility of some of the more common types of pensions:

Type of Pension	**Eligible**
Employer Sponsored Qualified Plan	Yes
Employer Sponsored Non-Qualified Plan	Yes
SIMPLE	Yes
KEOGH	Yes
Simplified Employee Pension - IRA	Yes
Deferred Compensation Plans including IRC 457 & IRC 401(K) **(See note #2 on following page.)**	Yes
Annuities	Yes
Lump-Sum Distributions	Yes
Disability Pension - Employer Provided **(See note #3 on following page.)**	Yes
IRA	Yes
ROTH IRA	Yes, if taxable distribution
EDUCATION IRA (Coverdell Education Savings Account) **(See note #4 on following page.)**	**No**
Income from converting a traditional IRA to a ROTH IRA	Yes
Income from converting a traditional IRA to a ROTH IRA - if reported ratably over four years	Yes, in each of the four years
Death Benefits **(See note #5 on following page.)**	Yes

Pension Exclusion Reference Notes

(1) Any distribution is eligible regardless of the reason for the distribution and is applicable regardless of age.

(2) Deferred compensation plans are always considered private.

(3) KRS 141.010(10)(i)(3)a exempts “Disability Pensions.” These benefits are distributions received before the minimum retirement age set by the plan and must be reported and taxed as wages on line 7, Federal Form 1040.

(4) EDUCATION IRA - Distributions are not eligible for the exclusion. Although "IRA" is used to designate the plan and it is a long term savings plan, contributions to this plan are not included in determining maximum contributions to other "IRA" plans and it is not a method of planning for retirement.

(5) DEATH BENEFITS - The **Small Business Job Protection Act of 1996** repealed IRC Section 101(b**)** and amended IRC Sections 101(c), 406(e), 407(e), and 7701(a)(20**)** relative to the death benefit exclusion.

Benefits paid by or on behalf of an employer by reason of the employee's death are no longer excludable for decedents dying after August 20, 1996.

Death benefits are now considered income under the Internal Revenue Code and, therefore, included in the computation of Kentucky adjusted gross income. However, a death benefit paid under a retirement plan is eligible for the pension income exclusion allowed under **KRS 141.010(10).**

A benefit paid by a federal, Kentucky state or Kentucky local retirement system after December 31, 1997 must be included in Kentucky gross income at the rate that other retirement benefits are included. If the deceased was retired before January 1, 1998, his or her benefits including the death benefit would remain fully tax exempt.

COMPUTING THE EXCLUSION

Part I – Exempt Retirement Income

Enter the federally taxable portion of pension income paid by the federal government, by the Commonwealth of Kentucky, or by any Kentucky local government. Also, include supplemental U.S. Railroad Retirement Board benefits reported on Federal Form 1040, line 16(b) or Federal Form 1040-A, line 12(b), and federal or Kentucky disability retirement income included on Federal Form 1040 or 1040-A, line 7. Do not include income from deferred compensation plans in Part I.

Line 1(a) Use if retired before January 1, 1998, to report fully exempt pension benefits.

Line 1(b) Use if retired after December 31, 1997, to compute the amount of pension income attributable to service credits earned before January 1, 1998. Multiply the taxable pension by the exempt percentage, enter the result (exempt amount) in Column A or Column B.

TIP: Subtract the exempt amount from the taxable pension amount and include the difference with other retirement income in Part II.

Part II – Other Retirement Income

Line 2 – Enter the amount reported on Federal Form 1040 or 1040-A of non-lump-sum pension and retirement income not reported on line 1(c). Also, include amounts from Schedule M, line 7 (Form 740-NP, line 45) that reflect pension and IRA bases differences.

Part III – Total To Be Excluded This Year

Line 3 – Enter the lesser of the amount on line 2 or $41,110.

Line 4 – Enter the total of lines 1(c) and 3. This is your pension income exclusion. Enter on line 4 and as follows: Schedule M, line 11; Form 740-NP, page 4, line 10(b); or Form 741, page 1, line 11.

WORKSHEET FOR PUBLIC RETIREES WHO RETIRE AFTER 12/31/97

Public retirees who retire after 12/31/97, and have service credit for pension income after that date, must complete the worksheet on the back of Schedule P to determine the percentage of exempt pension income. Once the exempt percentage is determined it will not change.

Line 1 – Total service credit (includes purchased time, purchased military time and sick leave). This will not change once established. This information can/should be secured from the administrator (payor) of the plan.

Line 2 – Service credit earned after 12/31/97. This will not change once established.

- Do not include time purchased pursuant to IRC §415(n).
- Include sick leave credited at date of retirement and service credit from the purchase of military and other service earned after 12/31/97, based on dates of service.

Line 3 – Total months of service before January 1, 1998. Subtract line 2 from line 1.

Line 4 – Exempt percentage based on a ratio of total months of service before January 1, 1998, to total months of service credit. Divide line 3 by line 1.

- This percentage is utilized to determine the amount of pension attributable to service earned before 1/1/98.
- This is determined in the year of retirement, will never change and is reflected in **Part I – Exempt Retirement Income,** line 1b.

SCHEDULE P **2010**

42A740-P

Department of Revenue

Use this form to calculate excludable retirement income.

KENTUCKY PENSION INCOME EXCLUSION

➤ **Attach to Form 740, 740-NP or 741.**

Enter name(s) as shown on tax return.	Your Social Security Number

Complete this schedule and file with Form 740 if:

1. your taxable pension and retirement income from all sources is **greater than $41,110**; and
   (a) you are retired from the federal government, the Commonwealth of Kentucky or a Kentucky local government; or
   (b) you receive supplemental (Tier 2) U.S. Railroad Retirement Board benefits.
2. you file Form 4972-K, Tax on Lump-Sum Distributions.

All others, STOP, you do not need to complete Schedule P. See instructions for Schedule M, line 11.

PART I—EXEMPT RETIREMENT INCOME (Do Not Include Income From Deferred Compensation Plans)

1. Enter on line (a) or (b) the amount of federal, Kentucky state and Kentucky local government pension income attributable to service credit earned before January 1, 1998, and supplemental (Tier 2) U.S. Railroad Retirement Board benefits included on federal Form 1040, line 16(b) (Form 1040A, line 12(b)). Also include federal or Kentucky disability retirement income attributable to service credit earned before January 1, 1998.

(a) If date of retirement is **before January 1, 1998**, enter here.

Names of Payers	Date of Retirement	A. Spouse	B. Yourself
	Total ➤		

(b) If date of retirement is **after December 31, 1997**, see the instructions.

Names of Payers	Date of Retirement	Taxable Pension	Exempt Percentage	A. Spouse	B. Yourself
			Total ➤		

(c) Add lines 1(a) and 1(b) .... (c)

PART II—OTHER RETIREMENT INCOME (Amounts Not Included in Line 1(c))

2. Enter the total of taxable retirement income not included in line 1(c) above as reported on federal Form 1040, line 15(b) and 16(b) (Form 1040A, line 11(b) and 12(b)). Also report other disability retirement income or deferred compensation included on federal Form 1040, line 7 (Form 1040A, line 7) 2

PART III—TOTAL TO BE EXCLUDED THIS YEAR

3. Enter the lesser of line 2 or $41,110 3
4. Add lines 1(c) and 3. Enter here and on Schedule M, line 11 (Form 740-NP, page 4, line 10(b) or Form 741, line 11) 4

***Joint filers**— Combine lines 4(a) and 4(b) and enter on appropriate form.*

STOP **Stop here unless you have a lump-sum distribution reported on Form 4972-K.**

Form 4972-K Filers—If line 3 is less than $41,110, enter the amount on Form 4972-K, Part II, line 2.

INSTRUCTIONS—SCHEDULE P

Types of Income Subject to Exclusion—All pension and retirement income paid under a written retirement plan is eligible for exclusion. This includes pensions, annuities, IRA accounts, 401(k) and similar deferred compensation plans, death benefits, and other similar accounts or plans. As a general rule, if the income is reported on the federal income tax return, Form 1040, line 15(b) or 16(b); Form 1040A, line 11(b) or 12(b); Form 4972; or is a disability retirement benefit or deferred compensation distribution reported on Form 1040, line 7 or 1040A, line 7, then it qualifies for the exclusion.

Form 740-NP filers report only pension income received while a resident of Kentucky.

LINE-BY-LINE INSTRUCTIONS

Column A, Column B—This exclusion is for each taxpayer. A husband and wife must compute and claim their own exclusion, regardless of filing status.

PART I—Exempt Retirement Income—Enter the federally taxable portion of pension income paid by the federal government, by the Commonwealth of Kentucky, or by any Kentucky local government. Also include supplemental (Tier 2) U.S. Railroad Retirement Board benefits reported on Form 1040, line 16(b) (Form 1040A, line 12(b)) and federal or Kentucky disability retirement income included on federal Form 1040, line 7 (Form 1040A, line 7). Do not include income from deferred compensation plans in Part I.

Use Line 1(a) if retired before January 1, 1998, to report fully exempt pension benefits.

Use Line 1(b) if retired after December 31, 1997, to compute the amount of pension income attributable to service credits earned before January 1, 1998. Multiply the taxable pension by the exempt percentage, enter the result (exempt amount) in Column A or Column B. **Use the worksheet below to compute the exempt percentage in the year of retirement.**

Note: Subtract the exempt amount from the taxable pension amount and include the difference with other retirement income in Part II.

PART II—Other Retirement Income, Line 2—Enter the amount reported on federal Form 1040 or 1040A of non-lump-sum pension and retirement income not reported on line 1(c). Also include amounts from Schedule M, line 7 (Form 740-NP, page 4, line 16) that reflect pension and IRA bases differences.

PART III—Total to Be Excluded This Year, Line 3—Enter the lesser of the amount on line 2 or $41,110.

Line 4—Enter the total of lines 1(c) and 3. This is your pension income exclusion. Enter on line 4 and as follows: Schedule M, line 11; Form 740-NP, page 4, line 10(b); or Form 741, page 1, line 11.

DEFINITIONS—For use with Schedule P and the worksheet below.

Service Credit—Number of months (years) used by your retirement system to determine retirement benefits.

Purchased Service Credit—Voluntary purchases of service credit as allowed by your retirement system (i.e., military service or prior service with the same or similar system). **Note:** Purchased time is credited based on the dates of service.

Purchased Service Credit (Air-time)—Certain retirement plans allow for the purchase of up to five years of service credit unrelated to prior work history. These purchases are commonly known as air-time. Air-time is not included in total service earned after December 31, 1997, regardless of when purchased.

Worksheet for Federal, Kentucky State and Kentucky Local Government Retirees Who Retired After 12/31/97

STOP Complete this worksheet only if you retired in 2010 or have not computed your exempt percentage in prior years. Keep this worksheet in your records. The percentage will be used this year and in future years to determine the amount of exempt retirement income.

Complete this worksheet to determine what percentage of your pension income is exempt. This percentage must be calculated for each pension.

If your retirement system has computed the exempt amount (earned before January 1, 1998), enter the amount on page 1, line 1(b), column A or B. If your retirement system has computed the exempt percentage, **enter the exempt percentage on page 1, line 1(b) in the exempt percentage column**. Use a separate worksheet for each governmental pension. Retain this worksheet with your tax records. **Use the percentage on line 4 to compute the exempt portion of your pension in future years.**

1. Enter total months of service credit including purchased service........ ____________
2. Enter months of service credit earned after 12/31/97. Include sick leave credited at date of retirement, and service credit from purchase of military and other service earned after 12/31/97. Do not include purchased credit unrelated to prior work history (air-time)........ ____________
3. Subtract line 2 from line 1. Total months of service before January 1, 1998........ ____________
4. Divide line 3 by line 1. Enter here and on page 1, line 1(b), in the exempt percentage column....... ____________
   Use this percentage to determine the amount of pension attributable to service earned before 1/1/98.

Part II – Kentucky

Section 4

A) Standard Deduction Vs. Itemized Deductions

- Standard Deduction

B) Schedule A

- Deductions
- Federal/State Comparison
- Limitation

C) Tax Computation

- Tax Rate Schedule/Tax Table
- Tax Due Comparison

STANDARD DEDUCTION VS. ITEMIZED DEDUCTIONS

Taxpayers in Kentucky are taxed on their **net income.** For individual income taxpayers, this income is determined by taking the taxpayer's Kentucky Adjusted Gross Income (KAGI) and subtracting either the standard deduction or the taxpayer's itemized deductions (claimed on Kentucky Schedule A). Because it directly impacts the taxpayer's liability, choosing whether to itemize deductions or simply take the standard deduction is an important step in completing the individual income tax return.

The concept of a standard deduction has been around since 1944, when federal legislation introduced a deduction that could be taken by anyone that was worth 10% of their adjusted gross income. Since that time, the standard deduction has gone through many changes. Currently, the Kentucky standard deduction is **$2,210 for 2010**. For tax year **2011** and every year thereafter, the standard deduction will be indexed to the **Consumer Price Index (CPI)**. Essentially, this means that as the price level of consumer goods and services purchased by households increases, so does the standard deduction.

Filing Status Impact

If the taxpayer is filing a single or a joint return, the standard deduction is **$2,210**. If the taxpayer is married and both spouses are filing a separate or combined return, they each are allowed to claim the **$2,210** standard deduction. Stated another way, married taxpayers who file using one column on the return to report income can only take one standard deduction. Married taxpayers using both columns on the return (or two separate returns) to report income can each claim a standard deduction for a total deduction of $4,420 for 2010.

Benefit of Itemizing Deductions

A taxpayer that owns a house, has excessive medical expenses, or perhaps makes substantial charitable contributions, etc. will likely have deductions in excess of the $2,210 or $4,420 standard deduction amounts. Deductions decrease your taxable income, thus lowering your tax liability. Therefore, such taxpayers can normally realize a tax savings by using Schedule A and choosing to itemize deductions.

Common Misconception

A common misconception is that taxpayers who file the federal return and take the standard deduction must also claim the standard deduction for Kentucky. This, of course, is false. How you file your federal return has no bearing on how you should file your Kentucky return.

Note: For married individuals filing separate or combined returns, it is important to remember that if one spouse itemizes deductions, the other must also itemize.

KENTUCKY SCHEDULE A

When comparing the **Kentucky Schedule A** (Form 740) to **federal Schedule A** (Form 1040) it is obvious there are some basic differences between the two forms. A few of these differences are as follows:

Medical and Dental Expenses – The amount of allowable medical and dental expenses may be different in that the 7.5% limitation is applied to adjusted gross income. There may be situations where Kentucky AGI and federal AGI may not be the same. If this is the case, even though the expenses are sometimes the same, the deduction amount for medical expenses will be different for Kentucky and federal tax purposes.

Further, health insurance premiums are generally included as a medical expense on the federal Schedule A; however, they are a separate deduction (claimed on Schedule M) on the Kentucky return. As such, there may also be differences in the amount of actual medical and dental expense reported.

Taxes – As outlined in **KRS 141.010(11)(a)**, the only difference in the deductible taxes is that on Kentucky Schedule A**,** you **cannot** deduct state income taxes. When using federal Schedule A amounts to complete the Kentucky Schedule A, it is necessary to determine how much in state taxes are included on line 5, Schedule A, federal Form 1040 and eliminate that from the amount to be entered on line 4, Kentucky Schedule A, Form 740.

Note: For tax year 2010 legislation was extended that allowed taxpayers the option of claiming Sales Tax in lieu of state and local tax on their federal Schedule A. Kentucky did not adopt this provision, therefore deducting sales tax is not allowed on the Kentucky Schedule A.

Casualty and Theft Losses – These losses are reduced by 10% of your AGI; therefore, should Kentucky AGI and federal AGI not be the same, the casualty and theft loss deduction would not be the same. It should be noted that Kentucky does use **federal Form 4684 - Casualties and Thefts**, but the amount on line 16 of Form 4684 is carried to line 20 of the Kentucky Schedule A. Line 16 is the amount of the loss before the 10% limitation is deducted. Kentucky Schedule A then allows you to deduct 10% of your Kentucky AGI from the loss that was on line 16 of Form 4684.

Job Expenses and Most Other Miscellaneous Deductions – Many of these expenses are also reduced by 2% of Kentucky AGI. Therefore, when federal and Kentucky AGI are different, Kentucky deductions will not be the same as federal.

Impact of Federal/Kentucky Difference on Allowable Deductions

To illustrate the impact that a difference between FAGI and KAGI has on the total allowable deductions for Schedule A review the example and chart below.

Example - Federal AGI = $32,000 which includes $4,000 interest income from U.S. bonds. Because Kentucky does not tax this type of interest income, KAGI is different than federal, thus the allowable Schedule A deductions amounts are also different.

	FEDERAL	KENTUCKY
Medical & Dental Expense	$3,000	$3,000
Less 7.5% of AGI	–2,400 (32,000 X 7.5%)	–2,100 (28,000 X 7.5%)
Deduction Allowed	**$600**	**$900**

Dividing Deductions between Spouses

Page 2 of the Kentucky Schedule A provides a worksheet for dividing the total amount of itemized deductions between spouses. This worksheet needs to be completed only if you are married filing separate on a combined return or filing separate returns. Only one Schedule A is required to be filed even if spouses are filing separate returns or separately on a combined return. The total deductions for each spouse are prorated based on each spouses Kentucky AGI income to total combined Kentucky AGI.

Example: Wife's KY. AGI = $40,000
Husband's KY. AGI = $20,000
Line 30 Schedule A = $7,000

Wife's Deduction $\frac{\$40,000}{\$60,000}$ = 66.7% X 7,000 = **$4,669**

Husband's Deduction $\frac{\$20,000}{\$60,000}$ = 33.3% X 7,000 = **$2,331**

Total Itemized Deductions = **$7,000** ($4,669 + $2,331)

TAX COMPUTATION

Kentucky has a graduated tax rate ranging from 2% to 6% depending upon the amount of taxable income. Computing the tax due on the return may be done two ways. The taxpayer may choose to use the tax table, contained in the instructions for preparing the return, or the tax rate schedule below.

Tax Rate Schedule

If taxable amount is:	*Tax is:*
$3,000 or less	2% of taxable amount
More than $3,000 but not over $4,000	$60 plus 3% of amount over $3,000
More than $4,000 but not over $5,000	$90 plus 4% of amount over $4,000
More than $5,000 but not over $8,000	$130 plus 5% of amount over $5,000
More than $8,000 but not over $75,000	$280 plus 5.8% of amount over $8,000
Over $75,000	$4,166 plus 6% of amount over $75,000

TAX DUE COMPARISON

Married Filing Separately on a Combined Return versus Joint Return

Tax Liability per Filing Status:

	Combined Return (Filing Status 2)		**Joint Return (Filing Status 3)**
	Spouse	**Yourself**	**Joint**
Taxable Income	$ 15,000	$ 15,000	$ 30,000
Tax Liability	$ 686	$ 686	$ 1,556
	$ 1,372		**$ 1,556**

Explanation

Kentucky's tax rate is 5.8% for income over $8,000 and under $75,000, with a 6% tax rate for income above $75,000. By utilizing Filing Status 2 the taxpayers minimize the taxing of income over $8,000.

	Spouse		Yourself	Joint
Taxable Income	$ 15,000		$ 15,000	$ 30,000
	- 8,000		- 8,000	- 8,000
	$ 7,000		$ 7,000	$ 22,000
Amount Subject to 5.8% Tax Rate		$ 14,000		$ 22,000

Additional Computation Issues

Farm Income Averaging, Schedule J. If you elect farm income averaging on your federal return, you may also use this method for Kentucky. Compute tax using Schedule J.

Lump-Sum Distributions. Kentucky allows a special 10-year averaging method for determining tax on lump-sum distributions received from certain retirement plans that qualify for federal purposes. If this method is used for federal purposes, then both Schedule P and Form 4972-K must be used to determine tax liability.

Recycling Composting Recapture. Use Schedule RC-R to determine amount of tax due and add to tax computed.

Note: Because our computer program is programmed to the exact dollar, often the tax assessed by the system may vary a few dollars from the tax table, which lists tax due in $100 increments.

Part II – Kentucky

Section 5

A) Business Incentive and Other Tax Credits

B) Personal Tax Credit(s)

C) Family Size Tax Credit

D) Education Tuition Tax Credit

E) Child and Dependent Care Credit

F) New Home Tax Credit

G) Refundable Tax Credits

KENTUCKY INCOME TAX CREDITS

Direct income tax credits come from legislation passed every year by the Kentucky General Assembly. These credits can be applicable to the corporate and/or non-corporate taxpayer; however, a taxpayer must meet various criteria in order to take advantage of a given credit.

Kentucky Revised Statutes determine the order these credits must be used, how the credits are calculated, any carryover provisions (if applicable) and whether a credit may pass through to a shareholder or partner.

Sequence of Nonrefundable Credits

The following is a list of credits that can be claimed on Section A, Business Incentive and Other Tax Credits, found on page 2 of Kentucky Forms 740 and 740-NP. These credits are listed in the sequence or order they must be taken (see **KRS 141.0205**):

- KRS 141. 0401 – Limited Liability Entity Tax Credit
- KRS 141.347, 141.400, 141.403, 141.407, 154.12-2088 – Skills Training Investment Credit and other Economic Development Credits
- KRS 171.397 – Nonrefundable Certified Rehabilitation Credit
- KRS 141.070 – Credit for Tax Paid to Other States
- KRS 141.065 – Unemployment Credit
- KRS 141.390 – Recycling and/or Composting Equipment Credit
- KRS 154.20-258 – Kentucky Investment Fund Credit
- KRS 141.0405 – Coal Incentive Credit
- KRS 141.395 – Qualified Research Facilities Credit
- KRS 151B.127 – GED Incentive Credit
- KRS 141.418 – Environmental Remediation Credit
- KRS 141.423 – Biodiesel Credit
- KRS 154.48-025 – Environmental Stewardship Credit
- KRS 141.428 – Clean Coal Incentive Credit

- KRS 141.4242 – Ethanol Credit
- KRS 141.4244 – Cellulosic Ethanol Credit
- KRS 141.436 – Energy Efficiency Products Credit
- KRS 141.385, 141.387 – Railroad Maintenance and Improvement Credit

Additional Nonrefundable Credits

There are five additional nonrefundable tax credits available to the individual taxpayer which are not reflected on Section A, Business Incentive and Other Tax Credits. These are:

- KRS 141.020 – Personal Tax Credit(s)
- KRS 141.066 – Family Size Tax Credit
- KRS 141.069 – Education Tuition Tax Credit
- KRS 141.067 – Child and Dependent Care Credit
- KRS 141.388 – New Home Tax Credit (expired in 2010 tax year)

Refundable Credits

Finally, there are two new refundable tax credits also available to the individual taxpayer beginning in the 2010 tax year.

- KRS 141.382 – Refundable Certified Rehabilitation Credit
- KRS 141.383 – Film Industry Tax Credit

BUSINESS INCENTIVE AND OTHER TAX CREDITS

Limited Liability Entity Tax Credit (for taxable years beginning on or after January 1, 2007)

An individual that is a partner, member or shareholder of a limited liability pass-through entity is allowed a limited liability entity tax (LLET) credit against the income tax imposed by KRS 141.020 equal to the individual's proportionate share of LLET computed on the gross receipts or gross profits of the limited liability pass-through entity as provided by KRS 141.0401(2), after the LLET is reduced by the minimum tax of $175 and by other tax credits for which the limited liability pass-through entity may be allowed.

The credit allowed an individual that is a partner, member or shareholder of a limited liability pass-through entity against income tax shall be applied only to income tax assessed on the individual's proportionate share of distributive income from the limited liability pass-through entity as provided by KRS 141.0401(3)(b). Any remaining LLET credit shall be disallowed and shall not be carried forward to the next year. The credit amount available to the partner, member or shareholder shall be reflected on the appropriate Kentucky Schedule K-1(s) or Form(s) 725.

Skills Training Investment Tax Credit

A credit is allowed for the amount of credit certified by the Bluegrass State Skills Corporation. A copy of the certification must be attached to the return in the first year the credit is claimed.

The credit is equal to fifty percent of the approved cost incurred in connection with the company's occupational or skills upgrade training program. The credit shall not exceed $500 per employee and $100,000 per approved company per biennium. The excess credit over the company's income tax liability in the year approved may be carried forward for three successive taxable years.

A taxpayer that has received a final authorizing resolution from the Bluegrass State Skills Corporation is entitled to a nonrefundable credit against Kentucky individual or corporation income tax.

Note: Effective for taxable years beginning after December 31, 1999, **KRS 141.405** was amended to allow S corporations and partnerships to pass through the skills training investment tax credit to shareholders and partners.

Certified Rehabilitation Credit

A nonrefundable credit may be taken against corporation or individual income taxes for a portion of the cost of restoring a qualified residential and commercial structure listed on the National Registry of Historic Places. The credit is equal to 30 percent of the rehabilitation expenses, in the case of owner-occupied residential property, and 20 percent of the rehabilitation expenses, in the case of all other property. The total credit available is capped at $3 million annually, with each individual owner-occupied property receiving no more than $60,000. Due to new legislation passed in 2009, the certified rehabilitation credit cap was increased from $3 million to $5 million effective for applications received on or after April 30, 2010.

An application for credit must be submitted to the Kentucky Heritage Council within thirty (30) days following the close of a calendar year. The council shall determine the amount of credit approved for each taxpayer and notify the taxpayer and Department of Revenue of the approved credit amount by the thirty first day of the third month following the close of the calendar year.

Credits received under this section may be transferred or assigned, for some or no consideration, along with any related benefits, rights, responsibilities, and liabilities to any entity subject to the tax imposed by KRS 136.505.

For applications received prior to April 30, 2010, the taxpayer may carry any excess tax credit forward until the tax credit is used, provided that any tax credits not used within seven (7) years of the taxable year the certified rehabilitation was complete shall be lost.

Effective for applications approved on or after April 30, 2010, the credit will be refundable if a proper election form is filed. **KRS 171.397**

Additional information on this credit can be found at www.heritage.ky.gov.

Credits Allowed Individuals for Tax Paid to Other States

- Per **KRS 141.070** - Credits Allowed Individuals for Tax Paid to Other States, all residents of Kentucky, within certain limitations, may claim a credit on the Kentucky income tax return for individual income tax paid to other states.

- Nonresidents are not entitled to a credit for tax paid to another state. A part year resident may be entitled to a credit, if, after they become a resident of Kentucky or before they become a nonresident of Kentucky, they have income from another state which is taxed by the other state.

- This credit can only be claimed on income derived from sources outside Kentucky. It cannot be claimed on income derived from Kentucky sources.

- S corporations and partnerships may elect to file combined or composite nonresident returns on behalf of their shareholders or partners to report the individual income tax due to other states. A credit may be allowed if the tax paid to the other states on the composite or combined return is in lieu of the individual shareholders or partners filing separate nonresident individual income tax returns to those states. The credit claimed on the Kentucky return is allowed as if each shareholder or partner filed separately. A copy of the composite return should also be attached to the taxpayer's Kentucky income tax return to verify the actual amount of individual income tax paid for that taxpayer. A schedule signed and certified by the tax manager, listing the individual's name and I.D. number; the income reported on behalf of the individual; and; and income tax paid to each state is an acceptable substitute for a copy of the composite or combined return.

- Franchise tax and intangible income tax are not allowed as credit against Kentucky individual income tax.

- Kentucky residents may claim a credit for nonrefundable income tax paid to other states. However, you may not claim credit for tax withheld by another state. You must file a return with the other state, and pay tax on income also taxed by Kentucky in 2010 in order to claim the credit. A copy of the other state's return must be attached to verify this credit. The credit is limited to the amount of Kentucky tax savings had the income reported to the other state been omitted, or the amount of the tax paid to the other state, whichever is less.

- The credit is computed by using the worksheet provided in the instructions. A copy follows.

Note: If tax is owed in more than one state, the credit for each state must be computed on separate worksheets.

Credit for Taxes Paid to Other States Worksheet

Kentucky residents/part-year residents only. Complete a separate worksheet for each state. See instructions for Form 740 or 740-NP, Section A, line 4.

Name of other state ____________________

1. List Kentucky taxable income from Form 740, line 11 .... __________
2. List any gambling losses from Schedule A, line 29 .... __________
3. Add lines 1 and 2 and enter total here...................................... __________
4. List income reported to other state included on Kentucky return .... __________
5. Subtract line 4 from line 3 and enter total here .... __________
6. Adjusted gambling losses. Compute gambling losses allowed on Kentucky return if income from other state is ignored .... __________
7. Subtract line 6 from Line 5 and enter total here........................ __________
8. Enter Kentucky tax on income amount on line 7 .... __________
9. Enter Kentucky tax on income amount on line 1 .... __________
10. Subtract line 8 from line 9. This is the tax savings on return if other state's income is ignored .... __________
11. Enter tax paid to other state on income claimed on Kentucky return .... __________
12. Enter the lesser of line 10 or line 11. This is your credit for tax paid to other state. Carry this total to Form 740, Section A, line 4.. ___________

Gambling Losses and Taking the Credit for Tax Paid to Other States

A credit for tax paid to another state on gambling income may be allowed if the income is taxed by **both** Kentucky and the other state. However, if you have paid tax on gambling income in another state **and** you claimed an itemized deduction on your Kentucky Schedule A for losses, the allowable credit may be reduced or eliminated. Any gambling income offset by a gambling loss deduction is not considered taxed in Kentucky. In this situation the income is not being taxed by both Kentucky and another state so no tax savings result.

Examples of Calculating Credit for Tax Paid to Other States

Example 1

Joe A. Smith, single, is a store manager for Wal-Mart. He has a permanent home in Frankfort, Kentucky. For eight months out of each year Joe manages the store in Frankfort, but is transferred to a store in Boulder, Colorado, for the late spring and summer months. Joe rents an apartment while in Colorado and stays there for the spring and summer months except for occasional trips back to Kentucky over this time frame.

Additional Facts:

1) Under Colorado law, for 2010, Joe Smith is required to file **Form 104 - Long Form - Colorado Individual Income Tax Return** as well as **Form 104PN - Part-Year Resident/Nonresident Tax Apportionment Schedule**. This enables Joe to report wages and calculate his tax liability applicable to wages earned in Colorado.

2) It is also necessary for Joe to file a resident return (Form 740) with Kentucky and report income from all sources.

3)

Ky. Wages	Ky. W/H	Colorado Wages	Colorado W/H
$32,000	$1,600	$18,000	$900

4) Taxpayer takes the standard deduction.

5) Taxpayer's Colorado return reflects a tax liability of $793.

Explanation/Solution:

The credit is limited to the amount of Kentucky tax savings had the income reported to the other state been omitted, or the amount of tax paid to the other state whichever is **less**. The following information illustrates this principle:

Ky. Income Tax Liability Based on Income From **All** Sources Before Any Credits ($50,000 - $2050 = $47,950 taxable income)	$2,597
Ky. Income Tax Liability **Excluding** Non-Kentucky Sources Before Any Credits ($32,000 - $2050 = $29,950 taxable income)	1,553
Maximum Credit Allowed	1,044
Colorado Tax Liability	793
Credit Allowed for Tax Paid to Another State	$ 793

Because the **tax paid was less** than the tax savings, this taxpayer qualifies for a credit of $793. Had the amount of tax paid to Colorado exceeded $1,044, the credit would have been limited accordingly.

In general, if adjustments to gross income and deductions (itemized/standard) are comparable between Kentucky and the nonresident state, Kentucky would allow credit for all tax paid to the other state providing that state's tax rate is less.

Example 2

A full year resident Kentucky taxpayer worked in New York for three months. The taxpayer earned $15,000 in New York and had a net liability of **$1,050** on the New York return. Taxable income on the Kentucky return was $58,700 and the tax liability was **$3,218**.

Explanation/Solution:

After deducting the income taxed by New York, the taxable income would be $43,700 and the tax liability would be **$2,348**. The difference between the $3,218 and $2,348 of **$870** is the allowable credit for tax paid to New York on the Kentucky return because the credit is limited to the amount of Kentucky tax savings had the income reported to the other state been omitted, or the amount of tax paid to the other state, whichever is **less**.

Example 3

A full year Kentucky resident worked part of the year in St. Louis. The taxpayer's Missouri W-2 showed taxable income of $16,000 and Missouri withholding of $920. The taxpayer filed a Missouri nonresident return and received a refund of $350 after calculating a liability of **$570** to Missouri. On the Kentucky return the taxpayer had taxable income of $49,000 and a tax liability of **$2,655**.

Explanation/Solution:

After deducting the income being taxed by Missouri a revised taxable income of $33,000 yields a tax liability of **$1,727**. The difference between $2,655 and $1,727 is **$928**. The allowable credit on the Kentucky return for tax paid to Missouri would be **$570**.

Remember the credit is limited to the **lesser** of the actual tax paid or the tax savings if the income is omitted.

Unemployment Tax Credit

If you hired unemployed Kentucky **residents** to work for you during the last six months of 2009 or anytime during 2010, you may be eligible to claim the unemployment tax credit. In order to claim a credit, each person hired must meet specific criteria. For each qualified person, you may claim a tax credit of $100.

The period of unemployment must be certified by the Office of Employment and Training, Education Cabinet, 275 East Main Street 2-WA, Frankfort, Ky. 40621-0001. The taxpayer must maintain a copy of the certification in his/her files. To claim this credit one must file **Schedule UTC - Unemployment Tax Credit**. **KRS 141.065**

Recycling and/or Composting Tax Credit

Individuals, who purchased recycling or composting equipment to be used exclusively in Kentucky for recycling or composting post-consumer waste materials, are entitled to a credit against the tax equal to 50 percent of the installed cost of the equipment. Application for this credit must be made on **Schedule RC - Application for Income Tax Credit for Recycling and/or Composting Equipment**, which may be obtained from the Department. A copy of **Schedule RC** reflecting the amount of credit approved by the Department must be attached to the return.

The credit claimed for the taxable year during which the equipment is purchased (installed) is limited to 10 percent of the total allowable credit and 25 percent of the tax liability less other credits claimed for the year. The unused portion of the total credit may be carried forward to succeeding tax years limited only to 25 percent of the tax liability for the taxable year.

This credit does pass through from a partnership or S corporation to the partner/shareholder. **Schedule RC (K-1) – Pro Rata/Distributive Share of Approved Recycling and/or Composting Equipment Tax Credit** is utilized to allocate the credit to each partner or shareholder.

Kentucky Investment Fund Tax Credit

The 1998 legislature created new sections of **KRS 154.20-263** to establish the Kentucky Investment Fund Program and authorized the Kentucky Economic Development Finance Authority (KEDFA) to certify investment funds and investment fund managers on or after July, 1999. An investor who makes cash contributions to an investment fund certified by KEDFA is allowed a nonrefundable credit against the Kentucky individual income tax, Kentucky corporation income tax or Kentucky corporation license tax equal to 40 percent of the cash contribution. The credit may be claimed in any tax year after December 31, 1998, during which the investment is made.

For investments before July 1, 2002, twenty-five percent of the total credit certified by the Kentucky Economic Development Finance Authority (KEDFA) is allowed in each year. For investments after June 30, 2002, the credit is claimed on the tax return filed for the tax year following the year in which the credit is granted and is limited in any tax year to 50 percent of the initial aggregate credit apportioned to the investor. A copy of the certification by KEDFA is required in the first year the credit is taken.

Unused credit may be carried forward. Any excess credit that may be claimed in a given year over the investor's liability may be carried forward but may not extend beyond 15 years of the initial certification.

Effective July 1, 2005, KIFA tax credits available to any single investment fund are limited to $1.3 million for all investors and all taxable years. Total KIFA tax credits available for all investors in all investment funds shall not exceed $5 million per fiscal year. **KRS 154.20-263**

Credit for the Purchase of Kentucky Coal (Coal Incentive Tax Credit)

(Effective for ten consecutive years beginning on July 15, 2001.) **KRS 141.0405** and **KRS 141.0406** were created to allow a nonrefundable credit against corporation income tax, individual income tax, corporation licenses tax and public service company property tax for Kentucky coal purchased and used for generating electricity. Only coal that is subject to Kentucky's coal severance tax qualifies for the credit. The credit is equal to $2 per ton of Kentucky coal purchased by the company that is above the amount of Kentucky purchased during the base year. The base year amount is the amount of coal purchased in 1999 for existing companies. For new entities established after 1999, the base year amount will be zero. This credit may be claimed on returns filed after July 15, 2001. **KRS 141.0405**

Qualified Research Facilities Tax Credit

A nonrefundable credit is allowed against individual and corporation income taxes equal to 5 percent of the cost of constructing and equipping new facilities or expanding or remodeling existing facilities in Kentucky for qualified research. “Qualified research” is defined to mean qualified research as defined in Section 41 of the IRC. Any unused credit may be carried forward 10 years. **KRS 141.395**

GED Assistance Credit

A Tax Credit for Employers Who Assist Employees in Obtaining His or Her High School Equivalency Diploma. (Effective July 14, 2000.)

Employers who assist employees in obtaining his or her high school equivalency diploma are eligible for a tax credit. A new effort to promote GEDs has direct benefits for Kentucky employers and the commonwealth’s workforce.

Employees can earn a tuition discount of $250 per semester for a maximum of four semesters at a Kentucky public postsecondary institution. Their employers can receive a state income tax credit for a portion of the paid release time given to the employee to study for the GED. The tax credit is calculated at half of the employee’s hourly salary for released time, up to a maximum of $1,250. The regulation became effective on September 5, 2001. **KRS 151B.127(3)**

Environmental Remediation Credit

(Effective for tax periods beginning after Dec. 31, 2004.) Taxpayers who agree to clean up or develop an existing abandoned Brownfield area may qualify for a nonrefundable credit against corporation or individual income taxes in a maximum amount of $150,000. The credit may be carried forward for ten successive taxable years. **KRS 141.418**

Biodiesel Credit

(Effective for tax periods beginning on or after Jan. 1, 2005.) A nonrefundable credit may be taken against corporation or individual income taxes for producing or blending biodiesel fuels of up to $1 per gallon produced or blended, limited to a maximum statewide credit of $1.5 million. The credit may not be carried forward. **KRS 141.423**

Environmental Stewardship Credit

(Effective for tax years ending on or after Jan. 31, 2007.) A nonrefundable credit is available against the corporation and individual income taxes for a corporation or individual that undertakes an environmental stewardship project with a minimum investment of at least $5 million. The Cabinet for Economic Development must approve these projects. The taxpayer must meet certain wage requirements in order to qualify. The credit will cover 100 percent of eligible skills upgrade training costs and up to 25 percent of eligible equipment costs. The project must produce an environmental stewardship product, which is defined to mean a new manufactured product or substantially improved existing manufactured product that has a lesser or reduced adverse effect on human health and the environment. It may also be used for improvement to human health and the environment when compared with existing products or competing products that serve the same purpose. The maximum amount of credit claimed for any single fiscal year may not exceed 25 percent of the total authorized inducement. **KRS 154.48-025**

Clean Coal Incentive Credit

(Effective for tax periods ending on or after Dec. 31, 2006.) A potential credit is available to an electricity generation facility certified as using clean coal equipment and technology and burning coal subject to Kentucky's severance tax. The nonrefundable credit may be taken against corporation income, individual income, corporation license and public service property taxes at the rate of $2 per ton of qualifying coal burned. The credit applies to electricity generation facilities with an investment of more than $150 million that meet Natural Resources and Environmental Protection Cabinet standards. **KRS 141.428**

Ethanol Tax Credit

For taxable years beginning after December 31, 2007, an ethanol producer shall be eligible for a nonrefundable tax credit against the taxes imposed by KRS 141.020 or 141.040 and 141.0401 in an amount certified by the department. The credit rate shall be one dollar ($1) per ethanol gallon produced, unless the total amount of approved credit for all ethanol producers exceeds the annual ethanol tax credit cap. If the total amount of approved credit for all ethanol producers exceeds the annual ethanol tax credit cap, the department shall determine the amount of credit each ethanol producer receives by multiplying the annual ethanol tax credit cap by a fraction, the numerator of which is the amount of approved credit for the ethanol producer and the denominator of which is the total approved credit for all ethanol producers. The credit allowed shall be applied both to the income tax imposed under KRS 141.020 or 141.040 and to the limited liability entity tax imposed under KRS 141.0401, with the ordering of credits as provided in KRS 141.0205. Any remaining ethanol credit shall be disallowed and shall not be carried forward to the next year. **KRS 141.4242**

Cellulosic Ethanol Tax Credit

For taxable years beginning after December 31, 2007, a cellulosic ethanol producer shall be eligible for a nonrefundable tax credit against the taxes imposed by KRS 141.020 or 141.040 and 141.0401 in an amount certified by the department. The credit rate shall be one dollar ($1) per cellulosic ethanol gallon produced, unless the total amount of approved credit for all cellulosic ethanol producers exceeds the annual cellulosic ethanol tax credit cap. If the total amount of approved credit for all cellulosic ethanol producers exceeds the annual cellulosic ethanol tax credit cap, the department shall determine the amount of credit each cellulosic ethanol producer receives by multiplying the annual cellulosic ethanol tax credit cap by a fraction, the numerator of which is the amount of approved credit for the cellulosic ethanol producer and the denominator of which is the total approved credit for all cellulosic ethanol producers. The credit allowed shall be applied both to the income tax imposed under KRS 141.020 or 141.040 and to the limited liability entity tax imposed under KRS 141.0401, with the ordering of credits as provided in KRS 141.0205. Any remaining cellulosic ethanol credit shall be disallowed and shall not be carried forward to the next year. **KRS 141.4246**

Energy Efficiency Products Credit

(Effective for taxable years beginning after December 31, 2008 and before January 1, 2016.) A person who installs a qualified energy efficient product shall be eligible for a nonrefundable tax credit against the taxes imposed by **KRS 141.020** in an amount certified by the department. The credit is equal to 30 percent of the installed costs subject to limitations and shall apply to the tax year in which the installation is completed. Form 5695-K must be completed to claim this credit and any unused credit shall be carried forward for one year. Some examples of energy efficient products that may qualify for the credit are: upgraded insulation, energy efficient windows, qualified energy property, active and passive solar heating systems, qualified solar water-heating systems, qualified wind turbine or wind machines and qualified solar photovoltaic systems. **KRS 141.436**

Railroad Maintenance and Improvement Credit

(Effective for taxable years beginning after December 31, 2009.) A nonrefundable credit against the individual income, corporation income and limited liability entity taxes was enacted in an amount equal to 50 percent of the qualified expenditures paid or incurred by an *eligible taxpayer* during the taxable year to maintain or improve railroads located in Kentucky. The credit applies to taxable years beginning after December 31, 2009. An *eligible taxpayer* means the owner of a Class II or Class III railroad located in Kentucky, the transporter of property using the rail facilities of a Class II or III railroad in Kentucky, or any person that furnishes railroad-related property or services to a Class II or Class III railroad located in Kentucky. The credit is reported on Form 740, Page 2, Section A, line 18. The credit cannot be carried forward. **KRS 141.385**

ADDITIONAL NONREFUNDABLE TAX CREDITS

As previously mentioned, there are five additional nonrefundable tax credits available to the individual taxpayer, which are not reflected on Section A, Business Incentive and Other Credits. These are:

- KRS 141.020 – Personal Tax Credit(s)
- KRS 141.066 – Family Size Tax Credit
- KRS 141.069 – Education Tuition Tax Credit
- KRS 141.067 – Child and Dependent Care Credit
- KRS 141.388 – New Home Tax Credit

PERSONAL TAX CREDITS

Personal and Dependency Credits

Personal tax credits are reported in Section B of Form 740 and 740-NP. A credit of $20 is allowed for each personal and dependency credit claimed.

Line 1(a), Yourself—You are always allowed to claim a tax credit for yourself (even if your parent(s) can claim a credit for you on their return). On line 1(a), there are five boxes under three separate headings. Always check the box under "Check Regular" to claim a tax credit for yourself. *If 65 or older*, also check the next two boxes on the line. *If legally blind*, also check the last two boxes on the line.

Line 1(b), Your Spouse—Do not fill in line 1(b) if (1) you are single; (2) you are married and you and your spouse are filing two separate returns; or (3) your spouse received more than half of his or her support from another taxpayer. However, if your spouse died during the taxable year, you may claim a credit for the deceased on line 1(b).

Fill in line 1(b) if you are married and (1) you and your spouse are filing a joint or combined return, or (2) if your spouse had no income or is not required to file a return. If you meet these criteria, check the first box on line 1(b) for your spouse. *If your spouse is 65 or older*, also check the next two boxes. *If your spouse was legally blind at the end of the taxable year*, also check the last two boxes on line 1(b).

Dependents—You are allowed to claim a tax credit for each person defined as a dependent by the IRC. Generally, dependents who qualify for federal purposes also qualify for Kentucky.

Line 2, Dependents Who Live With You

Use to claim tax credits for your dependent children, including stepchildren and legally adopted children, who lived with you during the taxable year. **If the dependent meets the requirements for a qualifying child under the provisions of IRC 152(c), check the box; this child qualifies to be counted to determine the family size.**

Line 2, Dependents Who Did Not Live With You

Also use line 2 to claim tax credits for your dependent children who did not live with you and to claim tax credits for other persons who qualify as dependents. **These dependents do not qualify to be counted to determine the family size.**

Children of Divorced or Separated Parents—Attach a copy of federal Form 8332 filed with your federal return. Children may only be counted for family size by the custodial parent.

Tax Credits for Individuals Supported by More Than One Taxpayer—Attach a copy of federal Form 2120 filed with your federal return.

Kentucky National Guard Members—Persons who were members of the Kentucky National Guard on December 31, 2010, may claim an additional credit on line 2. Designate this credit with the initials "N.G." Kentucky law specifically restricts this credit to Kentucky National Guard members; military reserve members are not eligible.

Lines 3A and 3B, Dividing the Credits—each taxpayer must claim all of his or her own tax credits including the credits for age and blindness. *Therefore, if married, each spouse must claim at least one credit. However, spouses may divide tax credits for dependents, or one spouse may claim all dependent credits and the other none.*

Example I—A husband who is 65 and a wife who is 60 are filing separately on a combined return. The husband must claim three credits (one regular and two for being 65 or older), and the wife must claim one.

Example II—A husband and wife have two dependents. The husband must claim his regular credit, and the wife must claim hers. However, the two dependent credits may be claimed by either spouse, or each spouse may claim one.

TIP: Remember to carry amounts from page 3, line 4A and/or 4B to page 1, line 17.

FAMILY SIZE TAX CREDIT

The Family Size Tax Credit is based on modified gross income (MGI) and the size of the family. For tax year 2010, if your total MGI is $29,327 or less, you may qualify for the Kentucky Family Size Tax Credit.

Modified Gross Income *is the* ***greater*** *of federal AGI plus tax-exempt interest from non-Kentucky municipal bonds and lump-sum distributions not included in FAGI* ***or*** *KAGI plus lump-sum distributions not included in FAGI.*

> **TIP:** The Family Size Tax Credit may be claimed by a resident, nonresident, or part year resident. The credit is not pro rata but is the full percentage based upon modified gross income.

To claim the credit you must complete line 20 and line 21 on Form 740 or Form 740-NP. If you are using Form 740-EZ, the Family Size Tax Credit is listed on line 7.

STEP ONE – Determine family size.

For taxpayers using the Form 740 or 740-NP, check the box on line 20 to the right of the number that represents your family size. Because the Form 740-EZ may only be used by single taxpayers, those filers will always be Family Size 1.

Family Size—Consists of yourself, your spouse if married and living in the same household and qualifying children.

Family Size 1 is an individual either single, or married living apart from his or her spouse for the entire year. You may qualify for the Family Size Tax Credit even if you are claimed as a dependent on your parent's tax return.

Family Size 2 is an individual with one qualifying child or a married couple.

Family Size 3 is an individual with two qualifying children or a married couple with one qualifying child.

Family Size 4 is an individual with three or more qualifying children or a married couple with two or more qualifying children.

Qualifying Dependent Child—Means a qualifying child as defined in Internal Revenue Code Section 152(c), and includes a child who lives in the household but cannot be claimed as a dependent if the provisions of Internal Revenue Code Section 152(e)(2) and 152(e)(4) apply. In general, to be a taxpayer's qualifying child, a person must satisfy four tests:

- **Relationship—**Must be the taxpayer's child or stepchild (whether by blood or adoption), foster child, sibling or stepsibling, or a descendant of one of these.

- **Residence—**Has the same principal residence as the taxpayer for more than half the tax year. A qualifying child is determined without regard to the exception for children of divorced or separated parents.

- **Age—**Must be under the age of 19 at the end of the tax year, or under the age of 24 if a full-time student for at least five months of the year, or be permanently and totally disabled at any time during the year.

- **Support—**Did not provide more than one-half of his/her own support for the year.

STEP TWO – Determine modified gross income.

Under the provisions of KRS 141.010 (8), "Modified gross income" means the **greater** of:

(a) Adjusted gross income as defined in Section 62 of the Internal Revenue Code of 1986, including any subsequent amendments in effect on December 31 of the taxable year, and adjusted as follows:

(1) Include interest income derived from obligations of sister states and political subdivisions thereof; and,
(2) Include lump-sum pension distributions taxed under the special transition rules of Pub. L. No. 104-188, sec. 1401(c)(2); **or**

(b) Adjusted gross income as defined in subsection (10) of this section and adjusted to include lump-sum pension distributions taxed under the special transition rules of IRS Pub. L. No. 104-188, sec. 1401(c)(2);

Item A above is the formula used to determine Kentucky Adjusted Gross Income and Item B above is the formula used to determine Federal Adjusted Gross Income. To properly compute the allowable Family Size Tax Credit, the greater of the two is used. A worksheet for computing the Family Size Tax Credit is included with the instructions for Kentucky Forms 740 & 740-NP. For taxpayers using Kentucky Form 740-EZ, both federal adjusted gross income and Kentucky adjusted gross income is the same amount.

STEP THREE – Determine the proper percentage.

Use the Family Size Table to look up the percentage of credit and enter on the appropriate line for the form used.

STEP FOUR – Computing amount of credit

Multiply Kentucky tax liability by the percentage determined in Step 3 and enter on the appropriate line of the form. This is your Family Size Tax Credit.

Below is the Family Size Tax Credit and computation worksheet.

NOTE: Form 740-EZ includes family size 1 tax credit information on page 2 of the form.

FORM 740 WORKSHEET FOR COMPUTATION OF MODIFIED GROSS INCOME FOR FAMILY SIZE TAX CREDIT

(a) Enter your federal adjusted gross income from Line 5. **If zero or less, enter zero** .... (a) ______

(b) If married filing separately on a combined return or married filing separate returns and living in the same household, enter your spouse's federal adjusted gross income. **If zero or less, enter zero** .... (b) ______

(c) Enter tax-exempt interest from municipal bonds (non-Kentucky) .... (c) ______

(d) Enter amount of lump-sum distributions not included in federal adjusted gross income (federal Form 4972) .... (d) ______

(e) Enter total of Lines (a), (b), (c) and (d) .... (e) ______

(f) Enter your Kentucky adjusted gross income from Line 9. **If zero or less, enter zero** .... (f) ______

(g) If married filing separately on a combined return or married filing separate returns and living in the same household, enter your spouse's Kentucky adjusted gross income from Line 9. **If zero or less, enter zero** .... (g) ______

(h) Enter amount of lump-sum distributions not included in adjusted gross income (Kentucky Form 4972-K) .... (h) ______

(i) Enter total of Lines (f), (g) and (h) .... (i) ______

(j) Enter the **greater** of Line (e) or (i). This is your **Modified Gross Income**. Use this amount to determine if you qualify for the Family Size Tax Credit .... (j) ______

Step Three—Use the Family Size Table to look up the percentage of credit and enter in the space provided on Line 21.

Family Size	One		Two		Three		Four or More		Credit Percentage is
If MGI . . .	is over	is not over	is over	is not over	is over	is not over	is over	is not over	
2010	$ ---	$ 10,830	$ ---	$14,570	$ ---	$18,310	$ ---	$22,050	100
	10,830	11,263	14,570	15,153	18,310	19,042	22,050	22,932	90
	11,263	11,696	15,153	15,736	19,042	19,775	22,932	23,814	80
	11,696	12,130	15,736	16,318	19,775	20,507	23,814	24,696	70
	12,130	12,563	16,318	16,901	20,507	21,240	24,696	25,578	60
	12,563	12,996	16,901	17,484	21,240	21,972	25,578	26,460	50
	12,996	13,429	17,484	18,067	21,972	22,704	26,460	27,342	40
	13,429	13,754	18,067	18,504	22,704	23,254	27,342	28,004	30
	13,754	14,079	18,504	18,941	23,254	23,803	28,004	28,665	20
	14,079	14,404	18,941	19,378	23,803	24,352	28,665	29,327	10
	14,404	---	19,378	---	24,352	---	29,327	---	0

Step Four—Multiply tax from Line 19 by the percentage and enter on Line 21. This is your **Family Size Tax Credit**.

KENTUCKY EDUCATION TUITION TAX CREDIT

The Hope and Lifetime Learning Credits are available to allow persons to receive tax credits for certain educational expenses (i.e. tuition, books and fees). In order to be eligible for a Kentucky education credit, the student must be enrolled in undergraduate studies only and attend a qualified educational institution that has a physical location within the Commonwealth of Kentucky. Further, the taxpayer cannot have a filing status of "married filing separate returns."

On the Kentucky return, the Hope Credit is available only for the first two years of post-secondary education and the maximum amount a taxpayer can claim is $450 per student. The maximum amount for the Lifetime Learning Credit is $500 per return. Any unused credit may be carried forward for up to five years.

Taxpayers claiming the Kentucky Education Tuition Tax Credit **must complete Kentucky Form 8863-K** (see example on following page) to determine the correct amount of Hope or Lifetime Learning Credits they are eligible to claim and any credit carry forwards that may apply.

CHILD AND DEPENDENT CARE CREDIT

Taxpayers claiming the Child and Dependent Care Credit must file **Form 740** or **740-NP** as this credit cannot be taken on **740-EZ**. The credit is claimed on line 25 of Form 740 by entering the amount of the federal credit from federal Form 2441 and multiplying by 20%.

Not Filing a Federal Return

If you did not meet the federal filing requirements but would have been entitled to the federal Child and Dependent Care Credit, you must complete and attach federal Form 2441 and attach to your Kentucky return. Also, you must state on the federal Form 2441 "Did not meet federal filing requirements." In that the law states that the credit allowed for Kentucky income tax purposes shall be 20% of the federal credit allowed, Kentucky will allow 20% of the credit computed on the federal Form 2441 even though the credit cannot be fully utilized for federal income tax purposes.

Part-Year Residents

Part-year residents may be allowed a prorated credit for the child and dependent care, based upon a ratio of such expenses paid within and without Kentucky. In other words, for a part-year resident to receive any credit at all, some child and dependent care expenses must have been paid while a resident of Kentucky. Full-year nonresidents are not entitled to this credit. A worksheet is included with the Form 740-NP to help facilitate computation of the credit.

Note: If a taxpayer and spouse file separate returns, the Child and Dependent Care Credit calculated for Kentucky must be divided based on the percentage of each spouse's Kentucky adjusted gross income to total Kentucky adjusted gross income.

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Department of Revenue

➤ Attach to Form 740 or Form 740-NP.

KENTUCKY EDUCATION TUITION TAX CREDIT

Enter name(s) as shown on Form 740 or Form 740-NP, page 1. | Your Social Security Number

If you have a credit carry forward from previous years, see Page 2, Part V.

Caution: Requirements for the 2010 Kentucky Education Tuition Tax Credit are different from the federal education requirements. Please review instructions to determine if you meet the qualifications for this credit.

PART I— Qualifications

	Yes	No
• Are all expenses claimed on this form from an eligible educational institution located within the Commonwealth of Kentucky (Kentucky institution)?		
• Are all of the expenses claimed on this form for undergraduate studies?		
• Is your Kentucky filing status single; married filing separately on a combined return; or married filing a joint return?		

If you answered "No" to any of these questions above, **STOP**, you do not qualify for this credit.
If you answered "Yes" to all questions above, go to Part II.

PART II— Hope Credit (List only expenses from Kentucky institutions.) See Instructions

1. (a) Student Name SSN	(c) Qualified Expenses (see instructions). **Do not** enter more than $2,400 for each student.	(d) Enter the **smaller** of the amount in column (c) or $1,200	(e) Add column (c) and column (d)	(f) Enter one-half of the amount in column (e)
	$	$	$	$
(b) Institution Name and Address				

(a) Student Name SSN	(c) Qualified Expenses (see instructions). **Do not** enter more than $2,400 for each student.	(d) Enter the **smaller** of the amount in column (c) or $1,200	(e) Add column (c) and column (d)	(f) Enter one-half of the amount in column (e)
	$	$	$	$
(b) Institution Name and Address				

2. **Tentative Hope Credit.** Add the amounts on line 1, column (f). If you are taking the Lifetime Learning Credit for another student, go to Part III; otherwise, go to line 7 2

PART III— Lifetime Learning Credit

3. (a) Student Name	(b) Student SSN	(c) Name and Address of Kentucky Institution	(d) Qualified Expenses (See instructions)

4. Add the amounts on line 3, column (d) and enter total here 4
5. Enter the smaller of line 4 or $10,000 5
6. **Tentative Lifetime Learning Credit.** Multiply line 5 by 20% (.20), enter here 6
7. Tentative Kentucky Education Credits. Add lines 2 and 6, enter here and on Page 2, line 8.......... 7

Note: If you have an unused credit from prior year(s), complete Page 2, Part V to determine your carryforward amount. You must have completed Form 8863-K in prior years to claim any allowable unused credit carryforward.

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PART IV— Allowable Education Credits

8.	Enter tentative Kentucky Education Credits from page 1, line 7	8	
9.	Enter: $120,000 if married filing jointly or married filing separately on a combined return; $60,000 if single	9	
10.	Enter the amount from Form 1040, line 37, or Form 1040A, line 21	10	
11.	Subtract line 10 from line 9. If zero or less, STOP; you cannot take any education credits for Kentucky	11	
12.	Enter $20,000 if married filing jointly or married filing separately on a combined return; $10,000 if single	12	
13.	If line 11 is equal to or more than line 12, enter the amount from line 8 on line 14 and go to line 15. If line 11 is less than line 12, divide line 11 by line 12. Enter the result as a decimal (rounded to at least three places)	13	x .
14.	Multiply line 8 by the decimal amount on line 13 and enter here	14	
15.	Multiply the amount on line 14 by 25% (.25) and enter total here	15	
16.	Enter tentative tax from Form 740 or Form 740-NP, page 1, line 22	16	
17.	Enter amount from Part V, line 37. If Part V, line 37 is blank, enter -0-	17	
18.	Subtract line 17 from line 16	18	
19.	Enter the smaller of line 18 or line 15	19	
20.	Add lines 17 and 19. Enter here and on Form 740 or Form 740-NP, line 23. This is your allowable 2010 education credit	20	
21.	If line 18 is smaller than line 15, subtract line 18 from line 15. This is the amount of **unused credit carryforward from 2010 to 2011.** Enter here and on the 2010 Carryforward Worksheet, Line E, provided below	21	

PART V— Credit Carryforward from Prior Years

22.	Enter tentative tax from Form 740 or Form 740-NP, page 1, line 22	22	
23.	Enter your credit carryforward from 2005	23	
24.	Enter your credit carryforward from 2006	24	
25.	Enter your credit carryforward from 2007	25	
26.	Enter your credit carryforward from 2008	26	
27.	Enter your credit carryforward from 2009	27	
28.	Add lines 23 through 27 and enter total here	28	
29.	Subtract line 23 from line 22. If zero or less, enter -0-	29	
30.	**Enter 2006 credit carryforward to 2011.** Subtract line 29 from line 24. If zero or less, enter -0-	30	
31.	Subtract line 24 from line 29. If zero or less, enter -0-	31	
32.	**Enter 2007 credit carryforward to 2011.** Subtract line 31 from line 25. If zero or less, enter -0-	32	
33.	Subtract line 25 from line 31. If zero or less, enter -0-	33	
34.	**Enter 2008 credit carryforward to 2011.** Subtract line 33 from line 26. If zero or less, enter -0-	34	
35.	Subtract line 26 from line 33. If zero or less, enter -0-	35	
36.	**Enter 2009 credit carryforward to 2011.** Subtract line 35 from line 27. If zero or less, enter -0-	36	
37.	Enter the smaller of line 22 or line 28	37	

2010 Carryforward Worksheet

A. From Part V, Line 30, 2006 to 2011 ____________
B. From Part V, Line 32, 2007 to 2011 ____________
C. From Part V, Line 34, 2008 to 2011 ____________
D. From Part V, Line 36, 2009 to 2011 ____________
E. From Part IV, Line 21, 2010 to 2011 ____________

If you have a carryforward of credit, maintain a copy of this worksheet or Form 8863-K for your records. This information will be needed to prepare future returns.

NEW HOME TAX CREDIT

The New Home Tax Credit is a nonrefundable individual income tax credit provided by **KRS 141.388** that applies to a "qualified buyer" who purchases a *qualified principal residence*. The provision was originally set to expire on July 25, 2010, but was extended to December 31, 2010. Also, the credit cap was lowered from $25 million to $15 million.

A *qualified buyer* is now defined as a resident of Kentucky that purchases a qualified principal residence. A *qualified principal residence* means a single-family dwelling, built to be occupied by a single family. It must be certified by the seller as having never been occupied and must be the principal residence of the qualified buyer for a minimum of two years. It may include a detached house, an attached condominium or townhouse, or a manufactured home, including house trailers and modular homes.

Under the provisions of the New Home Tax Credit, a qualified buyer shall be eligible for a nonrefundable tax credit up to $5,000 against the taxes imposed by **KRS 141.020** in an amount certified by the department.

In order to receive this credit, an application (available on DOR website) must have been completed and faxed in to the Department of Revenue at 502-564-3706 within seven (7) calendar days of escrow closing on the new home. Qualified buyer(s) approved for the credit will receive a credit allocation letter accompanied by a four (4) digit approval code by mail. This credit shall be claimed on Form 740 or 740-NP, Page 1, line 27. Electronic filers shall be required to complete the New Home Tax Credit Worksheet D and shall also be required to provide the four (4) digit approval code at the time of filing. Individuals who file a paper return will need to attach a copy of the approval letter.

Finally, as a result of House Bill 2, enacted during the 2010 Extraordinary Session of the Kentucky General Assembly, some taxpayers may now be eligible to claim both the federal Homebuyer Credit and the Kentucky New Home Tax Credit if they meet certain criteria.

REFUNDABLE TAX CREDITS

There are also two new refundable tax credits available to the individual taxpayer beginning in 2010 tax year. These are:

- **KRS 141.382 – Refundable Certified Rehabilitation Credit**

- **KRS 141.383 – Film Industry Tax Credit**

Refundable Certified Rehabilitation Credit

Effective for applications for the Certified Rehabilitation Credit received for preliminary approval on or after April 30, 2010, a taxpayer will be able to claim a refundable tax credit if a proper election form is filed. The refundable credit is reported on Page 2, line 32(c) of the From 740 or 740-NP.

Note: The certified rehabilitation credit cap was also increased from $3 million to $5 million effective for applications received on or after April 30, 2010. **(KRS 141.382)**

Film Industry Tax Credit

A refundable credit against individual income, corporation income, and limited liability entity taxes is allowed for Motion Picture and Entertainment Productions that take place within the Commonwealth of Kentucky. An approved company may receive the refundable tax credit beginning July 1, 2010 for tax incentive agreements approved by the Tourism, Arts and Heritage Cabinet and executed before January 2015. The refundable credit is 20 percent of an approved company's qualifying expenditures. There are minimum expenditure thresholds that must be met in order for the film or entertainment production company to be eligible for the credit. For individual taxpayers, the refundable credit should be reported on Form 740 or 740-NP, Page 2, line 32(d).

Note: The Film Industry Tax Credit is subject to a cap of $5 million for the fiscal year 2010-2011, and $7.5 million for the fiscal year 2011-2012. **(KRS 141.383 and 148.542– 148.548)**

Part II – Kentucky

Section 6

A) Use Tax

B) Credits against Tax Liability
- Withholding
- Estimated Tax
- Pass Through Entity Withholding

C) Contribution Funds

D) Penalties and Interest
- Form 2210-K
- Examples

USE TAX

In general, a six percent (6%) use tax is due if you make out-of-state purchases for storage, use or other consumption in Kentucky and did not pay at least 6 percent sales tax to the seller at the time of purchase. Examples include catalog orders, purchases via the Internet, or other purchases outside of Kentucky such as computer equipment, magazine subscriptions, etc.

Two options are available to report and pay use tax:

- By using Form 51A113 Kentucky Consumer's Use Tax Return, as purchases are made, or
- Reporting it on your annual Kentucky Individual Income Tax Return

Note: Taxpayers may choose to apply all or part of their individual income tax refund to use tax liability. In that situation, any 1099-G forms issued will reflect the **entire** amount of the refund. This is the proper handling, because using all or a portion of the refund to satisfy use tax liability, does not change the actual refund the taxpayer was to receive. It is only the way the taxpayer chose to have his refund appropriated.

CREDITS AGAINST TAX LIABILITY

Once the total tax liability is determined on the return, any credits available to the taxpayers are applied and the amount of tax due or refund due is determined. The taxpayer may have credit available from one or more of the following:

- **Kentucky Income Tax Withheld** – reported on W-2 wage statements and other supporting statements.
- **Estimated Tax Payments** – includes any overpayments carried forward from the prior year, as well as quarterly payments made by the taxpayer during the tax year.
- **Refundable Certified Rehabilitation Credit** (See previous section)
- **Film Industry Tax Credit** (See previous section)
- **Pass-Through Entity Withholding** – Kentucky Withholding reported for non-residents on PTE-WH statements (claimed only on Form 740-NP).

CONTRIBUTION FUNDS

The General Assembly over the years has enacted legislation permitting the designation of all or a portion of a taxpayer's income tax overpayment to various funds. These designations can be made whether filing Form 740, 740-EZ or 740-NP.

Therefore, our individual forms must be configured to allow voluntary donations to various funds. A brief description of each of these funds follows.

Nature and Wildlife Fund

This fund has been in existence since 7/15/80 and is codified as **KRS 141.450** through **KRS 141.480**.

It is worth noting that this fund was established as a means to protect animals such as bluebirds and river otter and areas of unusual natural significance such as old growth forests, wetlands and prairies. Your contribution will help to protect Kentucky's special places and animals before they are lost. You may contribute all or a portion of your overpayment to this fund which is managed by the Kentucky Department of Fish and Wildlife Resources and the Kentucky State Nature Preserves Commission. These efforts are funded almost exclusively by the tax deductible contributions to this fund. The amount of contribution will reduce your refund accordingly. Contributions may also be made directly to the ***Nature and Wildlife Fund, 801 Schenkel Lane, Frankfort, Ky. 40601 or c/o the Kentucky Department of Fish and Wildlife Resources, #1 Game Farm Road, Frankfort, Kentucky 40601.***

Child Victim's Trust Fund

This fund has been in existence since 1984 and is codified as **KRS 141.440 - Designation of Income Tax Refund to Child Victims' Trust Fund**.

You may contribute all or a portion of your overpayment to this fund which is administered through the Attorney General's Office. This fund finances local programs designed to prevent the sexual abuse and exploitation of children. This undertaking relies solely on the tax deductible contributions made by interested citizens. The amount of contribution will reduce your refund accordingly. Contributions may also be made directly to the ***Child Victim's Trust Fund, c/o Kentucky Attorney General, Capitol Building, Frankfort, Ky. 40601.***

Veteran's Program Trust Fund

This fund was effective 7/14/92 and codified as **KRS 141.444 - Designation of Income Tax Refund to Veteran's Program Trust Fund**.

It is worth noting that the 1992 General Assembly enacted legislation permitting the designation of all or a portion of your income tax overpayment to the Veterans' Program Trust Fund. The fund is administered by the Department of Military Affairs solely for the benefit of veterans' programs. The amount of contribution will reduce your refund accordingly. Contributions may also be made directly to the ***Kentucky Veterans' Program Trust Fund, 1111 Louisville Road, Frankfort, Kentucky 40601.***

Breast Cancer Research and Education Trust Fund

The 2005 General Assembly enacted legislation permitting the designation of all or a portion of your income tax overpayment to the Breast Cancer Research and Education Trust Fund. Contributions will be used to fund breast cancer research, education, treatment and screening. Additional contributions can be made to and information obtained from the state Division of Women's Physical and Mental Health, (502) 564-2154. Contributions may also be made directly to the ***Kentucky Department for Public Health, Division of Administration and Financial Management, 275 East Main Street, HS1GWA, Frankfort, Ky. 40621, (502) 564 6663.***

PENALTIES AND INTEREST

Taxpayers may be subject to interest on late payment of tax, penalties for underpayment of tax, late payment penalty and late filing penalty depending on the situation. A brief description of each follows.

Note: Penalties, but not interest, may be reduced or waived if reasonable cause for reduction or waiver can be shown.

Interest— Tax due paid after the due date is subject to interest. Interest is assessed at a rate determined each year by statute. The interest rate for unpaid taxes in 2010 is 5 percent.

Late payment penalty— If the amount of tax due is not paid by the original due date of the return, a penalty of 2 percent of the tax due may be assessed for each 30 days or fraction thereof that the tax is due, not to exceed 20 percent. However, if the amount timely paid is 75 percent of the tax due, no late payment penalty is assessed. The minimum late payment penalty is $10.

Late filing penalty— If a return is not filed by the due date or extended due date, a penalty of 2 percent of the tax due may be assessed for each 30 days or fraction thereof that the tax is due, not to exceed 20 percent. The minimum penalty is $10.

Penalty for Underpayment (Form 2210-K)

Underpayment of estimated tax— If the amount owed is more than $500 and more than 30 percent of the income tax liability due, the taxpayer may be subject to a penalty of 10 percent of the underpayment of tax. The amount of the penalty is calculated on Form 2210-K, which also lists exemptions from this penalty. The **minimum** penalty is $25.

Note: If the amount of additional tax due is $500 or less, estimated payments are not required.

Exceptions and Exclusions

Kentucky Form 2210-K is used to determine if the penalty applies and if any exceptions apply. The penalty shall not apply if one of the following exceptions is met:

- Death of the taxpayer
- Declaration not required until after 9/1/2010 & taxpayer files & pays full amount of tax due by 1/31/2011
- 2/3 or more of gross income from farming
- Prepaid tax equals or exceeds last year's tax liability

Interest on Underpayment Penalty

You may also be charged interest if you failed to make four equal installments timely pursuant to KRS 141.305. These payments are due by April 15, June 15, September 15 of the taxable year, and on January 15 of the succeeding taxable year. Failure to make these equal installments timely may result in interest due. The interest is computed separately for each due date. Kentucky Form 2210-K is used to calculate the interest.

Examples

The following three examples, using different tax situations, illustrate how to determine if an underpayment or non-estimating penalty applies:

- Example A – liability $2000; prepayments $1000
- Example B – liability $2000; prepayments $1,300, and
- Example C – liability $2000, prepayments $1,400

Assume no exceptions to the penalty are applicable.

	Example A	Example B	Example C
2010 Income Tax Liability	$2,000	$2,000	$2,000
Paid In	1,000	1,300	1,400
Additional Amount Owed	1,000	700	600

Part II - Form 2210-K

Line 1 - Liability	$2,000	$2,000	$2,000
Line 2 - Multiply by 70%	X 70%	X 70%	X 70%
Line 3 - Computation	1,400	1,400	1,400
Line 4 – Credits against tax	1,000	1,300	1,400
Line 5 – Underpayment	400	100	-0-
Line 6 – Multiply by 10%	X 10%	X 10%	
Penalty	40	10	
Penalty Assessed	$40	$25	-0-

Explanation/Solution:

- In **Example A**, the penalty would be applicable in that the taxpayer failed to pay in 70%.
- In **Example B** the minimum penalty of $25 would be assessed because the taxpayer failed to pay in 70% and the $10 penalty calculated is less than the minimum.
- In **Example C** the penalty would not be applicable as the taxpayer prepaid at least 70%.

2210-K

42A740-S1

Commonwealth of Kentucky
DEPARTMENT OF REVENUE

➤ Attach to Form 740 or 740-NP.

2010

UNDERPAYMENT OF ESTIMATED TAX BY INDIVIDUALS

Enter name(s) as shown on page 1, Form 740 or 740-NP.	Your Social Security Number

PART I—EXCEPTIONS AND EXCLUSIONS

The penalty shall not apply if one of the following exceptions is met. If one or more of the following applies to you, check the appropriate block(s), complete any necessary blank(s) and check the "Form 2210-K attached" block on Form 740, line 43a (Form 740-NP, line 43a). **If none of the exceptions apply, go to Part II.**

Check applicable block(s).

1. ☐ The taxpayer died during the taxable year.

2. ☐ The declaration was not required until after September 1, 2010, and the taxpayer files a return and pays the full amount of the tax computed on the return on or before January 31, 2011.

3. ☐ Two-thirds ($^2/_3$) or more of the gross income was from farming; this return is being filed on or before March 1, 2011; ***and*** the total tax due is being paid in full. Fiscal year taxpayers must file a return and pay the tax due on or before the first day of the third month following the close of the tax year.

a. Enter total gross income		
b. Multiply by $^2/_3$ (.67)		
c. Enter gross income from farming		

Line (c) must ***equal or exceed*** line (b) to qualify for the exception.

4. ☐ Prepaid tax ***equals or exceeds*** last year's income tax liability.

a. Enter the liability from the 2009 return, *Form 740*, line 28; *Form 740-NP*, line 28		
b. Enter amount from the 2010 Form 740, line 33 (Form 740-NP, page 2, line 33)*		

Line (b) must ***equal or exceed*** line (a) to claim the exception.

PART II—FIGURING THE UNDERPAYMENT AND PENALTY *(Complete Part II only if the* ***additional*** *tax due exceeds $500; otherwise, proceed to page 2, Part III.)*

1.	a. Enter 2010 income tax liability from Form 740, line 28 (Form 740-NP, page 1, line 28)	1a		
	b. Enter credit for taxes paid to another state from Form 740, Section A, line 4 (Form 740-NP, Section A, line 4)	1b		
	c. Total (add lines 1a and 1b)	1c		
2.	Percentage of liability required to be prepaid is 70%	2	x .7	
3.	Multiply line 1c by line 2	3		
4.	a. Enter the amount from Form 740, line 33 (Form 740-NP, page 2, line 33)*	4a		
	b. Enter credit for taxes paid to another state from Form 740, Section A, line 4 (Form 740-NP, Section A, line 4)	4b		
	c. Total (add lines 4a and 4b)	4c		
5.	Subtract line 4c from line 3 (If line 4c exceeds line 3, no penalty applies.)	5		
6.	Penalty percentage is 10%	6	x .1	
7.	Multiply line 5 by line 6. This is the amount of the penalty for underpayment of estimated tax (minimum penalty $25)	7		
8.	Enter interest amount due from Form 2210-K, page 2, line 22	8		
9.	Add lines 7 and 8. Enter here and on Form 740 or Form 740-NP, line 43(a). **Also check the "Form 2210-K attached" box**	9		

➲ ***To Avoid Underpayment Penalty in the Future, Obtain and File Form 740-ES.***

*Do not include amounts prepaid with extension after the due date of the fourth declaration installment.

FORM 2210-K (2010)
42A740-S1

Page 2

NOTE: Use this page to calculate interest amount due on underpaid or untimely required estimated payments. See instructions for list of exclusions.

PART III—REQUIRED ANNUAL PAYMENT

1.	Enter 2010 income tax liability: (Form 740 or Form 740-NP, page 1, line 28)	1	
2.	Enter 2010 income tax withheld and refundable credits: (Form 740 or Form 740-NP, page 2, line 32a, 32c and 32d)	2	
3.	Enter 2010 nonresident withholding: (Form 740-NP, page 2, line 32e)	3	
4.	Add lines 2 and 3. Enter total here	4	
5.	Subtract line 4 from line 1. (If the result is $500 or less, stop here. Do not compute this schedule.)	5	
6.	Enter 2009 income tax liability: (2009 Form 740 or Form 740-NP, page 1, line 28)	6	
7.	Required annual payment. Enter the smaller of line 1 or line 6	7	

Note: If line 4 is equal to or greater than line 7, stop here. You do not owe interest.

PAYMENT DUE DATES		A 4-15-10	B 6-15-10	C 9-15-10	D 1-15-11
8. **Required Installments.** Enter 1/4 (.25) of line 7 in each column	8				
9. **Estimated tax paid and tax withheld.** For column A only, enter the amount from line 9 on line 13. If line 9 is equal to or greater than line 8 for all payment periods (columns A through D), stop here. You do not owe interest. Complete lines 10 through 17 of each column before going to the next column	9				
10. Enter amount, if any, from line 17 of previous column	10				
11. Add lines 9 and 10. Enter here	11				
12. Enter the amount from line 16 of previous column.	12				
13. Subtract line 12 from line 11. If zero or less, enter -0-. For column A only, enter the amount from line 9	13				
14. If the amount on line 13 is zero, subtract line 11 from line 12. Otherwise, enter zero	14				
15. **Underpayment.** If line 8 is equal to or greater than line 13, subtract line 13 from line 8. Otherwise, go to line 17	15				
16. Add lines 14 and 15. Enter here. If line 8 is equal to or greater than line 13, then go to line 10 of the next column	16				
17. **Overpayment.** If line 13 is more than line 8, subtract line 8 from line 13, then go to line 10 of the next column	17				
FIGURING THE INTEREST					
18. Interest calculation payment date	18	6-15-10	9-15-10	1-15-11	4-15-11
19. Number of days **from** the payment due date shown at the top of the column above line 8 **to** the date the amount on line 16 was paid, or the date shown for that column on line 18, whichever is earlier	19				
20. Annual Percentage Rate (APR)	20	.05	.05	.05	.05
21. Underpayment from line 16 X Number of days from line 19 / 365 X APR on line 20	21				

22. **INTEREST DUE:** Add amounts on line 21 columns A through D. Enter the total here and on Form 2210-K, page 1, line 8 22

Part II – Kentucky

Section 7

A) Military Tax Issues

- Military Pay Exclusion
- Military Spouse
- Military Killed in Line of Duty

B) Additional Tax Topics

- Amended Returns
- Electronic Filing
- Electronic Payments
- Estimated Tax
- Extensions
- Injured Spouse
- Innocent Spouse
- Statute of Limitations
- Tax Incentive Programs

C) W-2 Information

MILITARY TAX ISSUES

Military Pay Exclusion

Effective for taxable years beginning on or after January 1, 2010, all military pay received by active duty members of the Armed Forces of the United States, members of reserve components of the Armed Forces, and members of the National Guard will be exempt from Kentucky individual income tax.

Soldiers will claim the exemption by excluding military pay when filing a Kentucky individual income tax return (if necessary) starting with the 2010 return. Provided the military member has no income other than military pay, he or she would not be required to file a Kentucky income tax return. The military pay exemption applies to all Kentucky military members regardless of where the member is stationed.

Kentucky income tax should no longer be withheld from checks received for military pay beginning January 2, 2010. If Kentucky income tax is incorrectly withheld from a soldier's military pay in 2010 and after, the Kentucky Department of Revenue will refund the tax withheld.

Military Spouse

The Military Spouses Residency Relief Act (MSRRA) was signed into law on November 11, 2009. This new law is effective beginning January 1, 2009. The MSRRA allows the same residency benefits permitted to military personnel under the Service members Civil Relief Act to also apply to a military spouse's nonmilitary income. The MSRRA prohibits a spouse's income from being considered income earned in a tax jurisdiction if the spouse is not a resident or domiciliary of such jurisdiction when the spouse is in that jurisdiction solely to be with a service member serving under military orders.

Those military spouses who fall under this law should file Form 740-NP Kentucky Individual Income Tax Nonresident or Part-Year Resident Return to request a refund of the Kentucky income tax withheld from his or her pay. The income would not be reported as taxable on the Kentucky income tax return. To assist the department in identifying those returns, please write across the top of the return "*MILITARY SPOUSE*."

Income Tax Exclusion for Military Killed in the Line of Duty

HB 380 amended **KRS.141.010** to exempt all income earned by soldiers killed in the line of duty from Kentucky tax for the years during which the death occurred and the year prior to the year during which the death occurred.

The changes are applicable for tax years beginning after December 31, 2001. The income exclusion applies to all income from all sources of the decedent, not just military income. The exclusion includes all federal and state death benefits payable to the estate or any beneficiaries.

Amended returns may be filed for the year the soldier was killed in the line of duty and the year prior to the year of death. The amended returns must be filed within the statute of limitations period; four years from the due date, the extended due date or the date the tax was paid, whichever is later.

If a combined return was filed, the exclusion would apply to the income reported in Column A or Column B of the Kentucky return attributable to the military member. If a joint return was filed, the income must be separated accordingly. Refunds will be issued in the names on the original return. Beneficiaries or estates that received death benefits that were included in a Kentucky return may file an amended return to request a refund of taxes paid on the benefit.

The Department of Revenue will use the Veterans Administration definition for “in the line of duty,” which is in active military service, whether on active duty or authorized leave, unless the death was the result of the person’s own willful misconduct.

Military Extensions

Federal law allows for a 180 day extension for members of the military serving in a combat zone. Kentucky allows a one year extension for members of the military serving in a combat zone.

ADDITIONAL TAX TOPICS

Amended Returns

Often, due to errors or sometimes to report additional information, taxpayers have a need to amend their original filed return. Due to recent law changes, there are three different options for amending your Kentucky Individual Income Tax Return, depending on the year in question. Kentucky Form 740-X may be used by taxpayers who need to amend their 2010, 2009, 2008 or 2007 Kentucky tax return. Form 740-XP is used for tax years 2004 and prior. For tax years 2005 and 2006, please visit the DOR website – www.revenue.ky.gov – and download the specific form for that year.

A claim for refund or credit may only be made within four (4) years of the last day prescribed by law, which includes:

- The original due date;
- The extended due date; or
- The date the tax was paid, whichever is later.

This means that for monies paid in with or prior to the extension, the statute of limitations is based on the extended due date. For any monies paid in after the extended due date, the statute of limitations is based on the extended date **or** the date that money was paid.

Note: There are no separate instructions for forms 740-X or 740-XP. Use the instructions for the tax year involved to prepare an amended return.

Amending Form 740 or 740-EZ

Use the appropriate form 740-X or 740-XP. These forms have a three (3) column format. Column 1 is used to report the original figures used, Column 2 is used to note net changes and Column 3 is used to report the corrected amounts.

Amending Form 740-NP

To amend form 740-NP, you must:

- Use another form 740-NP and mark the box on the face of the form labeled amended and include a copy of the original 740-NP filed;
- Enter the corrected amounts on this form and recalculate to arrive at the correct amount of tax liability; and

- Manually enter any previous amounts received or paid with the original return to arrive at the corrected additional tax to be paid or refunded.

Amending Filing Status

It is worth noting that if separate returns have been filed by both spouses for the taxable year, the husband and wife may elect to file an amended joint return if the Cabinet is notified in writing that the separate return election is rescinded.

Likewise, if husband and wife have filed a joint return, they may elect to file an amended combined or amended separate return.

Married couples electing to file a combined return **shall not** be permitted to rescind such election and file separate returns. **(See 103 KAR 17:020)**

103 KAR 17:020. Combined individual returns. Page 1 of 1

103 KAR 17:020. Combined individual returns.

RELATES TO: KRS 131.130, 141.180, 141.050

STATUTORY AUTHORITY: KRS Chapter 13A

NECESSITY, FUNCTION, AND CONFORMITY: This administrative regulation provides a basis for the combined individual income tax return which permits married taxpayers to gain benefits of separate filing on one return. The administrative regulation also covers other points related to individual income tax forms, including requirement for social security number.

Section 1. Forms. (1) Resident. A resident return shall be filed on Revenue Form 740 (long form) or 740-S (short form) except that a new resident may file on Revenue Form 740-NP (nonresidents and part-year residents).

(2) Nonresidents. A nonresident return shall be filed on Revenue Form 740-NP.

Section 2. Filing Elections. (1) Separate return. Any individual, whether married or single, may elect to file a separate return.

(2) Joint return. A husband and wife may elect, for any year, to file a joint return if they are married at the close of the taxable year; or a surviving spouse may elect to file a joint return if the husband or wife died during the taxable year even though one (1) spouse had no gross income. If a joint return is filed, the gross income and adjusted gross income of husband and wife are computed in an aggregate amount and the deductions and the net income are also computed on an aggregate basis. If separate returns have been filed by both spouses for the taxable year, the husband and wife may elect to file an amended joint return if the Revenue Cabinet is notified in writing that the separate return election is rescinded. Likewise, if husband and wife have filed a joint return for the taxable year, they may elect to file an amended combined or amended separate returns. A return marked "amended" will satisfy this requirement. Persons filing joint returns are jointly and severally liable for all taxes, penalties, and interest accruing under the return.

(3) Combined return. A husband and wife may elect, for any year, to file a combined retùrn if they are married at the close of the taxable year. If a combined return is filed, the gross income, adjusted gross income, deductions, net income, tax credits, and tax liabilities of the husband and wife are computed separately but the tax shall be assessed on an aggregate basis. If a husband and wife elect to file a combined return, refunds shall be made payable to the husband and wife jointly and the husband and wife shall be jointly and severally liable for all taxes, penalties, and interest. Married couples electing to file a combined return shall not be permitted to rescind such election and file separate returns for that taxable year.

Section 3. General Provisions. (1) Forms may be obtained from the Revenue Cabinet, Frankfort, Kentucky 40601. Each taxpayer must carefully prepare his return so as to set forth fully and clearly the information required and attach copies of all withholding statements designated to be filed with the Kentucky income tax returns. Returns which are not so prepared will not be accepted as meeting the requirements of the law. In the absence of a prescribed form, a statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return. If filed within the prescribed time, such statement will relieve the taxpayer from penalties for failure to file or late filing if the tentative return is promptly supplemented by a return made on the proper form.

(2) The social security number and complete home address of the taxpayer together with the official post office and zip code shall be given in the space provided at the top of the return for the name and address of the taxpayer. A taxpayer having a permanent business address may give that address as the principal or mailing address if the complete home address is also given within the space provided.

(3) The return may be made by an agent if the taxpayer is unable to do so. Whenever a return is made by an agent, it must be accompanied by a power of attorney, unless, by reason of absence, illness or other good cause, the taxpayer is unable to executive a power of attorney. (II-2; 1 Ky.R. 225; eff. 1-8-75; Am. 3 Ky.R. 147; eff. 9-1-76.)

Electronic Filing

The Kentucky Department of Revenue (KDOR) joined with the Internal Revenue Service (IRS) in 1994 to begin offering electronic filing of federal and state individual income tax returns. The Federal/State Electronic Filing Program allows taxpayers to file both their federal and state returns electronically through their tax preparer. This program is an effort to provide "one-stop shopping" for all tax preparation and filing. Taxpayers, tax practitioners and KDOR benefit from electronic filing. The program was offered to all Kentucky taxpayers during the 2010 filing season, with nearly 1,178,000 returns being received. This represents an increase of 2 percent from 2009.

State-Only Filing—Kentucky is accepting state-only returns for the 2010 tax year. We will not accept state-only returns for part-year residents and nonresidents. State-only filing is a method to file a state return through the current Fed/State system. The type returns that will be eligible for state-only filing are: 1) Previously rejected state e-filed returns and, 2) State returns input separately from a previously filed federal return. In all transmissions, the federal data must be attached. Please consult your software vendor to determine the availability of state only filing.

Note: For additional information on electronic filing, see IRS Publication KY-1345, Kentucky Handbook for Electronic Filers of Individual Income Tax Returns, available on the revenue website.

1–D Barcodes are imprinted on all Kentucky individual income tax forms. The barcode contains information identifying the form and year for indexing and scanning the forms.

2–D Barcodes may be found on some computer generated forms. 2-D Barcode returns are processed through our electronic filing program.

E-Filing Mandate

The Worker, Homeownership, and Business Assistance Act of 2009 is federal legislation that included a provision originally requiring tax preparers, beginning in the 2011 tax season, who expect to file more than 10 individual, estate, or trust returns to file them electronically.

However, the IRS has announced on its website that it has decided to phase in the e-file mandate over 2011 and 2012. As a result, the federal e-file mandate is as follows:

> **2011** – Return preparers who **reasonably anticipate** filing 100 or more tax returns in 2011 are required to file them electronically.
>
> **2012** – Return preparers who **reasonably anticipate** filing more than 10 tax returns in 2012 are required to file them electronically.

Delaying the full implementation for one year will allow both the IRS and small tax practitioners time to adapt to the new requirement.

Along the same lines, the Commonwealth of Kentucky became the 21st state to adopt an e-filing mandate for paid tax preparers, also beginning with the 2011 tax season. Kentucky will follow the IRS' lead as far as implementing the e-filing mandate over a two-year period.

Electronic Payments

The Kentucky Department of Revenue accepts payments by all major credit cards (MasterCard, VISA and Discover) and e-checks for any outstanding delinquent tax liabilities as well as any tax due when filing your current year Kentucky individual income tax.

- For outstanding tax liabilities contact a representative in the Division of Collections at (502) 564-4921 and
- For current year liabilities, payments may be made online by the taxpayer if made before the due date of the return.

Note: Convenience fees are charged on past due liabilities, but not on current year timely made payments.

Estimated Tax

Estimated tax payments are a means for taxpayers to avoid an underpayment of tax penalty. Estimated tax payments are also referred to as **declaration payments**. PF8 is the mainframe application designated as Income Tax Declaration. In that application you will find the history of individual taxpayers payments made and payments applied or "marked-off".

Individuals who can reasonably expect to have income in excess of $5,000 from which no Kentucky income tax will be withheld may be required to make estimated tax payments as required by KRS 141.300. Individuals who do not prepay at least 70 percent of the tax liability for the year may be subject to a 10 percent penalty for underpayment of estimated tax. Prepayments may be made through:

- Withholding;
- Credit forward from the previous tax year;
- Estimated tax payments; and,
- For taxpayers who have income subject to another states tax, credit for individual income tax paid to another state.

Vouchers

Individual estimated tax payments are set up to be made quarterly via Form 740-ES Estimated Tax Vouchers. Taxpayers may pay the full amount of estimated tax in one payment on the earliest applicable due date or they may be paid in installments.

Extensions

Kentucky individual and corporation income tax returns must be filed with the DOR by the due date, unless an extension is obtained. The request for the extension must be submitted in writing to the Revenue Cabinet on or before the due date of the return.

KRS 141.170(1) states in part "The Department of Revenue may grant a taxpayer other than a corporation a reasonable extension of time for filing his income tax return whenever good cause exists…"

Inability to pay is not an acceptable reason. Acceptable reasons include destruction of records by fire or flood and serious illness of taxpayer.

A taxpayer that is granted an extension of time for filing a federal income tax return shall be granted the same extension of time for filing a Kentucky income tax return. A copy of the federal extension approval or request for an automatic extension should be attached to the Kentucky income tax return when it is filed.

Extensions for Electronic Filed Returns

If the extension request is electronically filed with the IRS, taxpayers receive a confirmation number. Advise them to enter the confirmation number on form 4868 (federal extension) or a copy of the electronic acknowledgement and attach to the paper filed Kentucky individual income tax return.

For the six-month extension it is necessary to attach a copy of the approved federal extension **Form 2688 - Application for Additional Extension of Time to File U.S. Individual Tax Return.**

Extensions for Members of the Military – See separate information on military tax issues.

No Federal Extension

In some instances an extension may be required for the Kentucky return and not the federal return. Kentucky has its own form 40A102 for that situation.

Innocent Spouse Relief

House Bill 121 amended **KRS 141.180** to provide innocent spouse relief for a spouse who is jointly or severally liable for taxes levied under **KRS 141.020,** along with applicable penalties, and interest if the spouse has been relieved of liability for federal purposes or would have been relieved had there been a federal liability.

Any determination of qualifying for Kentucky purposes would be made by the Division of Collections.

Injured Spouse Relief

For federal purposes, Form 8379 can be attached to the joint return when filed and the spouse not owing delinquent past due child support or other obligations can get their refund. The portion of the refund that was attributable to withholding for the spouse owing the money would be kept and sent to the appropriate agency for the delinquent debt.

Kentucky law does not provide for injured spouse relief. Accordingly, Kentucky will capture the refund or a portion thereof and send such refund to the agency that is owed the delinquent debt. It is the Department of Revenue's position that the primary way to avoid having a state income tax refund offset to a spouse's liability is to utilize **Married Filing Separate on Separate Returns** as the filing status.

Note: Kentucky recognizes Injured Spouse relief for Child Support claims **only.** This claim can be made after the refund has been offset and sent to Child Support. At that time, it is recommended that the Injured Spouse contact Taxpayer Assistance in order to begin the process of claiming Injured Spouse Relief.

Statute of Limitations

A statute of limitations by definition defines the period within which legal action may be taken. As applied to taxes, the statute of limitations determines the legal time frame for making assessments and issuing refunds. The Statute of Limitations for Kentucky Individual Income Tax is administered as per KAR 15:040:

103 KAR 15:040. Statute of limitations; assessments and refunds.

NECESSITY, FUNCTION, AND CONFORMITY: This administrative regulation summarizes and explains provisions of income tax law pertaining to time limitations on assessments of additional taxes and the granting of tax refunds.

Section 1. Assessments. Additional income tax may be assessed within four (4) years from the due date of return, the extended due date, or the filing date of a late return. Exceptions are provided in this section and in Section 2 of this administrative regulation. If returns are not filed, or if fraudulent returns are filed, additional tax may be assessed at any time.

(1) Individuals. Additional tax may be assessed within six (6) years after the return was due or filed if an individual understates net income by twenty-five (25) percent, or omits from net income at least twenty-five (25) percent of net income reported.
(2) Corporations. Additional tax may be assessed within six (6) years after the return was due or filed if the corporation understates its taxable net income by twenty-five (25) percent, or omits from taxable net income at least twenty-five (25) percent of taxable net income reported.

Section 2. Agreements. The period for assessment and refund may be extended by written agreement between the cabinet and the taxpayer before the statutory limitation expires, and may be further extended by additional agreements. Any agreement extending the time for assessment specifically extends the time for refund or credit notwithstanding the limitation in Section 3 of this administrative regulation.

Section 3. Refunds. (1) Limitation. The cabinet may authorize refunds or credits within three (3) years from the due date of the return or the date the tax was paid, whichever is later, on payments received before January 1, 1966. Payments received on or after January 1, 1966 may be refunded or credited within four (4) years from the due date of the return or the date the tax was paid, whichever is later. Interest is paid on refunds for taxable years ended July 1, 1982 and thereafter in accordance with KRS 131.183.
(2) Claim. A refund claim may be filed by letter or Revenue Form 40A713. A claim must contain:
- (a) The taxpayer's name, address, and form of organization whether individual, corporation, or fiduciary;
- (b) The calendar or fiscal year of the taxpayer;
- (c) Amount paid and date of payment;
- (d) The validation number if available;
- (e) The amount of refund requested;
- (f) A certification that taxpayer is not indebted to the Commonwealth for any taxes; and
- (g) The basis for the claim.

(3) A separate claim must be filed for each year, and an amended return may be required to support any claim. If any claim is denied, a protest may be filed with the cabinet within forty-five (45) days from notice of disallowance.

Section 4. Statutory Date. A return filed before the due date is considered filed on the due date for purposes of this administrative regulation.

Note: The Statute of Limitations for federal purposes is three years.

Tax Incentive Programs

In an effort to increase economic development among Kentucky businesses and support, promote and finance economic development in the Commonwealth of Kentucky, the General Assembly has created special tax incentives by establishing programs with various income tax credits.

All these credits described below have one thing in common. These programs provide for assessment fees that are paid by the employee to the employer in the form of withholding by the employer from the employee's wages. The employee recoups a percentage of the amounts withheld from their wages by including the amount withheld on their Kentucky income tax return just like the regular Kentucky withholding tax.

That amount is verified on the W-2/K-2 wage statement. The amount of the assessment fee which can be taken as a withholding credit on the Kentucky return will be reflected on the wage statement just like the Kentucky withholding amount and will be identified by the specific program.

Examples of these current types of programs include:

- Kentucky Rural Economic Development Act (KREDA–KRS 154.22),
- Kentucky Jobs Development Act (KJDA–KRS 154.24)
- Kentucky Industrial Revitalization Act (KIRA–KRS 154.26)
- Kentucky Industrial Development Act (KIDA–KRS 154.28)
- Kentucky Economic Opportunity Zone (KEOZ–KRS 154.23)
- Kentucky Jobs Retention Agreement (KJRA–KRS 154.25)
- Kentucky Business Investment Program (KBI–KRS 154.32)

Note: Withholding for these programs may include either state or local withholding and should be identified as such on the wage statement. Only state withholding may be claimed as additional withholding by the taxpayer. Local tax may only be claimed as an itemized deduction.

W-2 INFORMATION

All employees should receive Form W-2 wage statement from each employer showing the amount of pay received for services and any other disbursements. These may include federal, state and local tax withheld and various other items. Most employers issue multiple copies; however, all copies may not include the same information. For example one copy may be designated as the "state" copy and only include state information.

Although the overall look of W-2 forms issued by different employers may be different, similar to the way checks vary, all have common information boxes on the form. Each box is identified by a letter or number and that information is consistent on all forms.

An example of Form W-2 is shown below:

22222	a Employee's social security number	OMB No. 1545-0008	
b Employer identification number (EIN)		1 Wages, tips, other compensation	2 Federal income tax withheld
c Employer's name, address, and ZIP code		3 Social security wages	4 Social security tax withheld
		5 Medicare wages and tips	6 Medicare tax withheld
		7 Social security tips	8 Allocated tips
d Control number		9 Advance EIC payment	10 Dependent care benefits
e Employee's first name and initial Last name Suff.		11 Nonqualified plans	12a Code
		13 Statutory employee / Retirement plan / Third-party sick pay	12b Code
		14 Other	12c Code
f Employee's address and ZIP code			12d Code

15 State Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form **W-2** **Wage and Tax Statement** 2010 Department of the Treasury—Internal Revenue Service

Copy 1—For State, City, or Local Tax Department

INFORMATION FOUND ON FORM W-2 WAGE STATEMENT

A brief description of each information box is listed below. For additional information regarding these items, review "Instructions for Form W-2" found on the IRS Web site: www.irs.gov.

Demographic information is shown on the W-2 as follows:

Box A	**Employee's Social Security number**
Box B	**Employer ID number**
Box C	**Employer's name, address, and ZIP code**
Box D	**Employer's control number - optional**
Box E & F	**Employee's name and address**

Dollar amounts allocated to the proper item and additional information is shown as follows:

Box 1	**Wages, tips, other compensation**
Box 2	**Federal income tax withheld**
Box 3	**Social Security wages, limits apply (may be different than Box 1)**
Box 4	**Social Security tax withheld**
Box 5	**Wages and tips subject to Medicare tax**
Box 6	**Medicare tax withheld**
Box 7	**Social Security tips**
Box 8	**Allocated tips**
Box 9	**Advance earned income credit**
Box 10	**Dependent care benefits**
Box 11	**Nonqualified plans**

Box 12 **"Catchall" box for Codes for various items (please see below).**

Box 13 **Check applicable boxes.**

Box 14 **Other items. Examples include union dues, parsonage allowance, etc.**

Box 15 **Enter state(s)**

Box 16 **Enter state wages**

Box 17 **State income tax withheld**

Box 18 **Local wages subject to tax**

Box 19 **Local tax withheld**

Box 20 **Name of locality**

Corrections – Should corrections need to be made to the original Form W-2 those can be made by the employer by using Form W-2C. Corrections may be needed to correct addresses, amounts of Kentucky income, etc.

REFERENCE GUIDE FOR BOX 12 CODES

A - Uncollected Social Security tax on tips

B - Uncollected Medicare tax on tips

C - Group-term life insurance over $50,000

D - Elective deferrals to a 401(k) cash of deferred arrangement

E - Elective deferrals to a 403(b) salary reduction agreement (tax-sheltered annuity programs for employees of public schools, hospitals and certain other tax-exempt organizations)

F - Elective deferrals to a 408(k)(6) salary reduction SEP plan

G - Elective and nonelective deferrals to a 457(b) deferred compensation plan (state and local government and certain tax-exempt employers)

H - Elective deferrals to a 501(c)(18)(D) tax-exempt organization plan (trusts created before June 25, 1959 - very rare)

J - Nontaxable sick pay (Not included in boxes 1, 3 or 5)

K - 20% excise tax on excess golden parachute payments

L - Substantiated employee business expense reimbursement (nontaxable)

M - Uncollected Social Security tax on group-term life insurance coverage > $50,000

N - Uncollected Medicare tax on group-term life insurance coverage > $50,000

P - Excludable reimbursed moving expenses

Q - Military employee basic quarters, subsistence and combat zone compensation

R - Employer contributions to your Medical Savings Account

S - Employee salary reduction contributions to a section 408(P) SIMPLE

T - Adoption Benefits (not included in line 1)

V - Income from the exercise of nonstatutory stock option

W - Employer's contributions to a Health Savings Account

Y - Deferrals under a section 409A nonqualified deferred compensation plan

Z - Income under section 409A on a nonqualified deferred compensation plan

AA - Designated Roth contributions under a section 401 (k) plan

BB - Designated Roth contributions under a section 403 (k) plan

Part II – Kentucky

Section 8

A) Kentucky Form 740-EZ Example

B) Kentucky Form 740-NP Example

C) Kentucky Form 740-NP-R Example

D) The Big Picture

EXAMPLES OF KENTUCKY INDIVIDUAL INCOME TAX FORMS

Example 1 – BASIC FACT SHEET FOR KENTUCKY FORM 740-EZ

- Joseph T. Taxpayer
  1234 South Main Street
  Nicholasville, KY 40356

- Joe is a high school senior who worked part time at Ed's Sporting Goods and earned $12,400 for 2010. Kentucky tax withheld totals $744. Joe is claimed as a dependent on his parents' return.

- His W-2 and 740-EZ form follow.

22222

a Employee's social security number: 4XX-XX-XXXX

OMB No. 1545-0008

b Employer identification number (EIN): 61- XXXXXXX

c Employer's name, address, and ZIP code:
Ed's Sporting Goods, Inc.
100 Ballpark Avenue
Lexington, KY 40509

d Control number

e Employee's first name and initial / Last name / Suff.
Joseph T. Taxpayer
1234 South Main Street
Nicholasville, KY 40356

f Employee's address and ZIP code

Box	Amount	Box	Amount
1 Wages, tips, other compensation	12400	2 Federal income tax withheld	527
3 Social security wages	12400	4 Social security tax withheld	769
5 Medicare wages and tips	12400	6 Medicare tax withheld	180
7 Social security tips		8 Allocated tips	
9 Advance EIC payment		10 Dependent care benefits	
11 Nonqualified plans		12a Code	
13 Statutory employee / Retirement plan / Third-party sick pay		12b Code	
14 Other		12c Code	
		12d Code	

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name
KY	654321	12400	744	12400	237	Fayette

Form **W-2** Wage and Tax Statement **2010**

Department of the Treasury—Internal Revenue Service

Copy 1—For State, City, or Local Tax Department

740-EZ

Single Persons With No Dependents
42A740-EZ
Department of Revenue

KENTUCKY
INDIVIDUAL INCOME TAX RETURN

Kentucky UNBRIDLED SPIRIT

2010

Your Social Security Number
4XX-XX-XXXX

LABEL

Name—Last, First, Middle Initial
Taxpayer Joseph T

Mailing Address (Number and Street or P.O. Box) Apartment Number
1234 South Main Street

City, Town or Post Office State ZIP Code
Nicholasville KY 40356

FAMILY SIZE 1

POLITICAL PARTY FUND Designating $2 will not change your refund or tax due. Mark an X in Box 1 for **Democratic**, Box 2 for **Republican**, or Box 3 for **No Designation**.

1 [ ] 2 [ ] 3 [X]

INCOME

		Line	Amount
1.	Enter federal Adjusted Gross Income from **Form 1040EZ, line 4.** This is your **Kentucky Modified Gross Income (If $14,404 or less, you may qualify for the Family Size Tax Credit. See instructions on page 2.)**	1 •	12,400 00
2.	Standard deduction	2	2,210 00
3.	Subtract line 2 from line 1. This is your Taxable Income	3	10,190 00
TAX 4.	Enter tax from Tax Table or Tax Computation for amount on line 3	4	407 00
5.	Personal tax credit	5	20 00
6.	Subtract line 5 from line 4. If line 5 is larger than line 4, enter zero	6	387 00
7.	Multiply line 6 by the Family Size Tax Credit for **Family Size 1** decimal amount 0.6 (60%) and enter here (see instructions on page 2)	7 •	232 00
8.	Subtract line 7 from line 6. This is your **Income Tax Liability**	8	155 00
9.	Enter **Kentucky Use Tax**	9 •	00
10.	Add lines 8 and 9. This is your **Total Tax Liability**	10 •	155 00
11.	Enter **Kentucky Income Tax** withheld as shown on ***attached*** 2010 Form W-2, Wage and Tax Statement(s)	11 •	744 00
12.	If line 11 is larger than line 10, enter **AMOUNT OVERPAID** (see instructions)	12	589 00

Fund Contributions; See instructions ➤ ***(Enter amount(s) checked)***

13. a **Nature and Wildlife Fund**
[X] $10 [ ] $25 [ ] $50 [ ] Other ____ • 10

b **Child Victims' Trust Fund**
[ ] $10 [ ] $25 [ ] $50 [ ] Other ____ •

c **Veterans' Program Trust Fund**
[ ] $10 [ ] $25 [ ] $50 [ ] Other ____ •

d **Breast Cancer Research/Education Trust**
[X] $10 [ ] $25 [ ] $50 [ ] Other ____ • 10

		Line	Amount
14.	Add amounts contributed on lines 13a, 13b, 13c and 13d	14	20 00
15.	Subtract line 14 from line 12. Amount to be **refunded to you** **REFUND**	15 •	569 00
16.	If line 10 is larger than line 11, enter amount you owe. Enclose check payable to **Kentucky State Treasurer.** Write your Social Security number and "KY Income Tax—2010" on the check **OWE**	16 •	00

Attach Form W-2, Wage and Tax Statement(s) and Payment Here

I, the undersigned, declare under penalties of perjury that I have examined this return, including any accompanying statements, and to the best of my knowledge and belief, it is true, correct and complete.

Your Signature Telephone Number (daytime) Date Signed

Typed or Printed Name of Preparer Other Than Taxpayer I.D. Number of Preparer Date

Mail to: **REFUNDS** **Kentucky Department of Revenue, Frankfort, KY 40618-0006.**
PAYMENTS **Kentucky Department of Revenue, Frankfort, KY 40619-0008.**

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Example 2 – BASIC FACT SHEET FOR KENTUCKY FORM 740-NP

- John and Jane Smith
  321 University Drive
  Eugene, OR 97404

- John and Jane Smith moved out of Kentucky in 2009. During 2010, they sold their share in a local restaurant located in Louisville, Kentucky and earned income from a partnership that is based in Kentucky. The partnership paid withholding to Kentucky on behalf of the Smiths.

- Capital gain income received from a Kentucky source - $82,739

- Income received from partnership - $77,276

- Withholding paid by the partnership to Kentucky - $4,716

- The Smiths itemized their deductions for 2010

740-NP 42A740-NP Department of Revenue

Check if return is: ☐ *Amended (Attach copy of original return.)*

KENTUCKY INDIVIDUAL INCOME TAX RETURN
Nonresident or Part-Year Resident
2010

For calendar year or other taxable year beginning ________, 2010, and ending ________, 20___

A. Spouse's Social Security Number	B. Your Social Security Number
4xx-xx-xxxx	1xx-xx-xxxx

LABEL

Name—Last, First, Middle Initial (Joint or combined return, give both names and initials.)
Smith, John and Jane

Mailing Address (Number and Street or P.O. Box) Apartment Number
321 University Drive

City, Town or Post Office: Eugene State: OR ZIP Code: 97404

FILING STATUS (see instructions)
1 ☐ Single
2 ☑ *Married,* filing joint return.
3 ☐ *Married,* filing separate returns. Enter spouse's Social Security number above and full name here. ________

POLITICAL PARTY FUND
Designating $2 will not change your refund or tax due.

	A. Spouse	B. Yourself
Democratic	(1) ☐	(4) ☐
Republican	(2) ☐	(5) ☐
No Designation	(3) ☑	(6) ☑

RESIDENCY STATUS *(check one box)*
4 ☑ Full-year nonresident. I did not live in Kentucky during the year. Enter state of residence as of December 31, 2010 ________.
5 ☐ Part-year resident. Complete appropriate line(s) below.
Moved into Kentucky ___/___/ 10. State moved from ________.
Moved out of Kentucky ___/___/ 10. State moved to ________.
6 ☐ Full-year resident of a **reciprocal state** with Kentucky income of wages and salaries only. Circle the state of residence. ➤ IL IN MI OH VA WV WI

COMPLETE SECTIONS A, B, C AND D ON PAGES 2 THROUGH 4 BEFORE COMPLETING LINES 7 THROUGH 30.

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Attach Form W-2(s), Other Supporting Statement(s) and Payment Here—Staple to Top Page Only

INCOME/TAX

Line	Description		Amount		Amount	
7	Enter percentage from page 4, line 36 ➤	7	61.8 %			
8	Enter amount from page 4, line 35, Column A. This is your **Federal Adjusted Gross Income**	• 8			243,044	00
9	Enter amount from page 4, line 35, Column B. This is your **Kentucky Adjusted Gross Income**	• 9			150,114	00
10	**Nonitemizers:** Enter $2,210 (do not prorate). Skip lines 11 and 12	10				00
11	**Itemizers:** Enter itemized deductions from Kentucky Schedule A, Form 740-NP	• 11	29,802	00		
12	Multiply line 11 by the percentage on line 7	12	18,418	00		
13	Subtract line 10 or 12 from line 9. This is your **Taxable Income**	13			131,696	00
14	Enter tax from Tax Table	14			7,568	00
15	Enter amount from page 2, Section A, line 19	15				00
16	Subtract line 15 from line 14	16			7,568	00
17	**Enter personal tax credit amounts from page 3, Section B, line 4**	• 17	100	00		
18	Multiply line 17 by the percentage on line 7	18	62	00		
19	Subtract line 18 from line 16	19			7,506	00
20	Check the box that represents your total family size (**see instructions** for lines 20 and 21)	• 20			1 ☐ 2 ☐ 3 ☑ 4 ☐	
21	Multiply line 19 by the **Family Size Tax Credit** decimal amount 0 . 00 (0 %) and enter here	• 21				00
22	Subtract line 21 from line 19	22			7,506	00
23	Enter the **Education Tuition Tax Credit** from Form 8863-K	• 23				00
24	Subtract line 23 from line 22	24			7,506	00
25	Enter **Child and Dependent Care Credit** from worksheet in the instructions	• 25				00
26	Subtract line 25 from line 24	26			7,506	00
27	Enter the **New Home Tax Credit (see instructions)**	• 27				00
28	**Income Tax Liability.** Subtract line 27 from line 26. If line 27 is larger than line 26, enter zero	28			7,506	00
29	Enter **KENTUCKY USE TAX** from worksheet in the instructions	• 29				00
30	Add lines 28 and 29. Enter here and on page 2, line 31	30			7,506	00

FORM 740-NP (2010)

REFUND/TAX PAYMENT SUMMARY

Line	Description	Sub-line	Amount		Line	Amount	
31	Enter amount from page 1, line 30. This is your **Total Tax Liability**				• 31	7,506	00
32	(a) Enter **Kentucky income tax withheld** as shown on **attached** 2010 Form W-2(s) and other supporting statements	• 32(a)		00			
	(b) Enter 2010 Kentucky estimated tax payments	• 32(b)		00			
	(c) Enter 2010 refundable certified rehabilitation credit (KRS 141.382(1)(b))	• 32(c)		00			
	(d) Enter 2010 film industry tax credit (KRS 141.383)	• 32(d)		00			
	(e) Enter **Nonresident Withholding** from Form PTE-WH, line 9 (KRS 141.206(4)(b)(1))	• 32(e)	4,716	00			
33	Add lines 32(a) through 32(e)				• 33	4,716	00
34	If line 33 is larger than line 31, enter **AMOUNT OVERPAID** (see instructions)				34		00

Fund Contributions; See instructions. ➤ *(Enter amount(s) checked)*

Line	Fund						Amount	
35	**Nature and Wildlife Fund**	☐ $10	☐ $25	☐ $50	☐ Other ____	• 35		00
36	**Child Victims' Trust Fund**	☐ $10	☐ $25	☐ $50	☐ Other ____	• 36		00
37	**Veterans' Program Trust Fund**	☐ $10	☐ $25	☐ $50	☐ Other ____	• 37		00
38	**Breast Cancer Research/Education Trust Fund**	☐ $10	☐ $25	☐ $50	☐ Other ____	• 38		00

Line	Description	Sub-line	Amount		Line	Amount	
39	Add lines 35 through 38				39		00
40	Amount of line 34 to be **CREDITED TO YOUR 2011 ESTIMATED TAX**				• 40		00
41	Subtract lines 39 and 40 from line 34. Amount to be **REFUNDED TO YOU** REFUND				• 41		00
42	If line 31 is larger than line 33, enter **ADDITIONAL TAX DUE**				• 42	2,790	00
43	(a) Estimated tax penalty and/or interest. ☐ *Check if Form 2210-K attached*	• 43(a)	54	00			
	(b) Interest	• 43(b)		00			
	(c) Late payment penalty	• 43(c)		00			
	(d) Late filing penalty	• 43(d)		00			
44	Add lines 43(a) through 43(d). Enter here				• 44		00
45	Add lines 42 and 44 and enter here. This is the **AMOUNT YOU OWE** OWE				45	2,844	00

- Make check payable to **Kentucky State Treasurer** or visit **www.revenue.ky.gov** for more options.
- Write your Social Security number and "KY Income Tax—2010" on the check.

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SECTION A—BUSINESS INCENTIVE AND OTHER TAX CREDITS

Line	Description	Line	Amount	
1	Enter nonrefundable limited liability entity credit (KRS 141.0401(2)) **(attach Kentucky Schedule(s) K-1 or Form(s) 725)**	1		00
2	Enter skills training investment credit (attach copy(ies) of certification)	2		00
3	Enter nonrefundable certified rehabilitation credit (KRS 171.397(1)(a))	3		00
4	Enter credit for tax paid to another state **(attach copy of other state's return(s))**	4		00
5	Enter unemployment credit (attach Schedule UTC)	5		00
6	Enter recycling and/or composting equipment credit (attach Schedule RC)	6		00
7	Enter Kentucky Investment Fund credit (attach copy(ies) of certification)	7		00
8	Enter coal incentive credit	8		00
9	Enter qualified research facility credit (attach Schedule QR)	9		00
10	Enter GED incentive credit (attach Form DAEL-31)	10		00
11	Enter voluntary environmental remediation credit (attach Schedule VERB)	11		00
12	Enter biodiesel and renewable diesel credit	12		00
13	Enter environmental stewardship credit	13		00
14	Enter clean coal incentive credit	14		00
15	Enter ethanol credit (attach Schedule ETH)	15		00
16	Enter cellulosic ethanol credit (attach Schedule CELL)	16		00
17	Enter energy efficiency products credit (attach Form 5695-K)	17		00
18	Enter railroad maintenance and improvement credit (attach Schedule RR-I)	18		00
19	Add lines 1 through 18. **Enter here and on page 1, line 15**	19		00

FORM 740-NP (2010)

SECTION B—PERSONAL TAX CREDITS

	Check Regular	Check both if 65 or over		Check both if blind	
1 (a) Credits for yourself:	☑	☑	☑	☐	☐
(b) Credits for spouse:	☑	☐	☐	☐	☐

1 Enter number of boxes checked on line 1 .... **4**

2 **Dependents:**

First name	Last name	Dependent's Social Security number	Dependent's relationship to you	Check if qualifying child for family size tax credit
Billy	Smith	5xx-xx-xxxx	Son	☑
				☐
				☐
				☐

2 Enter number of dependents who:

- lived with you........... 1
- did not live with you (see instructions).......
- other dependents......

3 Add lines 1 and 2 and enter here.................... •3 5

x $20

4 Multiply credits on line 3 by $20. Enter here and **on page 1, line 17**.................... 4 100

SECTION C—FAMILY SIZE TAX CREDIT (List the name and Social Security number of qualifying children that are not claimed as dependents in Section B.)

First name	Last name	Social Security number	First name	Last name	Social Security number

A copy of pages 1 and 2 of your federal income tax return and all supporting schedules must be attached to Kentucky Form 740-NP.

I, the undersigned, declare under penalties of perjury that I have examined this return, including all accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete. I also understand and agree that our election to file a combined return under the provisions of Regulation 103 KAR 17:020 will result in refunds being made payable to us jointly and in each of us being jointly and severally liable for all taxes accruing under this return.

Your Signature (If joint return, both must sign.) Spouse's Signature Date Signed **Telephone Number (daytime)**

Typed or Printed Name of Preparer Other than Taxpayer I.D. Number of Preparer Date

Firm Name EIN Date

Mail to: **REFUNDS** **Kentucky Department of Revenue, Frankfort, KY 40618-0006.**

PAYMENTS **Kentucky Department of Revenue, Frankfort, KY 40619-0008.**

Official Use Only				
EST	CF	NT	P B F R	

FORM 740-NP (2010)

SECTION D
INCOME

		A. Total from *Attached* Federal Return		B. Kentucky	
1 Enter all wages, salaries, tips, etc. ***(attach wage and tax statements)*** Do not include moving expense reimbursements	1		00		00
2 Moving expense reimbursement *(attach Schedule ME)*	2		00		00
3 Interest	3	3,824	00	1,051	00
4 Dividends	4	31,991	00		00
5 Taxable refunds, credits or offsets of state and local income taxes	5		00		00
6 Alimony received	6		00		00
7 Business income or loss *(attach federal Schedule C or C-EZ)*	7		00		00
8 Capital gain or loss *(attach federal Schedule D)*	8	-3,000	00	82,739	00
9 Other gains or losses *(attach federal Form 4797)*	9		00		00
10 (a) Federally taxable IRA distributions, pensions and annuities	10(a)		00		00
(b) Pension income exclusion *(attach Schedule P if more than $41,110)*	10(b)			(	00)
11 Rents, royalties, partnerships, estates, trusts, etc. *(attach federal Schedule E)*	11	193,630	00	77,276	00
12 Farm income or loss *(attach federal Schedule F)*	12		00		00
13 Unemployment compensation (see instructions)	13		00		00
14 Taxable Social Security benefits	14	16,599	00		
15 Gambling winnings	15		00		00
16 Other income (list type and amount) ______	16		00		00
17 Combine lines 1 through 16. This is your **Total Income**	17	243,044	00	161,066	00
ADJUSTMENTS TO INCOME					
18 RESERVED	18		00		00
19 Certain business expenses of reservists, performing artists and fee-basis government officials *(attach federal Form 2106 or 2106-EZ)*	19		00		00
20 Health savings account deduction *(attach federal Form 8889)*	20		00		00
21 Moving expenses *(attach Schedule ME)*	21		00		00
22 Deduction for one-half of self-employment tax	22		00		00
23 Self-employed SEP, SIMPLE, and qualified plans deduction	23		00		00
24 Self-employed health insurance deduction	24		00		
25 Penalty on early withdrawal of savings	25		00		00
26 Alimony paid (enter recipient's name and Social Security number) ______	26		00		00
27 IRA deduction	27		00		00
28 Student loan interest deduction	28		00		00
29 RESERVED	29		00		00
30 Domestic production activities deduction	30		00		00
31 Long-term care insurance premiums (see instructions)	31			1,581	00
32 Health insurance premiums (see instructions)	32			9,371	00
33 Other deductions (list type and amount) ______	33		00		00
34 Add lines 18 through 33. **Total Adjustments to Income**	34		00	10,952	00
35 Subtract line 34 from line 17. This is your **Adjusted Gross Income**	35	243,044	00	150,114	00
36 Divide line 35, Column B, by line 35, Column A. If amount is equal to or greater than 100%, enter 100%. This is your **Percentage of Kentucky Adjusted Gross Income to Federal Adjusted Gross Income**	36	61 . 8 %			

SCHEDULE A
Form 740-NP
42A740-NP-A
Department of Revenue
➤ See instructions. ➤ Attach to Form 740-NP.

KENTUCKY SCHEDULE A ITEMIZED DEDUCTIONS **2010**

Enter name(s) as shown on Form 740-NP, page 1.
Smith, John and Jane

Your Social Security Number
1xx-xx-xxxx

Section	Line	Description	Line no.	Amount		Total	
Medical and Dental Expenses		**Do not include expenses reimbursed or paid by others.**					
	1.	Medical and dental expenses	1	12,157	00		
	2.	Enter amount from Form 740-NP, page 1, line 8 .... 2 243,044 00					
	3.	Multiply the amount on line 2 by 7.5% (.075). Enter result	3	18,228	00		
	4.	**Total medical and dental.** Subtract line 3 from line 1. If zero or less, enter -0-	➤ 4				00
Taxes	5.	Local income taxes (do not include state income tax)	5	34	00		
	6.	Real estate taxes	6	4,761	00		
Note: Sales and use taxes and new motor vehicle taxes are not deductible.	7.	Personal property taxes	7		00		
	8.	Other taxes (list)	8		00		
	9.	**Total taxes.** Add the amounts on lines 5 through 8. Enter here	➤ 9			4,795	00
Interest Expense	10.	Home mortgage interest and points reported to you on federal Form 1098	10	4,431	00		
Note: Personal interest is not deductible.	11.	Home mortgage interest not reported to you on federal Form 1098 (if paid to an individual, show that person's name and address)	11		00		
		See instructions for lines 12 and 13.					
	12.	Points not reported to you on federal Form 1098	12		00		
	13.	Qualified mortgage insurance premiums	13		00		
	14.	Investment interest (attach federal Form 4952 if required)	14		00		
	15.	**Total interest.** Add the amounts on lines 10 through 14. Enter here	➤ 15			4,431	00
Contributions	16.	Contributions by cash or check	16	10,864	00		
Note: For any contribution of $250 or more, see instructions.	17.	Other than cash or check (attach federal Form 8283 if over $500)	17		00		
	18.	Carryover from prior year	18		00		
	19.	**Total contributions.** Add the amounts on lines 16 through 18. Enter here	➤ 19			10,864	00
Casualty and Theft Losses	20.	Enter amount from attached federal Form 4684, Section A, line 16	20		00		
	21.	Enter amount from Form 740-NP, page 1, line 8 .... 21 00					
	22.	Multiply the amount on line 21 by 10% (.10). Enter result	22		00		
	23.	**Total casualty or theft loss(es).** Subtract line 22 from line 20. If zero or less, enter -0-	➤ 23				00
Job Expenses and Most Other Miscellaneous Deductions	24.	Unreimbursed employee expenses—job travel, union dues, job education, etc. (attach Form 2106 or 2106-EZ if applicable) list	24		00		
	25.	Tax preparation fees	25	1,050	00		
	26.	Other (investment, safe deposit box, etc.) list Custodial Fees	26	13,523	00		
	27.	Add the amounts on lines 24, 25 and 26. Enter here	27	14,573	00		
	28.	Enter amount from Form 740-NP, page 1, line 8 .... 28 243,044 00					
	29.	Multiply the amount on line 28 by 2% (.02). Enter result	29	4,861	00		
	30.	**Total.** Subtract line 29 from line 27. If zero or less, enter -0-	➤ 30			9,712	00
Other Miscellaneous Deductions	31.	Other (see instructions)	➤ 31				00
Total Itemized Deductions	32.	Add the amounts on lines 4, 9, 15, 19, 23, 30 and 31. Enter here	➤ 32			29,802	00

• If married filing separate returns, or spouse is not filing a Kentucky return, complete lines 33 through 36 below. If single or married filing jointly, enter total deductions (line 32 above) on Form 740-NP, page 1, line 11.

Line	Description	Line no.	Amount		Total	
33.	Enter your income from Form 740-NP, page 1, line 8	33		00		
34.	Enter joint or combined *federal* Adjusted Gross Income	34		00		
35.	Divide line 33 by line 34. Enter percentage	35				%
36.	Multiply line 32 by line 35. This is your portion of total itemized deductions. Enter here and on Form 740-NP, page 1, line 11	➤ 36				00

Example 3 – BASIC FACT SHEET FOR FORM 740-NP-R

- Mary Jane Watson
  1400 South Elm Street Apt. #4
  Cincinnati, OH 45202

- Mary Jane lives in Cincinnati, OH and works for the Internal Revenue Service in Covington, KY.

- Her W-2 form and Kentucky return follows.

22222	a Employee's social security number 3xx-xx-xxxx	OMB No. 1545-0008	
b Employer identification number (EIN) 78-xxxxxxx		1 Wages, tips, other compensation 25485	2 Federal income tax withheld 2786
c Employer's name, address, and ZIP code Department of the Treasury c/o USDA, National Finance Center PO Box 60000 New Orleans, LA 70160		3 Social security wages 26770	4 Social security tax withheld 1660
		5 Medicare wages and tips 26770	6 Medicare tax withheld 388
		7 Social security tips	8 Allocated tips
d Control number		9 Advance EIC payment	10 Dependent care benefits
e Employee's first name and initial Last name Suff. Mary Jane Watson 1400 South Elm Street Apt. #4 Cincinnati, OH 45202		11 Nonqualified plans	12a Code D 1285
		13 Statutory employee / Retirement plan / Third-party sick pay	12b Code
		14 Other	12c Code
f Employee's address and ZIP code			12d Code

15 State	Employer's state ID number	16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name
KY	054321	25485	1222	25485	669	Covgtn
				25485	19	Kenton

Form **W-2** Wage and Tax Statement **2010**

Department of the Treasury—Internal Revenue Service

Copy 1—For State, City, or Local Tax Department

740-NP-R
42A740-NP-R
Department of Revenue

KENTUCKY INCOME TAX RETURN
Nonresident—Reciprocal State **2010**

Kentucky UNBRIDLED SPIRIT

Last name	Your first name and middle initial	Your Social Security no.	Did you file a Kentucky income tax return for 2009? Yes ☐ No ☑ If no, give reason:
Watson	Mary Jane	3xx-xx-xxxx	Filed an Ohio return.

Mailing Address	Number and street or P.O. box	Apt. no.	City, town or post office	State	ZIP code
	1400 South Elm	#4	Cincinnati	OH	45202

Attach Kentucky Wage and Tax Statements Here

INSTRUCTIONS

This form may be used by qualifying full-year nonresidents to claim a refund of Kentucky income taxes withheld during 2010. To determine if you qualify, you must check "Yes" or "No" for the applicable statements below. *If eligible, complete lines 1–6.* Enter only the taxpayer's name in which the Kentucky wages and salaries were earned in the name box above. Do not include your spouse's name. If both spouses earned only Kentucky wages and salaries as a resident of a reciprocal state, **each spouse must file a separate Form 740-NP-R.**

A. I was a **nonresident** of Kentucky during all of 2010. ☑ Yes ☐ No

B. My only 2010 Kentucky income was from salaries or wages earned while a resident of any of the following states: ☑ Yes ☐ No
(circle state(s)) **1**–Illinois **2**–Indiana **3**–Michigan **4**–Ohio **5**–Virginia **6**–West Virginia **7**–Wisconsin
Note: *Race track, lottery and other gambling winnings are not salaries or wages.*

For Virginia residents only:
C. I commuted ***daily*** to a place of employment in Kentucky. ☐ Yes ☐ No

Nonresidents who answered "No" to any of the statements above must file Form 740-NP to report Kentucky income.
Enter name and address of principal employer in Kentucky

Department of the Treasury
Name
PO Box 60000
Number and street
New Orleans LA 70160
City State ZIP code

Form 740-NP and other Kentucky tax forms can be downloaded.
www.revenue.ky.gov

1.	Enter total **Kentucky income tax withheld.** Do not include local tax withheld. *Attach 2010 wage and tax statement(s)* ● 1		1,222 00
2.	**Nature and Wildlife Fund Contribution** ☐$10 ☐$25 ☐$50 ☐Other ______ *Enter amount checked* ● 2	00	
3.	**Child Victims' Trust Fund Contribution** ☐$10 ☐$25 ☐$50 ☐Other ______ *Enter amount checked* ● 3	00	
4.	**Veterans' Program Trust Fund Contribution** ☐$10 ☐$25 ☐$50 ☐Other ______ *Enter amount checked* ● 4	00	
5.	**Breast Cancer Research/Education Trust Fund Contribution** ☐$10 ☐$25 ☐$50 ☐Other ______ *Enter amount checked* ● 5	00	
6.	From line 1, subtract lines 2, 3, 4 and 5. Amount to be **REFUNDED** ● 6		1,222 00

ATTACH A COPY OF THE 2010 RETURN FILED WITH YOUR STATE OF RESIDENCE.

I declare under the penalties of perjury that I have examined this return and to the best of my knowledge and belief, it is a true, correct and complete return.

Your Signature ______ Date Signed ______ **Telephone Number (daytime)**

Typed or Printed Name of Preparer Other than Taxpayer ______ I.D. Number of Preparer ______ Date ______

Mail to: Kentucky Department of Revenue, Frankfort, KY 40618-0006

Note: Nonresidents of reciprocal states who want to prevent their Kentucky employer from withholding Kentucky income tax from their paychecks should file a copy of Revenue Form 42A809, Certificate of Nonresidence, with their employer. The form is available from the employer, the Kentucky Department of Revenue, Frankfort, KY 40620, or by visiting www.revenue.ky.gov

THE "BIG" PICTURE

The Kentucky Finance and Administration Cabinet is responsible for the construction of state facilities, property management, expenditure control, state purchasing and postal and printing services. The Cabinet provides the administrative support and the facilities to enable agencies to provide the access to government that the public needs and deserves.

The Secretary of Finance provides executive policy and management for the departments and divisions of the Cabinet and serves as the chief financial officer and manager of the financial resources of the Commonwealth. The Secretary also serves on numerous boards and commissions including the Kentucky Economic Development Partnership Board, the Kentucky Economic Development Finance Authority, the Kentucky Economic Roundtable, the Kentucky Higher Education Assistance Authority, the Kentucky Infrastructure Authority and the Kentucky Housing Corporation.

The Cabinet's **Department of Revenue** is the statutory agency of state government responsible for the administration and enforcement of all state revenue laws and for the assessment and collection of state taxes. Its mission is to provide courteous, accurate and efficient services for the benefit of Kentucky and its citizens, and administer the tax laws of the Commonwealth in a fair and impartial manner. The Department of Revenue is made up of many divisions including the Office of Income Taxation.

Office of Income Taxation

The Office of Income Taxation is responsible for administering all matters related to the individual income, withholding, corporation income and corporation license taxes, including technical tax research, compliance, taxpayer assistance, tax specific training, public announcements, publications, forms and any other matter related to those taxes. It consists of the following divisions:

The **Division of Individual Income Tax** is responsible for administering the taxes for returns filed by the following taxpayers: individual income, fiduciary, employer withholding, pass-through entity withholding and partnership. It consists of two branches: Individual Income Tax Branch and Withholding Tax Branch.

The **Division of Corporation Tax** is responsible for administering the following taxes and programs: corporation income tax; corporation license tax; pass-through entity withholding; and partnerships. It consists of two branches: Corporation Income and License Tax Branch; and Pass-Through Entity Branch.

INVOLVEMENT WITH OTHER AREAS

The Office of Income Taxation comes into contact with many other areas of Revenue and often other state agencies, such as the Department of Treasury, as well. Resolving cases may include contacts with more than one area of Revenue. A brief description of the various areas within Revenue follows.

The **Disclosure Branch** is the liaison between the DOR and the Internal Revenue Service, and other agencies of federal, local and state government. The branch administers the provisions of KRS 131.190 to ensure the confidentiality of taxpayer information and protect against unauthorized use or release. Additionally, this branch is responsible for granting electronic security access to DOR information systems and physical access to DOR facilities.

The **Division of Legislative Services** provides technical support and research assistance; performs studies, surveys and research projects to assist in policy-making decisions; coordinates development and drafts proposed tax legislation and regulations; coordinates review of tax legislation; and testifies before legislative committees on tax matters.

The **Office of Processing and Enforcement** is responsible for promoting the enterprise services available to the commonwealth related to document processing, depositing of funds and collecting debt. Additionally, the office is responsible for coordinating, planning and implementing a data integrity strategy. The office consists of the following three divisions:

The **Division of Operations** is responsible for opening all incoming tax returns, preparing the returns for data capture, coordinating the data capture process, depositing receipts and maintaining the tax data. Additionally, the division assists other agencies with similar operational aspects as negotiated with that agency.

The **Division of Collections** is responsible for enforced collection activities related to tax and other debts owed to the commonwealth. The division also collects delinquent child support referred by the Cabinet for Families and Children.

The **Division of Registration and Data Integrity** is responsible for registering taxpayers and ensuring that the data entered into the tax systems is accurate and complete. The Registration Branch processes all business tax applications and assists registrants as needed. This branch also ensures that all taxpayers, who may have overlooked their tax registration obligations, are contacted and brought into compliance.

The **Office of Property Valuation** is responsible for administering all matters related to property and severance taxes. This includes technical tax research, compliance, taxpayer assistance, tax specific training, public announcements, publications, forms and any other matter related to those taxes. The office consists of the following divisions:

The **Division of State Valuation** is responsible for administering all centrally assessed taxes including public service property tax, motor vehicle property tax and the tangible/intangible program.

The **Division of Local Valuation** is responsible for overseeing the real property tax assessment and collection process throughout the state in the 120 PVA and sheriffs' offices.

The **Division of Minerals Taxation and GIS Services** is responsible for administering the taxes related to severance tax and the unmined minerals property tax. It also coordinates the DOR's GIS mapping efforts. It contains three branches: mineral resource valuation; mineral assessment compliance; and cartography/GIS.

The **Office of Sales and Excise Taxes** is responsible for administering all matters related to sales and use tax and the miscellaneous excise taxes. This includes technical tax research, compliance, taxpayer assistance, tax specific training, public announcements, publications, forms and any other matter related to those taxes. It includes the divisions of Sales and Use Tax and Miscellaneous Taxes.

The **Division of Sales and Use Tax** is responsible for administering the sales and use tax and telecommunications excise and gross revenue taxes. It has two branches: Program Compliance and Taxpayer Assistance. The branches are responsible for conducting office audits, administering various exemption programs, initiating compliance activities, assisting taxpayers and discovery of nonfiler populations.

The **Division of Miscellaneous Taxes** is responsible for administering the following taxes: alcoholic beverage taxes; cigarette enforcement fee, license, excise tax and surtax; gasoline tax; health care provider tax; inheritance and estate tax; insurance premiums and insurance surcharge taxes; state bank franchise tax; legal process; marijuana and controlled substance; motor vehicle tire fee; motor vehicle usage taxes; PSC annual assessment; pari-mutuel excise, racing license and admissions taxes; RECC and RTCC; special fuels taxes; other tobacco products and snuff taxes; transient room tax; utility gross receipts tax and underground storage fee. It consists of two branches: Road Fund Branch and Miscellaneous Tax Branch.

The **Office of Field Operations** is responsible for managing the regional taxpayer service centers and field audit program. The ten centers are located in Ashland, Bowling Green, Central Kentucky (Frankfort), Corbin, Hopkinsville, Louisville, Northern Kentucky (Florence), Owensboro, Paducah and Pikeville.

The **Audit Support and Training Branch** is responsible for supporting the work of DOR field auditors and compliance officers throughout the commonwealth, including the support related to computer-assisted audits, audit selection and training. The 10 regional offices are geographically divided among three regional managers to oversee the field operations of the commonwealth. Region 1 consists of Ashland, Northern Kentucky and Pikeville Taxpayer Service Centers. Region 2 consists of Louisville, Corbin and Bowling Green Taxpayer Service Centers; and the Audit Selection Section. Region 3 consists of Hopkinsville, Central Kentucky, Owensboro and Paducah Taxpayer Service Centers.

The **Office of Legal Services for Revenue** provides administrative and legal services for their respective offices/departments and to the Finance and Administration Cabinet and Cabinet-related entities. Members of this office also represent the Cabinet before administrative boards and at all levels of state and federal court.

The **Division of Protest Resolution** reviews and bills tax audits completed by field auditors in the Department of Revenue's 10 taxpayer service centers. The Division is also responsible for responding to and resolving taxpayers' protest of the assessments, which may result from both field audits and office audits.

PVA Offices (Accounting) provide budget, fiscal, personnel and payroll administration for all 120 PVAs and more than 680 deputies throughout the commonwealth. It also coordinates open enrollment for health and life insurance and directs property tax educational courses. It conducts workshops at summer and fall PVA conferences and meetings.

INDIVIDUAL INCOME TAX IMPACT

According to the last available annual report for the Department of Revenue, which covers Fiscal Year 2009-2010, over **43 percent** of General Fund revenues were generated from the **Office of Income Taxation**, which includes Individual, Corporation and Limited Liability Entity Tax. The next-largest source of revenue was the Sales & Use Tax category, which generated almost 34 percent of total revenues.

The revenue generated by **Individual Income Tax** for the Fiscal Year 2009-2010 was in excess of **$3.15 billion** and the total General Fund receipts was over $8.23 billion.

ADMINISTRATE – COLLECT – PROVIDE

Ultimately, employees of the Division of Income Tax, through the application and administration of the tax laws, generate revenue for the Commonwealth of Kentucky and provide service to taxpayers. This is best summed up in the Department of Revenue Mission Statement:

As part of the Finance and Administration Cabinet the mission of the Kentucky Department of Revenue is to administer tax laws, collect revenue, and provide services in a fair, courteous, and efficient manner for the benefit of the Commonwealth and its citizens.