141.205 Disallowance of certain deductions for affiliated entities or related parties.

(1) As used in this section:

(a) "Intangible property" means franchises, patents, patent applications, trade names, trademarks, service marks, copyrights, trade secrets, and similar types of intangible assets;

(b) "Intangible expenses" includes the following only to the extent that the amounts are allowed as deductions or costs in determining taxable net income before the application of any net operating loss deduction provided under Chapter 1 of the Internal Revenue Code:

1. Expenses, losses, and costs for, related to, or in connection directly or indirectly with the direct or indirect acquisition, use, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property;
2. Losses related to, or incurred in connection directly or indirectly with, factoring transactions or discounting transactions;
3. Royalty, patent, technical, and copyright fees;
4. Licensing fees; and
5. Other similar expenses and costs;

(c) "Intangible interest expense" means only those amounts which are directly or indirectly allowed as deductions under Section 163 of the Internal Revenue Code for purposes of determining taxable income under that code, to the extent that the amounts are directly or indirectly for, related to, or connected to the direct or indirect acquisition, use, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property;

(d) "Management fees" includes but is not limited to expenses and costs paid for services pertaining to accounts receivable and payable, employee benefit plans, insurance, legal, payroll, data processing, purchasing, tax, financial and securities, accounting, reporting and compliance services or similar services, only to the extent that the amounts are allowed as a deduction or cost in determining taxable net income before application of the net operating loss deduction for the taxable year provided under Chapter 1 of the Internal Revenue Code;

(e) "Affiliated group" has the same meaning as provided in KRS 141.200;

(f) "Foreign corporation" means a corporation that is organized under the laws of a country other than the United States and that would be a related member if it were a domestic corporation;

(g) "Related member" means a person that, with respect to the entity during all or any portion of the taxable year, is:

1. A person or entity that has, directly or indirectly, at least fifty percent (50%) of the equity ownership interest in the taxpayer, as determined under Section 318 of the Internal Revenue Code;
2. A component member as defined in Section 1563(b) of the Internal

Revenue Code;

3. A person to or from whom there is attribution of stock ownership in accordance with Section 1563(e) of the Internal Revenue Code; or

4. A person that, notwithstanding its form of organization, bears the same relationship to the taxpayer as a person described in subparagraphs 1. to 3. of this paragraph;

(h) "Recipient" means a related member or foreign corporation to whom the item of income that corresponds to the intangible interest expense, the intangible expense, or the management fees, is paid;

(i) "Unrelated party" means a person that has no direct, indirect, beneficial or constructive ownership interest in the recipient; and in which the recipient has no direct, indirect, beneficial or constructive ownership interest;

(j) "Disclosure" means that the entity shall provide the following information to the Department of Revenue with its tax return regarding a related party transaction:

1. The name of the recipient;

2. The state or country of domicile of the recipient;

3. The amount paid to the recipient; and

4. A description of the nature of the payment made to the recipient;

(k) "Other related party transaction" means a transaction which:

1. Is undertaken by an entity which was not required to file a consolidated return under KRS 141.200;

2. Is undertaken by an entity, directly or indirectly, with one (1) or more of its stockholders, members, partners, or affiliated entities; and

3. Is not within the scope of subsections (2) and (3) of this section;

(l) "Related party costs" means intangible expense, intangible interest expense, management fees and any costs or expenses associated with other related party transactions; and

(m) "Entity" means any taxpayer other than a natural person.

(2) An entity subject to the tax imposed by this chapter shall not be allowed to deduct an intangible expense, an intangible interest expense, or a management fee directly or indirectly paid, accrued or incurred to, or in connection directly or indirectly with one (1) or more direct or indirect transactions with one (1) or more related members or with a foreign corporation as defined in subsection (1) of this section, or with an entity that would be included in the affiliated group based upon ownership interest if it were organized as a corporation.

(3) The disallowance of deductions provided by subsection (2) of this section shall not apply if:

(a) The entity and the recipient are both included in the same consolidated Kentucky corporation income tax return for the relevant taxable year; or

(b) The entity makes a disclosure, and establishes by a preponderance of the

evidence that:

1. The payment made to the recipient was subject to, in its state or country of commercial domicile, a net income tax, or a franchise tax measured by, in whole or in part, net income. If the recipient is a foreign corporation, the foreign nation shall have in force a comprehensive income tax treaty with the United States; and
2. The recipient is engaged in substantial business activities separate and apart from the acquisition, use, licensing, management, ownership, sale, exchange, or any other disposition of intangible property, or in the financing of related members, as evidenced by the maintenance of permanent office space and full-time employees dedicated to the maintenance and protection of intangible property; and
3. The transaction giving rise to the intangible interest expense, intangible expense, or management fees between the entity and the recipient was made at a commercially reasonable rate and at terms comparable to an arm's-length transaction; or

(c) The entity makes a disclosure, and establishes by preponderance of the evidence that the recipient regularly engages in transactions with one (1) or more unrelated parties on terms identical to that of the subject transaction; or

(d) The entity and the Department of Revenue agree in writing to the application or use of an alternative method of apportionment under KRS 141.120(9).

(4) An entity subject to the tax imposed by this chapter may deduct expenses or costs associated with an other related party transaction only in an amount equal to the amount which would have resulted if the other related party transaction had been carried out at arm's length. In any dispute between the department and the entity with respect to the amount which would have resulted if the transaction had been carried out at arm's length, the entity shall bear the burden of establishing the amount by a preponderance of the evidence.

(5) Nothing in this section shall be deemed to prohibit an entity from deducting a related party cost in an amount permitted by this section, provided that the entity has incurred related party costs equal to or greater than the amounts permitted by this section.

(6) If it is determined by the department that the amount of a deduction claimed by an entity with respect to a related party cost is greater than the amount permitted by this section, the net income of the entity shall be adjusted to reflect the amount of the related party cost permitted by this section.

(7) For tax periods ending before January 1, 2005, in the case of entities not required to file a consolidated or combined return under subsection (1) of this section that carried on transactions with stockholders or affiliated entities directly or indirectly, the department shall adjust the net income of such entities to an amount that would result if such transactions were carried on at arm's length.

Effective: June 25, 2013

History: Amended 2013 Ky. Acts ch. 119, sec. 17, effective June 25, 2013. -- Amended

2006 (1st Extra. Sess.) Ky. Acts ch. 2, sec. 8, effective June 28, 2006. -- Amended 2006 Ky. Acts ch. 6, sec. 16, effective March 6, 2006. -- Amended 2005 Ky. Acts ch. 85, sec. 488, effective June 20, 2005; and ch. 168, sec. 16, effective March 18, 2005. -- Amended 1976 Ky. Acts ch. 155, sec. 11. -- Amended 1974 Ky. Acts ch. 163, sec. 5. -- Amended 1972 Ky. Acts ch. 62, Pt. III, sec. 3. -- Amended 1970 Ky. Acts ch. 216, sec. 6. -- Amended 1968 Ky. Acts ch. 40, Part II, sec. 2. -- Amended 1966 Ky. Acts ch. 176, Part I, sec. 8. -- Amended 1962 Ky. Acts ch. 124, sec. 4. -- Amended 1960 Ky. Acts ch. 186, Art. III, sec. 1. -- Created 1954 Ky. Acts ch. 79, sec. 15.

Legislative Research Commission Note (6/25/2013). 2013 Ky. Acts ch. 119, sec. 25, provides that the amendments to this statute in 2013 Ky. Acts ch. 119, sec. 17, apply to taxable years beginning on or after January 1, 2014.

Legislative Research Commission Note (6/25/2013). A reference to "subsections (2) to (5)" in subsection (1)(k)3. of this statute has been changed in codification to "subsections (2) and (3)" under KRS 7.136(1)(e) and (h). In 2013 Ky. Acts ch. 119, sec. 17, subsections (4) and (5) were stricken from this statute and subsequent subsections renumbered, but the internal reference in the existing language was overlooked.

Legislative Research Commission Note (6/28/2006). 2006 (1st Extra Sess.) Ky. Acts ch. 2, sec. 73, provides that "unless a provision of this Act specifically applies to an earlier tax year, the provisions of this Act shall apply to taxable years beginning on or after January 1, 2007."

Legislative Research Commission Note (6/28/2006). 2005 Ky. Acts ch. 85, sec. 701, instructs the Reviser of Statutes to correct statutory references to agencies and officers whose names have been changed in the Act, as it confirms the reorganization of the Finance and Administration Cabinet. Such a correction has been made in this section.

Legislative Research Commission Note (3/6/2006). 2006 Ky. Acts ch. 6, sec. 30, provides that this section applies retroactively for taxable years beginning on or after January 1, 2005.

Legislative Research Commission Note (3/18/2005). 2005 Ky. Acts ch. 168, sec. 165, provides that this section shall apply to tax years beginning on or after January 1, 2005.

Legislative Research Commission Note (3/18/2005). 2005 Ky. Acts chs. 11, 85, 95, 97, 98, 99, 123, and 181 instruct the Reviser of Statutes to correct statutory references to agencies and officers whose names have been changed in 2005 legislation confirming the reorganization of the executive branch. Such a correction has been made in this section.