KY Tax Modernization

2005
Corporation Income Tax

(Revised November 14, 2005)

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Foreword from the Commissioner

Mark A. Treesh, CPA, CMA

In March of this year the Governor signed into law HB 272, the most sweeping tax change in the history of the Commonwealth. Significant changes were made in the way that Kentucky taxes businesses and individuals, and that has been the cause of no small amount of uncertainty on what the impact of all this will be on both taxpayers and tax preparers.

We at the Department of Revenue have been working since the bill was passed to prepare for the full implementation of the new act. We have been making changes in computer systems, forms, and regulations and we have been doing our best to provide information as soon as it is ready.

We are glad to be able to assist in this explanation of the new tax law. This program would not have come together if it were not for the efforts of many dedicated tax administrators at the Department of Revenue. They are truly among the finest tax professionals with whom I have had the privilege to work. We certainly also appreciate the efforts of all the tax preparers outside the Department who have contributed much time and effort. Their input has been invaluable.

It is my goal as Commissioner that we implement tax modernization in a way that is as simple as the law will allow for both taxpayers and tax preparers. This manual and the seminars in which it will be used will do much to accomplish that goal. I would further encourage everyone to follow the latest Kentucky tax developments on our website at http://revenue.ky.gov/. It is the best source for the latest news on tax administration.

Frankfort, KY
October, 2005

Taxpayer Assistance

If you file your return with the department's preprinted labels affixed to the envelope and the tax return, you will be able to access information about the receipt of your return using a touch-tone telephone. This information is available through the Automated Refund and Tax Information System (ARTIS). **Receipt of the return can only be verified with the use of the bar-coded labels**. *Use of the labels does not increase your chance of audit or in any other way subject your return to closer examination by the Department of Revenue.*

ARTIS also provides information on the status of your income tax refund after the tax return has been processed. A touch-tone telephone and the following information from your return will be required: the first Social Security number on your return and the **exact** whole-dollar amount of refund.

Once you have the required information, call (502) 564-1600 and follow the recorded instructions.

If during the call you do not receive a refund mailing date, please allow seven days before calling again.

Information and forms are available from Kentucky Taxpayer Service Centers in the following cities.

Ashland
134 Sixteenth Street, 41101-7670
(606) 920-2037

Bowling Green
201 West Professional Park Court, 42104-3278
(270) 746-7470

Central Kentucky (Frankfort)
200 Fair Oaks Lane, 40620-0001
(502) 564-4581 (General Information)
(502) 564-3058 (Telecommunication Device for the Deaf)
(502) 564-3658 (Forms)
www.revenue.ky.gov (Internet)

Corbin
15100 North US 25E
Suite 2, 40701-6188
(606) 528-3322

Hopkinsville
181 Hammond Drive, 42240-7926
(270) 889-6521

Louisville
620 South Third Street
Suite 102, 40202-2446
(502) 595-4512

Northern Kentucky
Turfway Ridge Office Park
7310 Turfway Road, Suite 190
Florence, 41042-4871
(859) 371-9049

Owensboro
311 West Second Street, 42301-0734
(270) 687-7301

Paducah
Clark Business Complex, Suite G
2928 Park Avenue, 42001-4024
(270) 575-7148

Pikeville
Uniplex Center
126 Trivette Drive, Suite 203, 41501-1275
(606) 433-7675

Filing Tips

- ✓ ***File*** early!
- ✓ ***File*** electronically and use direct deposit or direct debit.
- ✓ ***Avoid*** delays by attaching all necessary forms and W-2s.
- ✓ ***Exclude*** up to $41,110 of any IRA, pension or retirement plan distribution, even if you are not retired.
- ✓ ***Pay*** use tax due on out-of-state purchases and avoid penalties and interest.

KENTUCKY e-file

DIRECT Debit

Direct Deposit

YOUR RIGHTS AS A KENTUCKY TAXPAYER

The mission of the Kentucky Department of Revenue (DOR) 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.

As a Kentucky taxpayer, you have the right to expect the DOR to honor its mission and uphold your rights every time you contact or are contacted by the DOR.

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RIGHTS OF TAXPAYER

Privacy—You have the right to privacy of information provided to the DOR.

Assistance—You have the right to advice and assistance from the DOR in complying with state tax laws.

Explanation—You have the right to a clear and concise explanation of:

- basis of assessment of additional taxes, interest and penalties, or the denial or reduction of any refund or credit claim;
- procedure for protest and appeal of a determination of the DOR; and
- tax laws and changes in tax laws so that you can comply with the law.

Protest and Appeal—You have the right to protest and appeal a determination of the DOR if you disagree with an assessment of tax or penalty, reduction or a denial of a refund, a revocation of a license or permit, or other determination made by the DOR.

Conference—You have the right to a conference to discuss a tax matter.

Representation—You have the right to representation by your authorized agent (attorney, accountant or other person) in any hearing or conference with the DOR. You have the right to be informed of this right prior to the conference or hearing. If you intend for your representative to attend the conference or hearing in your place, you may be required to give your representative a power of attorney before the DOR can discuss tax matters with your authorized agent.

Recordings—You have the right to make an audio recording of any meeting, conference or hearing with the DOR, or to be notified in advance if the DOR plans to record the proceedings and to receive a copy of any recording.

Consideration—You have the right to consideration of:

- waiver of penalties or collection fees if "reasonable cause" for reduction or waiver is given ("reasonable cause" is defined in KRS 131.010(9) as: "an event, happening, or circumstance entirely beyond the knowledge or control of a taxpayer who has exercised due care and prudence in the filing of a return or report or the payment of monies due the department pursuant to law or administrative regulation");
- installment payments of delinquent taxes, interest and penalties;
- waiver of interest and penalties, but not taxes, resulting from incorrect written advice from the DOR if all facts were given and the law did not change or the courts did not issue a ruling to the contrary;
- extension of time for filing reports or returns; and
- payment of charges incurred resulting from an erroneous filing of a lien or levy by the DOR.

Guarantee—You have the right to a guarantee that DOR employees are not paid, evaluated or promoted based on taxes assessed or collected, or a tax assessment or collection quota or goal imposed or suggested.

Damages—You have the right to file a claim for actual and direct monetary damages with the Kentucky Board of Claims if a DOR employee willfully, recklessly and intentionally disregards your rights as a Kentucky taxpayer.

Interest—You have the right to receive interest on an overpayment of tax, except delinquent property tax, payable at the same rate you would pay if you underpaid your tax.

DEPARTMENT OF REVENUE RESPONSIBILITIES

The DOR has the responsibility to:

- perform audits, conduct conferences and hearings with you at reasonable times and places;
- authorize, require or conduct an investigation or surveillance of you only if it relates to a tax matter;
- make a written request for payment of delinquent taxes which are due and payable at least 30 days prior to seizure and sale of your assets;
- conduct educational and informational programs to help you understand and comply with the laws;
- publish clear and simple statements to explain tax procedures, remedies, your rights and obligations, and the rights and obligations of the DOR;
- notify you in writing when an erroneous lien or levy is released and, if requested, notify major credit reporting companies in counties where lien was filed;
- advise you of procedures, remedies and your rights and obligations with an original notice of audit or when an original notice of tax due is issued, a refund or credit is denied or reduced, or whenever a license or permit is denied, revoked or canceled;
- notify you in writing prior to termination or modification of a payment agreement;
- furnish copies of the agent's audit workpapers and a written narrative explaining the reason(s) for the assessment;
- resolve tax controversies on a fair and equitable basis at the administrative level whenever possible; and
- notify you in writing at your last known address at least 60 days prior to publishing your name on a list of delinquent taxpayers for which a tax or judgment lien has been filed.

PROTEST AND APPEAL PROCEDURE

Protest—If you receive a notice of assessment, a Notice of Tax Due for tax or penalty or if the DOR notifies you that a tax refund or credit has been reduced or denied, a license or permit revoked or denied, or other determination made by the DOR, you have the right to protest. To do so:

- submit a written protest within 45 days from the original notice date;
- identify the type of tax involved and give the account number, Social Security number or other identification number and attach a copy of the DOR notice of determination to support that protest is timely;
- explain why you disagree;
- attach any proof or documentation available to support your protest or request additional time to support your protest;
- sign your statement, include your daytime telephone number and mailing address; and
- mail to the Kentucky Department of Revenue, Frankfort, KY 40620.

Conference—If you have not been able to resolve the tax matter through your protest, you have the right to request a conference to discuss the issue.

Independent Informal Review—If you feel after the conference that you have not been treated in a fair and equitable manner, you have the right to request an independent informal review.

Final Ruling—If you do not want to have a conference or if the conference did not resolve your protest, you have the right to request a final ruling of the DOR so that you can appeal your case further.

Appeal—If you do not agree with the DOR's final ruling, you can file a written appeal with the Kentucky Board of Tax Appeals. If you do not agree with the decision of the Kentucky Board of Tax Appeals, you have the right to appeal the ruling to the Kentucky courts (first to the circuit court in your home county or in Franklin County, then to the Kentucky Court of Appeals, and you have the right to request a review by the Kentucky Supreme Court).

Note: The above protest and appeal procedures do not apply for assessments of all types of property tax. Contact the local PVA for information about how to appeal the valuation of real property.

WHERE TO GET ASSISTANCE

The DOR has offices in Frankfort and taxpayer service centers in nine cities and towns throughout Kentucky. DOR employees in the service centers answer tax questions and provide assistance. The office locations and telephone numbers are listed elsewhere in this packet.

The DOR also has a Taxpayer Ombudsman's Office which consists of the Ombudsman and a staff whose job is to serve as an advocate for taxpayers' rights. One of the main functions of the office is to ensure that your rights as a Kentucky taxpayer are protected by the DOR.

Also, an important function of the Taxpayer Ombudsman's Office is to confer with DOR employees when you have a problem or conflict that you have been unable to resolve. However, it is not the role of the Ombudsman's Office to intercede in an audit, handle a protest, waive taxes, penalty or interest, or answer technical tax questions. To file a protest, see PROTEST AND APPEAL PROCEDURE. Please do not mail your protest to the Ombudsman.

The Ombudsman's Office is your advocate and is there to make sure your rights are protected. If you think you are not being treated fairly or if you have a problem or complaint, please contact the Ombudsman's Office so they can help you.

The Taxpayer Ombudsman's Office may be contacted by telephone at (502) 564-7822 (between 8:00 a.m. and 4:30 p.m. weekdays). From a Telecommunication Device for the Deaf (TDD), call (502) 564-3058. The mailing address is: Office of Taxpayer Ombudsman, P.O. Box 930, Frankfort, Kentucky 40602-0930.

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This information merely summarizes your rights as a Kentucky taxpayer and the responsibilities of the Department of Revenue. The Kentucky Taxpayers' Bill of Rights may be found in the Kentucky Revised Statutes (KRS) at Chapter 131.041—131.081. Additional rights and responsibilities are provided for in KRS 131.020, 131.110, 131.170, 131.183, 131.500, 133.120, 133.130, 134.580 and 134.590.

KY Tax Modernization

Corporation Income Tax

Chapter 1 - Corporation License Tax
Chapter 2 - Expansion of Corporation Income Tax Base
Chapter 3 - Consolidated Corporation Income Tax Returns
Chapter 4 - Calculation of Corporation Income Tax Liability Based on the Alternative Minimum Calculation
Chapter 5 - Tax Calculation Based on Taxable Net Income
Chapter 6 - Related Party Expense Deduction

DISCLAIMER

Every effort and care has been taken in the preparation of this manual. However, the possibility of mechanical and/or human error does exist.

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 or regulatory authority.

Corporation License Tax Repeal

Repeal Effective Date—Pursuant to KRS 136.0701, corporation license tax was repealed, effective for tax periods ending on or after December 31, 2005. License tax remains due for all tax periods that end prior to December 31, 2005.

52 – 53 Week Year End Filers—For purposes of the corporation license tax repeal, a 52 – 53 week fiscal year end that ends within the last week of December of 2005 will be considered to end on December 31, 2005, and a license tax return will not be due from that taxpayer.

Special Holding Company Provisions – Post ITW Changes

KRS 136.071 has long provided certain holding companies a reduction to their corporation license tax liability. Until a court ruling in the Illinois Tool Works (ITW) case, this benefit was limited to corporations that maintained their commercial domicile in Kentucky. The commercial domicile provision was ruled unconstitutional in the ITW case and refunds were ordered for back periods open to refund under the two year statute of limitations (KRS 134.590) that applies to refunds for taxes held to be unconstitutional. The ITW ruling also stipulated that no corporation could take advantage of the special holding company benefits in KRS 136.071 for tax returns due, without regard to extension, on or after April 15, 2004.

Subsequent to the ITW ruling, the 2003 Kentucky General Assembly passed House Bill 390 which provided a one year temporary fix to the ITW ruling's elimination of the holding company benefit. The bill was vetoed by former Governor Patton and his veto was challenged in the Citizens National case. Pending the result of the Citizens National case, Governor Fletcher announced on April 15, 2004 that corporations may utilize the provisions of House Bill 390. Those provisions provided the special holding company benefit to corporations that passed an ownership test. Ten percent (10%) of the capital excluded under the holding company benefit was to be added back in computing capital subject to tax. The adoption of the House Bill 390 rules applied to license tax returns due, without regard to extension, on or after April 15, 2004, and before April 15, 2005.

HB 272 Impact – KRS 136.071 was amended to override the temporary adoption of the license tax provisions of House Bill 390 and preserve the special holding company benefit. KRS 136.071(1)(b) states:

> "Notwithstanding the provisions of KRS 136.070, a corporation other than a bank holding company that holds directly or indirectly stock or securities in other corporations equal to or greater than fifty percent

(50%) of its total assets may, at the option of the taxpayer, compute capital employed in the business using one (1) of the following options:

1. The corporation and its subsidiaries may file a consolidated license tax return that computes capital employed in the business under KRS 136.070 and includes the parent corporation and all subsidiary corporations in which the parent corporation owns more than fifty percent (50%) of the outstanding stock; or,

2. The corporation may file a separate license tax return and deduct from capital, determined in accordance with KRS 136.070(2), the book value of its investment in the stock and securities of any corporation in which it owns more than fifty percent (50%) of the outstanding stock."

Bank Holding Companies

Bank holding companies were afforded the preservation of the deduction option under the provisions of House Bill 292, enacted by the 2004 General Assembly. KRS 136.071(1)(a) states:

> "Notwithstanding KRS 136.070, a bank holding company as defined in KRS 287.900 that holds directly or indirectly stock or securities in financial institutions subject to the tax imposed by KRS 136.500 to 136.570 equal to or greater than fifty percent (50%) of its total assets may, at the option of the taxpayer, compute its "capital" under KRS 136.070(2) as follows:
>
> 1. Determine the corporation's total capital as provided in KRS 136.070(2).
>
> 2. Deduct from the amount determined in subsection (a) of this section, the book value of its investment in the stock and securities of any financial institutions subject to the tax imposed by KRS 136.500 to 136.570 in which it owns more than fifty percent (50%) of the outstanding stock.

The bank holding company provisions of KRS 136.071(1)(a) were effective for license tax returns due, without regard to extension, on or after April 15, 2004. Bank holding companies cannot file a consolidated license tax return for license tax returns due, without regard to extension, on or after April 15, 2004.

Effective Date

The House Bill 272 amendments to KRS 136.071 apply to corporation license tax returns due without regard to extension on or after April 15, 2004. This means that the revised KRS 136.071 provisions will apply to license tax returns filed for calendar years ended December 31, 2003 and December 31, 2004. The last tax period to which the revised KRS 136.071 provisions apply is the fiscal year ending November 30, 2005.

52 – 53 Week Year Rules

The Department of Revenue applies the following rules to taxpayers that file a license tax return based on a 52 – 53 week fiscal year:

1. A 52 – 53 week fiscal year end that ends within the last week of December of 2003 will be considered to end on December 31, 2003.

2. A 52 – 53 week fiscal year end that ends within the first week of December of 2005 will be considered to end on November 30, 2005. A corporation that has such a fiscal year end must file a corporation license tax return.

Amended Returns

Corporations that filed license tax returns under the temporary adoption of the provisions of House Bill 390 (2003) may file an amended return to recoup the 10% add-back computed on returns filed due without regard to extension on or after April 15, 2004, and before April 15, 2005. Form 720X, amended corporation income and license tax return should be used to apply for the refund. A copy of form 720X is at the end of this chapter.

Special Issues Regarding the Consolidated Return Option

The Department of Revenue has received many inquiries regarding the impact of the House Bill 272 changes on a holding company's ability to file a consolidated corporation license tax return. Many of the questions received relate to the determination of which affiliated corporations can be included in the consolidated license tax return. The following discussion and examples of the consolidated return option assumes that the fifty percent (50%) of total assets ownership test has been met by a holding company that wants to file a consolidated return.

KRS 136.071(1)(b)1 states that a consolidated license tax return "includes the parent corporation and all subsidiary corporations in which the parent corporation owns more than fifty percent (50%) of the outstanding stock." The Department of

Revenue's position on who should be included in the consolidated return is as follows:

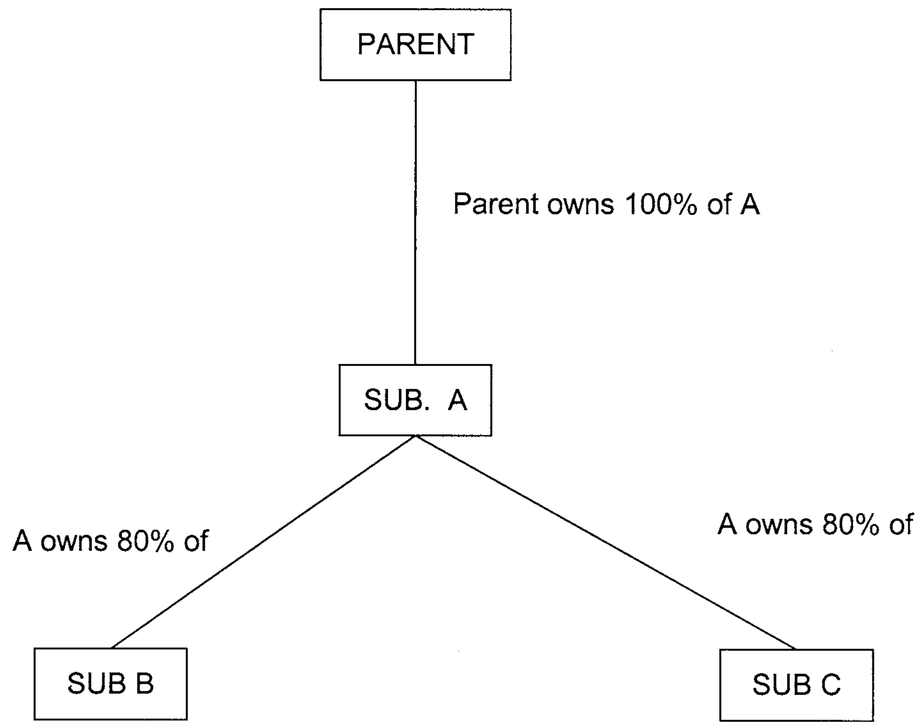
1. The parent corporation can include in the consolidated return those directly owned subsidiaries for which the parent owns more than fifty percent (50%) of the outstanding stock.

2. The parent corporation can include in the consolidated return those indirectly owned subsidiaries for which the parent can demonstrate an indirect ownership percentage that is greater than 50%.

3. To determine whether a parent corporation has an indirect ownership percentage that is greater than 50%, the parent must multiply its percentage of ownership interest in first tier subsidiaries by the percentage of ownership of first tier subsidiaries in second tier subsidiaries.

Example 1-1 depicts a multi-tiered organizational structure for which the parent corporation can include multiple tiers of subsidiaries in a consolidated license tax return.

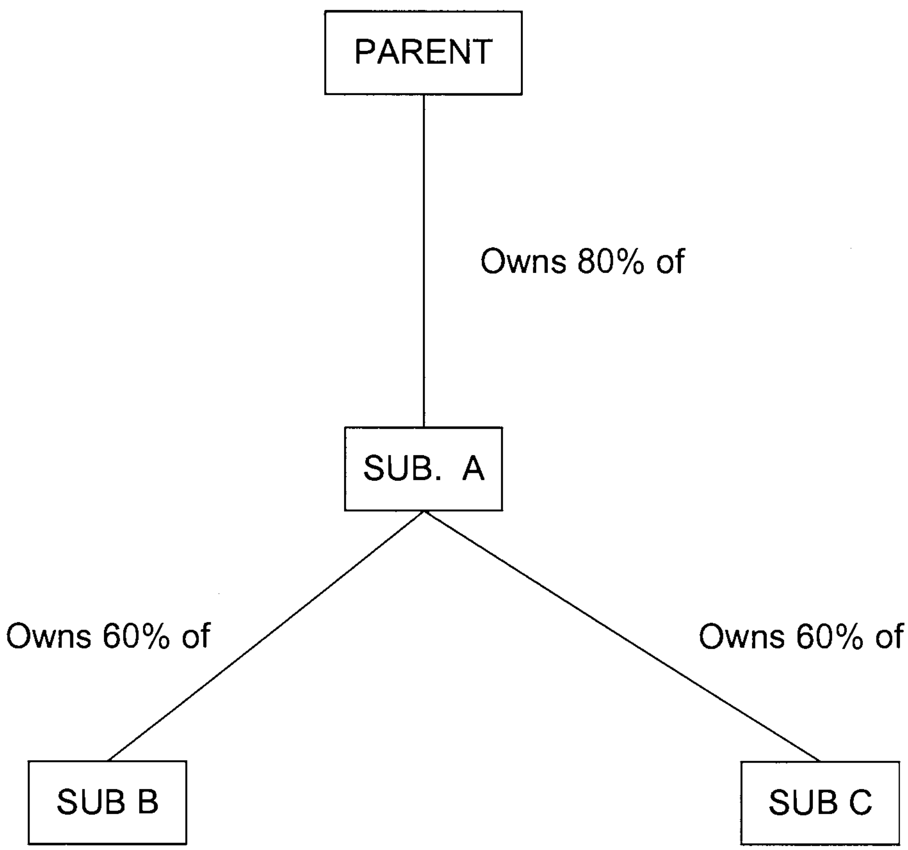
Example 1-1



Parent can include subsidiaries A, B and C in the consolidated return. The parent indirectly owns 80% of B and C via its 100% ownership of A (100% X 80%).

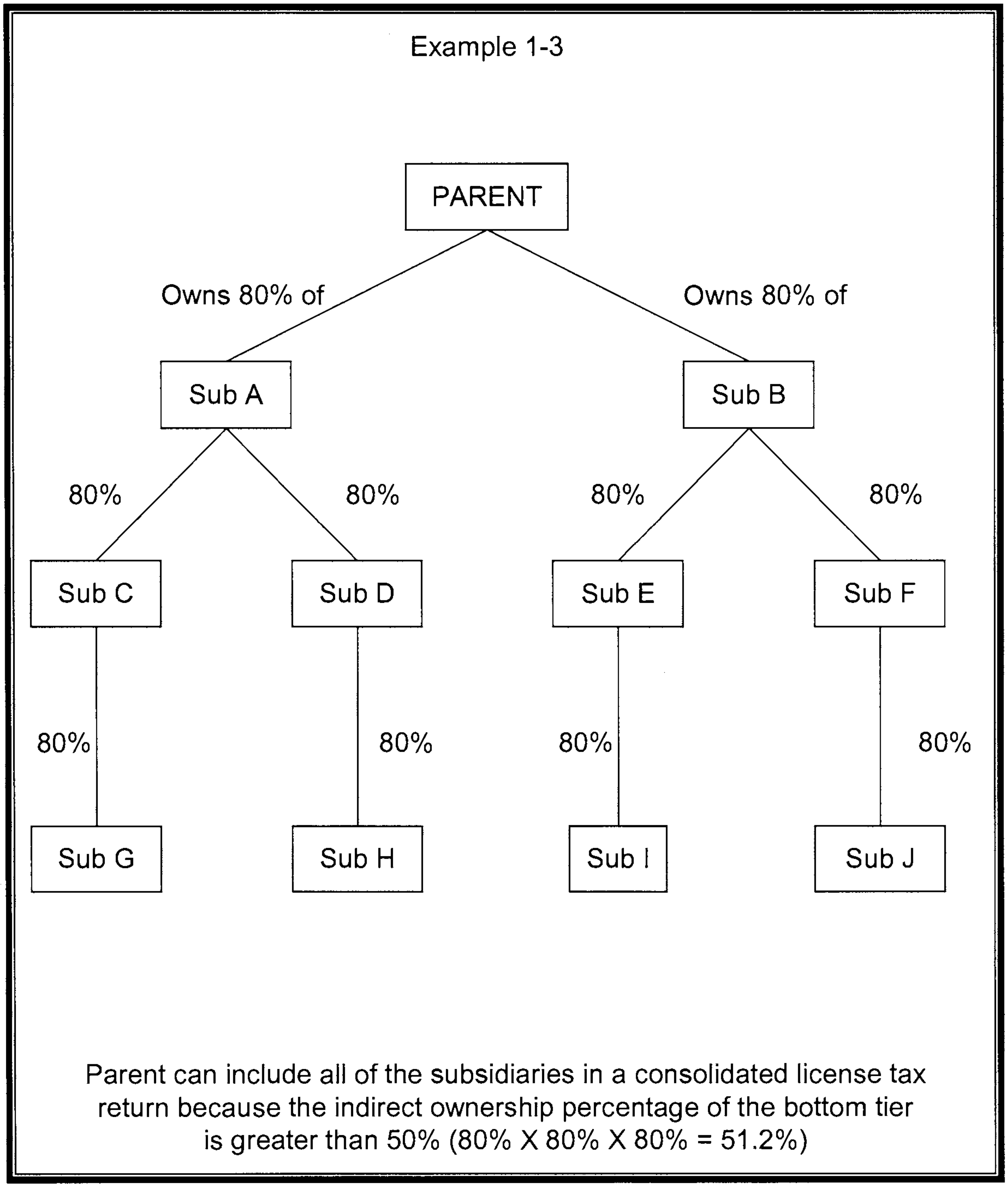
Example 1-2 depicts a multi-tiered organizational structure for which the parent can include only one tier of subsidiaries in a consolidated return.

Example 1-2



Parent can include subsidiary A in the consolidated return. Subsidiaries B and C cannot be included in a consolidated return since the parent only indirectly owns 48% of B and C (80% X 60%). Ownership of greater than 50% must be demonstrated.

Example 1-3 depicts who can be included in a consolidated license tax return for a multi-tiered organizational structure that includes three tiers of subsidiaries.



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720X Kentucky

41A720X (10-05)

Department of Revenue

AMENDED
KENTUCKY CORPORATION INCOME TAX AND CORPORATION LICENSE TAX RETURN

To be used for tax periods beginning prior to January 1, 2005.

Taxable Year Ended

__ __ / __ __
Mo. Yr.

☐ Check if reporting federal audit adjustments.	Name of Corporation or Affiliated Group				Kentucky Corporation Account No.
	Number and Street				Federal Identification No.
	City	State	ZIP Code	Telephone Number	NAICS Code No.
	State and Date of Incorporation	Principal Business Activity in Kentucky			

➤ **Fill in applicable items and use Part III to explain any changes.**

NOTE: *Use Form 720X to correct Form 720. A corporation taxable both within and without Kentucky must complete lines 1 through 9. A 100% Kentucky corporation must complete line 1 and enter the amount on line 1 on line 7, omitting lines 2 through 6.*

PART I—INCOME TAX		A. As Previously Reported	B. Net Change—Increase or (Decrease) (explain in Part III)	C. Corrected Amount
1. Net income before NOL deduction (NOLD)	1			
2. Nonbusiness income (net)	2			
3. Total business income (line 1 less line 2)	3			
4. Apportionment factor	4			
5. Kentucky business income (line 3 multiplied by line 4)	5			
6. Kentucky nonbusiness income (net)	6			
7. Taxable net income before NOLD (line 5 plus line 6, or line 1)	7			
8. Kentucky NOLD (attach schedule)	8			
9. Taxable net income after NOLD (line 7 less line 8)	9			
10. Total income tax (see instructions)	10			
11. Enter credits (see instructions)	11			
12. **Amended income tax liability.** Subtract line 11 from line 10. (If line 11 exceeds line 10, enter 0)	12			
13. Income tax previously paid	13			
14. **Income tax due** (If line 12, column C, exceeds line 13, enter difference as **INCOME TAX DUE**)	14			
15. **Income tax refund** (If line 13 exceeds line 12, column C, enter difference as **INCOME TAX REFUND**)	15			

PART II—LICENSE TAX		A. As Previously Reported	B. Net Change—Increase or (Decrease) (explain in Part III)	C. Corrected Amount
1. Total capital employed	1			
2. Apportionment factor (wholly KY corporations enter 100%)	2			
3. Capital subject to license tax (line 1 multiplied by line 2)	3			
4. Total license tax before credit	4			
5. License tax credit (maximum $490) (see instructions)	5			
6. License tax (line 4 less line 5) (minimum $30)	6			
7. Enter other credits (see instructions)	7			
8 **Amended license tax liability.** Subtract line 7 from line 6. (If line 7 exceeds line 6, enter 0)	8			
9 License tax previously paid	9			
10. **License tax due** (If line 8 exceeds line 9, enter difference as LICENSE TAX DUE)	10			
11. **License tax refund** (If line 9 exceeds line 8, enter difference as LICENSE TAX REFUND)	11			

TAX PAYMENT SUMMARY

Income Tax ______________ License Tax ______________ Interest ______________ **TOTAL** ______________

I, the undersigned, declare under the penalties of perjury, that I have examined this return, including all accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct and complete.

______________________________ ______________
Signature of principal officer or chief accounting officer Date

____
Name and Social Security or federal identification number of person or firm preparing return

Make check payable to Kentucky State Treasurer.

Mail return with payment to Kentucky Department of Revenue, Frankfort, Kentucky 40620.

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Chapter Two – Expansion of Corporation Income Tax Base

Expanded Definition of Corporation

Effective for tax years beginning on or after January 1, 2005, House Bill 272 expanded the corporation income tax to apply to pass-through entities with limited liability protection. The definition of "corporations" in KRS 141.010(24) was amended to include the following entities:

(a) "Corporations" as defined in Section 7701(a)(3) of the Internal Revenue Code;
(b) S corporations as defined in Section 1361(a) of the Internal Revenue Code;
(c) A foreign limited liability company as defined in KRS 275.015(6);
(d) A limited liability company as defined in KRS 275.015(8);
(e) A professional limited liability company as defined in KRS 275.015(19);
(f) A foreign limited partnership as defined in KRS 362.401(4);
(g) A limited partnership as defined in KRS 362.401(7);
(h) A registered limited liability partnership as defined in KRS 362.155(7);
(i) A real estate investment trust as defined in Section 856 of the Internal Revenue Code;
(j) A regulated investment company as defined in Section 851 of the Internal Revenue Code;
(k) A real estate mortgage investment conduit as defined in Section 860D of the Internal Revenue Code;
(l) A financial asset securitization investment trust as defined in Section 860L of the Internal Revenue Code;
(m) Other similar entities created with limited liability for their partners, members, or shareholders."

Single member limited liability companies meet the above definition of "corporations". General partnerships are not "corporations" and therefore don't have to pay corporation income tax. General partnerships are still required to a file a return. The "doing business" nexus standard determines whether or not a general partnership has a filing responsibility in Kentucky under the provisions of KRS 141.206. A new form 765-GP has been developed for exclusive use by general partnerships.

Publicly traded partnerships and their publicly traded partnership affiliates are not considered to be "corporations" under the provisions of KRS 141.010(24) and are not subject to the corporation income tax if the publicly traded partnership is treated as a partnership for federal income tax purposes. Publicly traded partnerships meeting this definition are treated as general partnerships for Kentucky income tax purposes.

“Corporations” as defined in KRS 141.010(24) are subject to corporation income tax under the provisions of KRS 141.040(1), which imposes the tax on every corporation doing business in this state except for:

(a) Financial institutions, as defined in KRS 136.500 (state and national banks), except bankers banks organized under KRS 287.135;
(b) Savings and loan associations organized under the laws of this state and under the laws of the United States and making loans to members only;
(c) Banks for cooperatives;
(d) Production credit associations;
(e) Insurance companies;
(f) Corporations or other entities exempt under Section 501 of the Internal Revenue Code;
(g) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit; and
(h) Corporations whose only owned or leased property located in this state is located at the premises of a printer with which it has contracted for printing.

Special Note: *The exemption from corporation income tax for “corporations” exempt from federal income tax under Section 501 of the Internal Revenue Code includes those entities that are part of the expanded definition of “corporation” provided that the limited liability company, etc. is designated as a tax exempt Section 501 organization by the Internal Revenue Service.*

Practitioner Question: What corporation income tax return must be filed by a nonprofit single member LLC whose single member is a corporation designated as a tax exempt 501(c)(3) corporation by the Internal Revenue Service? Both entities are assumed to be doing business in this state.

Answer: A single member LLC meets the definition of "corporations" in KRS 141.010(24) and would be subject to Kentucky corporation income tax unless otherwise exempt under Kentucky law. KRS 141.040(1) imposes the corporation income tax on "any corporation doing business in this state". KRS 141.040(1) also exempts certain types of "corporations" from corporation income tax. Exempted entities under KRS 141.040(1)(g) include "religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit". The Department of Revenue will consider the nonprofit single member LLC to be a corporation not organized for profit and therefore exempt from corporation income tax under KRS 141.040(1)(g). A corporation income tax return does not have to be filed.

Please note that a different paragraph in the law, KRS 141.040(1)(f) exempts corporations exempt under Section 501 of the Internal Revenue Code. Therefore, the single member also is exempt from filing a Kentucky corporation income tax return.

The position outlined in this answer will be null and void if the single member LLC or its member corporation become a for profit entity. If you receive a request from the Department of Revenue to register the single member LLC, please attach a copy of this ruling to your response.

Change to Corporation Income Tax Nexus Standard

As stated on the previous pages, corporations that are "doing business" in this state are subject to Kentucky's corporation income tax unless the corporation is specifically exempted from the tax by KRS 141.040(1). "Doing business" is the new corporation income tax nexus standard enacted by House Bill 272 that is a broader nexus standard than the one in effect for tax periods that begin before January 1, 2005. Nexus is the minimal amount of business activity that must be present in order for a state to impose a tax. Prior to House Bill 272, Kentucky's nexus standard for corporation income tax was referred to as a "physical presence" nexus standard of property and payroll. "Doing business" is defined under KRS 141.010(25) to include but not be limited to:

(a) Being organized under the laws of this state;
(b) Having a commercial domicile in this state;
(c) Owning or leasing property in this state;
(d) Having one or more individuals performing services in this state;
(e) Maintaining an interest in a general partnership doing business in this state;
(f) Deriving income from or attributable to sources within this state, including deriving income directly or indirectly from a trust doing business in this state; or
(g) Directing activities at Kentucky customers for the purpose of selling them goods or services.

"Doing business" will be further explained in an Administrative Regulation. Important highlights to note from the regulation are:

1. "Doing business" doesn't include an activity that is protected or exempt from state income taxation under the provisions of the United States Constitution or Public Law 86-272. Public Law 86-272 prohibits a state from imposing its income tax on a foreign corporation whose only activity in the state is the solicitation of sales of tangible personal property if the sales orders are approved outside the state and are filled by shipment or delivery from a point outside of Kentucky. The regulation gives several examples of activities that

are deemed to be solicitation activities. Please see the lists below of activities that are protected or not protected under Public Law 86-272.

2. "Deriving income" includes performing services in Kentucky, whether directly by the corporation or indirectly by directing activity performed by a third party.

3. "Doing business" includes being the single member of a single member LLC that is disregarded for federal income tax purposes.

4. "Doing business" doesn't include a corporation who has no connection to Kentucky other than being a single member of a single member LLC that is doing business here.

5. "Doing business" includes entering into franchising or licensing agreements and receiving income from franchising or licensing agreements that have acquired a Kentucky business situs.

6. "Doing business" also includes being the parent of a qualified real estate investment trust subsidiary or qualified subchapter S subsidiary that is doing business in Kentucky.

List of Activities Considered as Protected Under Public Law 86-272

The following activities are considered to be protected or exempt from state income taxation when these are the only activities performed in Kentucky. If a corporation performs some of the protected activities listed in Kentucky and also conducts activities in this state that are not protected under the provisions of the United States Constitution or Public Law 86-272, then the Commonwealth has corporation income tax nexus over the taxpayer. This is not an all-inclusive list.

1. Solicitation of orders through advertising.

2. Carrying samples and promotional materials only for display or distribution without charge or other consideration.

3. Soliciting of orders by an in-state resident employee or representative of the company, so long as such person does not maintain or use any office or other place of business in the state other than an "in-home".

4. Furnishing and setting up display racks and advising customers on the display of the company's products without charge or other consideration.

5. Checking customer inventories for re-order without a charge therefore, but not for other purposes such as quality control.

6. Recruitment, training or evaluating of sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.

7. A sales employee's in-home work space that is not paid for by the company.

8. Missionary sales activities; i.e., the solicitation of indirect customers for the company's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if such solicitation activities are otherwise immune.

9. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.

10. Maintaining a sample or display area for an aggregate of 14 calendar days or less at any one location within Kentucky during the tax year, provided that no other activities inconsistent with solicitation take place.

11. Mediating direct customer complaints if the sole purpose is to ingratiate sales personnel with the customer and facilitating requests for orders.

12. Passing orders, inquiries and complaints on to the home office.

13. Providing automobiles to sales personnel for use solely in solicitation activities.

14. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is solely limited to the conducting of solicitation activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software that are limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation or permitted by this Section shall not, by itself, remove the protection.

List of Activities Not Considered as Protected by Public Law 86-272

The following are examples of activities in this state that fall outside the scope of "solicitation" and are not protected by Public Law 86-272 unless they are de minimis within the meaning of *Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 112 S.Ct. 2447 (1992):*

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Installation or supervision of installation at or after shipment or delivery.
3. Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
4. Credit investigations.
5. Repossessing property.
6. Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation.
7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.
8. Approving or accepting orders.
9. Securing deposits on sales.
10. Picking up or replacing damaged or returned property, including stale or unsaleable property.
11. Maintaining sample or display area for an aggregate of 15 days or more at any one location during the tax year.
12. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.
13. Hiring, training or supervising personnel for other than solicitation activities.
14. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel.

15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.

16. Providing shipping information and coordinating deliveries.

17. Supervising the operations of a franchisee or similar party.

18. Monitoring, inspecting, or approving work performed by an independent contractor under a warranty or similar contractual arrangement.

19. Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale.

20. Fulfilling sales orders by shipment or delivery from a point within Kentucky.

21. Owning, leasing, maintaining or otherwise using any of the following facilities or property in Kentucky:

    (a) Repair shop.
    (b) Parts department.
    (c) Any kind of office other than an in-home office as described as permitted under this regulation.
    (d) Warehouse.
    (e) Meeting place for directors, officers, or employees.
    (f) Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
    (g) Telephone answering service that is publicly attributed to the company or to employees or agent(s) of the company in their representative status.

22. Maintaining, by any employee or other representative, an office or place of business of any kind other than an in-home office located within the residence of the employee or representative that (i) is not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity, and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the company; or for such other activities that are protected under Public Law 86-272 or under this regulation. A telephone listing or other public listing within the state for the company or for an employee or representative of the company in such capacity or other indications through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or representative in a representative capacity. However, the normal distribution and use of business cards and stationery

identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the company shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the company or its employee or representative. The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described in this paragraph shall, by itself, cause the loss of protection under this subsection. For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in home office.

23. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchisor or licensor to its franchisee or licensee within the state.

24. Conducting any other activity which is not entirely ancillary to the solicitation of orders, even if such activity helps to increase purchases.

Important Note: *"Corporations" as defined by KRS 141.010(24), including limited liability companies, limited partnerships and limited liability partnerships that are organized under the laws of this state are subject to corporation income tax even if the corporation is not actively engaged in business. The minimum tax due of $175 is due from any dormant corporation that has not dissolved if that corporation is organized under the laws of Kentucky.*

The impact of the new nexus standard in relation to consolidated returns is discussed in the next chapter.

Registration Issues

Every corporation doing business in Kentucky must register for a corporation income tax account number unless the corporation is exempt from taxation under the provisions of KRS 141.040(1). Any pass-through entities that are now "corporations" subject to corporation income tax must register for a corporation income tax account number. Existing pass-through entities that currently have a Kentucky sales, withholding or coal tax account number and are subject to the corporation income tax under the provisions of House Bill 272 have been assigned a corporation income tax account number by the Department of Revenue. Those entities were notified by letter that the account number was assigned. Existing pass-through entities subject to the corporation income tax under the provisions of KRS 141.040(1) but not registered for sales, withholding or coal tax must file Form 10A100 Kentucky Tax Registration Application or use a special one page registration form available from our website. On the Department's website, http://revenue.ky.gov/, click on the "Tax Modernization" button on the left side of the page. Scroll down to "New Tax Forms" and click on "Corporation Income Tax - Limited Liability Entities". The one-page registration application is "Tax Modernization Fast-Track Corporation Application - Form LLE-272", and you may choose either the fill-in form or the downloadable form. The link to go directly to this page with the application is http://revenue.ky.gov/TaxModernization/CITax_LLEnt.htm.

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Chapter Three – Consolidated Corporation Income Tax Returns

House Bill 272 changed the consolidated corporation income tax return rules. Prior to the law change, corporations subject to the tax filed separate entity returns unless an affiliated group of corporations elected to file a consolidated return for a ninety-six month period. House Bill 272 preserved the elective consolidated return provisions for certain periods and enacted new mandatory nexus consolidated return provisions. This chapter explains both the elective and mandatory nexus consolidated return rules.

Elective Consolidated Returns

KRS 141.200(2) through (7) permits an affiliated group of corporations to make an election to file a consolidated income tax return for a group of corporations that meet the federal definition of affiliated group as defined in Section 1504(a) of the Internal Revenue Code and related regulations. The election to file a consolidated return for an affiliated group as defined under the federal rules applies for taxable periods ending before January 1, 2005, and election periods beginning prior to January 1, 2005 (KRS 141.200(1).

An **"election period"** means a period of ninety-six (96) consecutive calendar months that:

(a) Begins prior to January 1, 2005; and,

(b) Begins with the first day of the first taxable year for which an election to file a consolidated return is made and ending on the last day of the taxable year which includes the 96th consecutive calendar month provided the affiliated group remains in existence in accordance with Treasury Regulation section 1.1502-75(d).

The Department of Revenue will honor existing valid consolidated return elections, including initial elections or re-elections made for calendar or fiscal years beginning prior to January 1, 2005. A new election must be made on form 722, Election to File Consolidated Income Tax Return and the form must be included with a return filed either on the original due date or on or before the extended due date. An affiliated group of corporations that wishes to elect to file a consolidated return upon expiration of an initial ninety-six month election period may make the election by filing a consolidated return for the first period of the new election period and indicate the election is made by checking the appropriate box on the front page of the return. A written statement of re-election, or a form 722 may also be included with the first return of a new ninety-six month election period.

If the last twelve month taxable year of a ninety-six month election period ends on or after December 31, 2005, then the affiliated group will be subject to the nexus consolidated return provisions of KRS 141.200(8) through (14) for future periods.

Example 3-1—A group of affiliated corporations makes its first election to file a consolidated return with the return due for the calendar year ended December 31, 2004. The election may be made when the return is timely filed. Elective consolidated returns may be filed for every calendar year return through the return due for the period ending December 31, 2011 provided the affiliated group remains in existence under the federal rules provided in Treasury Regulation 1.1502-75.

Example 3-2—A group of affiliated corporations that files on a calendar year basis is operating under a valid consolidated return election that began with the calendar year ended December 31, 1998. Assuming the affiliated group remains in existence under the federal rules provided in Treasury Regulation 1.1502-75, a consolidated return may be filed for every taxable year through the calendar year ending December 31, 2005. Upon the expiration of the election period on December 31, 2005, the affiliated group will be subject to the nexus consolidated return provisions of KRS 141.200(8) through (14).

The net income of an elective consolidated group is calculated under the provisions of KRS 141.200(2) through (7) and Administrative Regulation 103 KAR 16:200. An elective consolidated group is subject to the Alternative Minimum calculation provided by KRS 141.040(5)(b) and the other provisions enacted by House Bill 272 that are related to the calculation of the tax liability, the computation of taxable net income, and the computation of the apportionment factor.

Practitioner Question: Can I include limited liability companies, limited partnerships or limited liability partnerships in a Kentucky elective consolidated return filed for calendar years ending on or after December 31, 2005?

Answer: No, under the elective consolidated rules, the federal definition of affiliated group in Section 1504(a) of the Internal Revenue Code (IRC) and related regulations limits the affiliated group to the federal definition of "includible corporations" in Section 1504(b) of the IRC. Non-corporate entities cannot be included as part of the elective consolidated affiliated group. Kentucky will recognize a limited liability company that elects to be taxed as a corporation as an "includible corporation" for an elective consolidated group, provided that the LLC is recognized as a member of the affiliated group under the federal consolidated rules.

Practitioner Question: An affiliated group of corporations is currently filing under a valid consolidated return election that began with the calendar year ended December 31, 2002 return. Can the affiliated group file a new election with the calendar year ended December 31, 2004 return and cancel the old election?

Answer: No, the original election cannot be cancelled just to begin a new ninety-six month election period. The Department of Revenue considers a consolidated return election to be a binding agreement between the taxpayer and the Commonwealth for the duration of the ninety-six month period unless the affiliated group ceases to exist under Treasury Regulation 1.1502-75. The 2002 election is considered to be binding and a request for a new election with the 12/31/04 return will be denied.

The computation of consolidated net income for an elective consolidated return group is discussed in Chapter 5 of this book – How the tax is calculated and related forms.

Nexus Consolidated Returns

The nexus consolidated return provisions apply to taxable years beginning on or after January 1, 2005. Excluding those affiliated groups under a valid consolidated return election provided under the provisions of KRS 141.200(1) through (7), all other corporations that are doing business in Kentucky are required by KRS 141.200(10) to file a separate return unless the corporation was, for any part of the taxable year:

(a) An includible corporation in an affiliated group;

(b) A common parent corporation doing business in this state;

(c) A qualified subchapter S Subsidiary that is included in the return filed by the Subchapter S parent corporation; or,

(d) A qualified real estate investment trust subsidiary that is included in the return filed by the real estate investment trust parent.

"Common parent corporation" is defined by KRS 141.200(9)(b) to be the member of an affiliated group that meets the ownership requirement of KRS 141.200(9)(a)1.

KRS 141.200(9)(a)1. defines "affiliated group" to be "one or more chains of includible corporations connected through stock ownership, membership interest, or partnership interest with a common parent corporation if:

(a) The common parent owns directly an ownership interest meeting the requirements of subparagraph 2. of this paragraph in at least one other includible corporation; and,

(b) An ownership interest meeting the requirements of subparagraph 2. of this paragraph in each of the includible corporations, excluding the common parent, is owned directly by one or more of the other corporations.

Subparagraph 2. of KRS 141.200(9)(a) states: "The ownership interest of any corporation meets the requirements of this paragraph if the ownership interest encompasses at least eighty percent (80%) of the voting power of all classes of ownership interests and has a value equal to at least eighty percent of the total value of all ownership interests."

"Ownership interest" is defined by KRS 141.200(9)(e) to mean stock, a membership interest in a limited liability company, or a partnership interest in a limited partnership or limited liability partnership.

"Includible corporation" is defined by KRS 141.200(9)(d) to mean any corporation that is doing business in this state except:

1. Corporations exempt from corporation income tax under KRS 141.040(1)(a) to (h);

2. Foreign corporations;

3. Corporations with respect to which an election under Section 936 of the Internal Revenue Code is in effect for the taxable year;

4. Real estate investment trusts as defined in Section 856 of the Internal Revenue Code;

5. Regulated investment companies as defined in section 851 of the Internal Revenue Code;

6. A domestic international sales company as defined in section 992(a)(1) of the Internal Revenue Code;

7. An S corporation as defined in Section 1361(a) of the Internal Revenue Code;

8. Any corporation that realizes a net operating loss whose Kentucky property, payroll, and sales factors pursuant to subsection (8) of KRS 141.120 are de minimis; and,

9. Any corporation for which the sum of the property, payroll and sales factors described in subsection (8) of KRS 141.120 is zero.

"Foreign corporation" is defined by KRS 141.200(9)(c) to be a corporation that is organized under the laws of a country other than the United States and is related to a member of an affiliated group through stock ownership.

Chains of includible corporations can be part of an affiliated group. Thus, a multi-tiered group of affiliated corporations that are doing business in Kentucky can file a nexus consolidated return provided:

1. All the includible corporations, including the common parent of the multiple-tiered structure have nexus (doing business) in Kentucky;

2. All the includible corporations except for the common parent corporation are directly owned by eighty percent or more by one or more of the other includible corporations in the group;

3. The common parent directly owns eighty percent or more of at least one other of the includible corporations in the group.

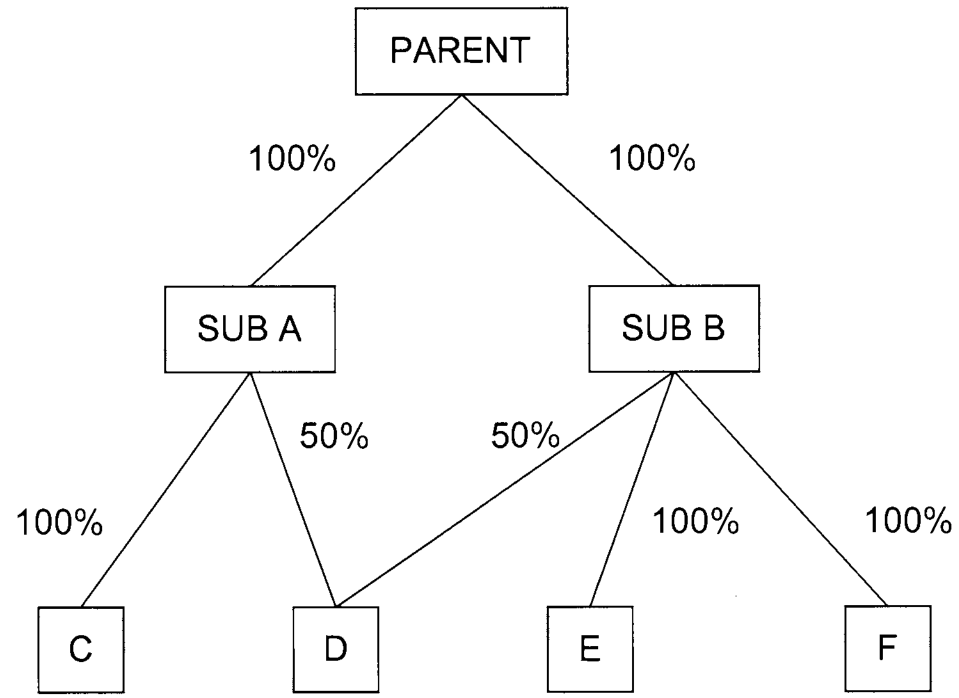
If the chain or chains of corporations are broken by a member not having nexus in this state or a member not being directly owned by eighty percent or more by another member, then it is possible for there to be more than one nexus consolidated group within a group of related corporations.

Practitioner Question: Can I include limited liability companies, limited partnerships or limited liability partnerships in a Kentucky nexus consolidated return filed for calendar years ending on or after December 31, 2005?

Answer: Yes, limited liability corporations, limited partnerships and limited liability partnerships that are doing business in this state can be included in a nexus consolidated return provided those entities meet the definition of "includible corporation" in KRS 141.200(9)(d).

On the following pages are examples of nexus consolidated groups.

Example 3–3



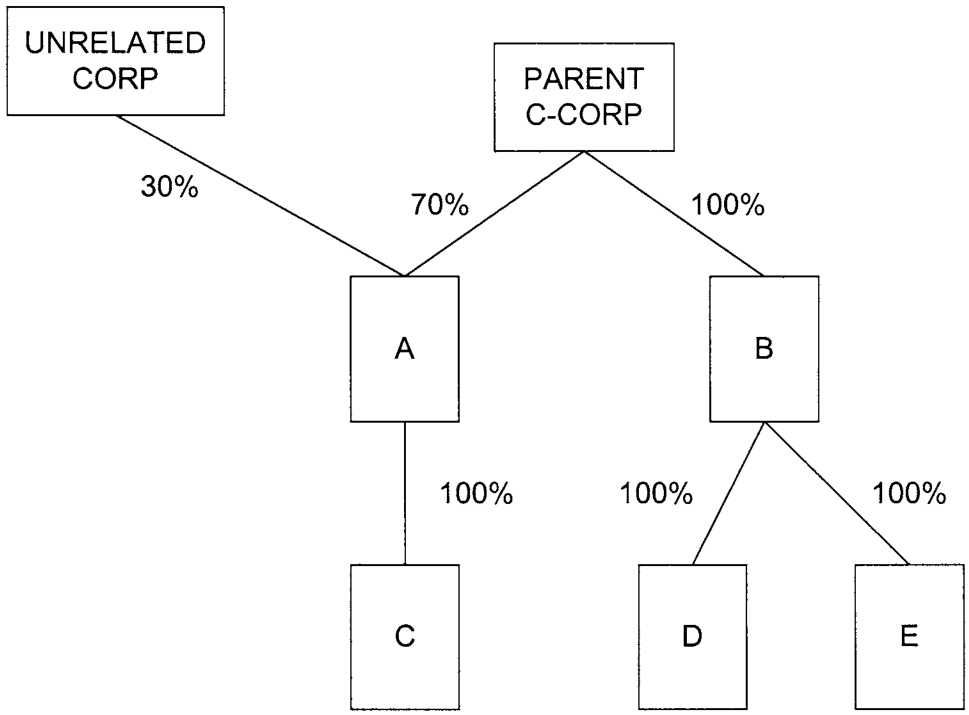
Parent and all subsidiairies have nexus.

Parent and all subsidiairies are C-corporations.

Nexus consolidated return includes Parent, A, B, C, D, E and F.

D is included in the consolidated return because D is 80% or more owned by one or more (A & B) of the includible corporations in the affiliated group.

Example 3–4



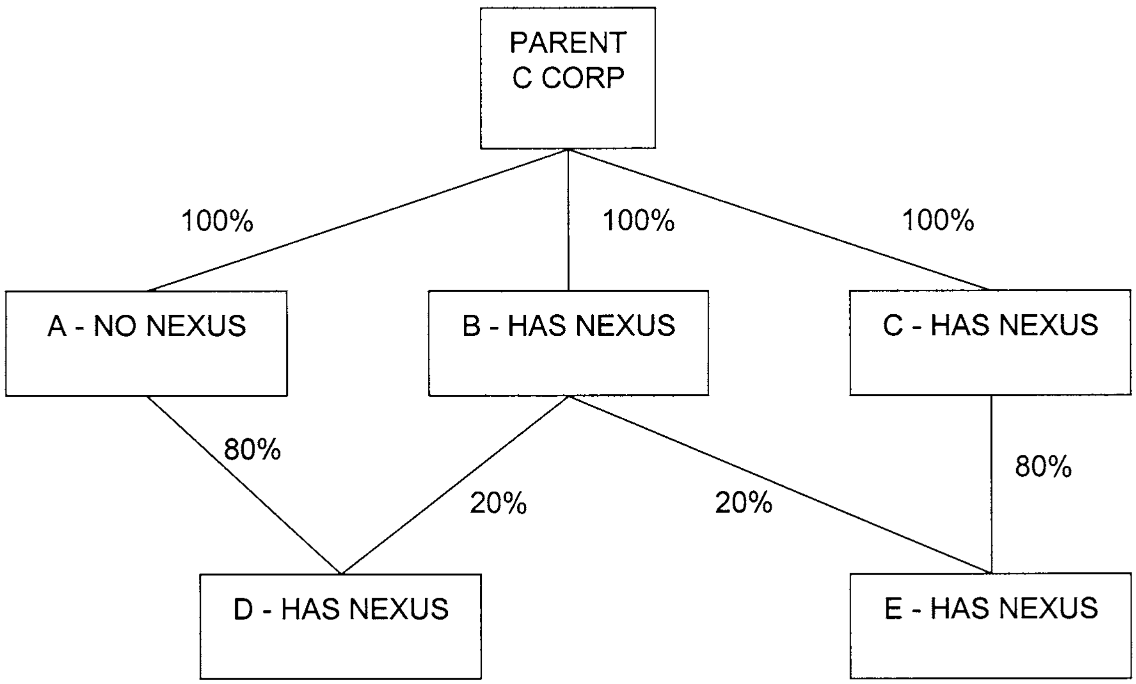
All are C corporations that have nexus in Kentucky.

A cannot be included in the consolidated return because the parent does not own 80% or more of A.

The parent, B, D & E will form one nexus consolidated group.

A and C form another nexus consolidated group, with A being the common parent.

Example 3–5



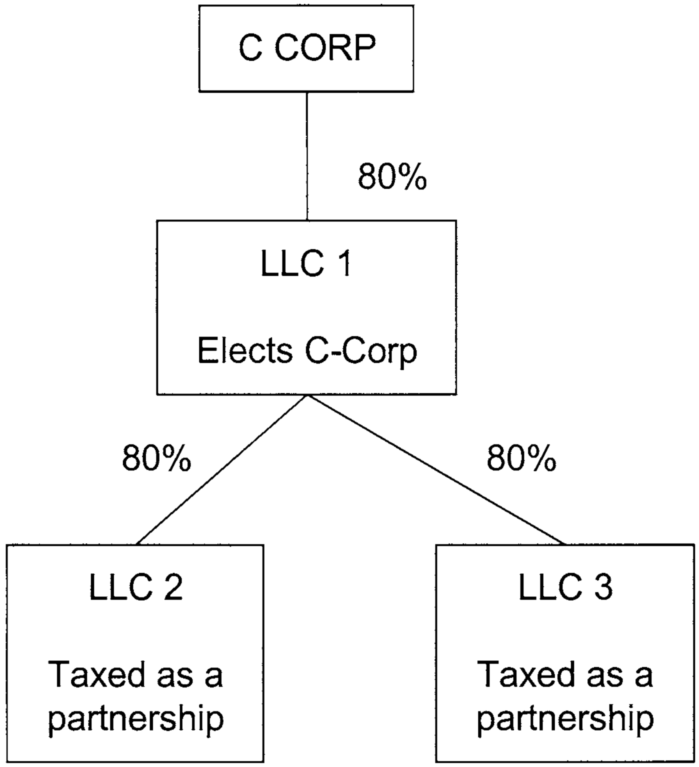
Parent and all subsidiaires are C corporations.

Parent, B, C and E can file a nexus consolidated return.

D has to file a separate entity return.

A doesn't have to file.

Example 3–6



Assume that C corporation and all LLC's have nexus.

All entities will be included in a nexus consolidated return.

Federal tax status of LLC2 and LLC3 doesn't impact their inclusion in a nexus consolidated return.

Practitioner Question: Can a brother-sister controlled group of corporations file a nexus consolidated return?

Answer: No. The term "brother-sister controlled group of corporations" is a federally defined term in Section 1563 of the Internal Revenue Code. Under that federal definition the brother-sister controlled group of corporations must be owned by a person who is an individual, estate or trust. Individuals, estates or trusts don't meet the definition of corporation in KRS 141.010(24). Individuals, estates or trusts don't meet the definitions of "includible corporations" in KRS 141.200(9)(d) and "common parent corporation" in KRS 141.200(9)(b). An affiliated group of includible corporations that is doing business in Kentucky must have a common parent corporation. Therefore, a brother-sister controlled group doesn't qualify to file a nexus consolidated return.

The computation of consolidated net income is discussed in Chapter 5 of this book.

Chapter Four – Calculation of Corporation Income Tax Liability Based on the Alternative Minimum Calculation

For tax years beginning on or after January 1, 2005, corporations subject to corporation income tax under the provisions of KRS 141.040 will pay the greater of the tax due based on the corporation's net income or the tax due under the alternative minimum calculation (AMC). Every corporation will pay at least a minimum of $175 per taxable year.

The AMC is the lesser of the following two separate computations:

1. Nine and one-half cents per one hundred dollars (.00095) of the corporation's gross receipts; or,

2. Seventy-five cents per one hundred dollars (.0075) of the corporation's Kentucky gross profits.

TIP: *The AMC computed as part of the Kentucky corporation income tax has no relation to the alternative minimum tax imposed at the federal level.*

Gross Receipts Computation

"Gross receipts" for purposes of computing the AMC is defined by KRS 141.040(5) to mean; "the numerator of the sales factor under the provisions of KRS 141.120(8)(c)." The numerator of the sales factor reflects gross receipts assignable to Kentucky.

KRS 141.120(8)(c)1 defines the numerator of the sales factor to be "the total sales of the corporation in this state during the tax period."

KRS 141.120(1)(g) defines "sales" to be: "all gross receipts of the corporation not allocated under subsections (3) through (7) of this section. "Allocated under subsections (3) through (7) of this section" refers to nonbusiness income gross receipts. "Business income" is income arising from transactions and activities in the regular course of the corporation's trade or business and includes income from tangible and intangible property if its acquisition, management, or disposition constitute integral parts of the regular trade or business operations. "Nonbusiness income" means all income other than business income. For the purposes of the sales factor and the AMC, the term "sales" generally means all gross receipts derived by a corporation from transactions and activities in the course of its regular trade or business operations which produce business income. Administrative Regulation 16:060 provides further guidance on the terms "business income" and "nonbusiness income".

Gross Receipts from Sales of Tangible Personal Property

In the case of a corporation whose business activity consists of manufacturing and selling or purchasing and reselling goods or products, "sales" includes all gross receipts from the sales of goods or products (or other property which would properly be included in inventory if on hand at the close of the taxable year) held by the corporation primarily for sale in the ordinary course of its trade or business. Gross receipts for this purpose means gross sales, less returns and allowances, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales taxes) shall be included as part of such receipts if such taxes are passed on to the buyer or included as part of the selling price of the product.

KRS 141.120(8)(c)2 provides that sales of tangible personal property are in this state if:

(a) The property is delivered or shipped to a purchaser, other than the United States government, or to the designee of the purchaser within this state regardless of the f.o.b. point or other conditions of the sale; or

(b) The property is shipped from an office, store, warehouse, factory or other place of storage in this state and the purchaser is the United States government.

Important points to remember in determining whether or not property is delivered or shipped to a purchaser in Kentucky are:

1. Property shall be deemed to be delivered or shipped to a purchaser within Kentucky if the recipient is located in Kentucky, even though the property is ordered from outside Kentucky. Example: The corporation, with inventory in State A, sold $100,000 of its products to a purchaser with branch stores in several states including Kentucky. The purchase order was placed by the purchaser's central purchasing department located in State B. $25,000 of the purchase order was shipped directly to the purchaser's branch store in Kentucky. The branch store in Kentucky is the "purchaser within this state" with respect to $25,000 of the corporation's sales.

2. Property is delivered or shipped to a purchaser in Kentucky if the shipment terminates in Kentucky, even though the property is later transferred by the purchaser to another state. Example: The corporation makes a sale to a purchaser who maintains a central warehouse in Kentucky where all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All products shipped to the purchaser's warehouse in Kentucky are property "delivered or shipped to a purchaser within this state."

3. The term "purchaser within this state" includes the ultimate recipient of the property if the corporation in Kentucky, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient in Kentucky. Example: A corporation in Kentucky sold merchandise to a purchaser in State A. The corporation directed the purchaser of the merchandise in State B to ship the merchandise to the purchaser's customer in this state pursuant to the purchaser's instruction. The sale by the corporation is "in this state."

4. When property being shipped by a seller from the state of origin to a consignee in another state is diverted while enroute to a purchaser in Kentucky, the sales are in Kentucky. Example: The corporation, a produce grower in State A, begins shipment of perishable produce to the purchaser's place of business in State B. While enroute the produce is diverted to the purchaser's place of business in Kentucky where the corporation is subject to tax. The sale by the corporation is assigned to Kentucky.

Gross receipts from the sales of tangible personal property to the United States Government are in Kentucky if the property is shipped from an office, store, warehouse, factory, or other place of storage in Kentucky. Only sales for which the United States Government makes direct payment to the seller, pursuant to the terms of its contract, constitute sales by a subcontractor to the United States Government. Thus, as a general rule, sales by a subcontractor to the prime contractor, the party to the contract with the United States Government, do not constitute sales to the United States Government. Example: A corporation is a subcontractor and contracts to build a component of a rocket for $1,000,000. The sale by the subcontractor to the prime contractor is not a sale to the United States Government.

If a corporation regularly derives receipts from the sale of equipment used in its business, they are included in the sales factor. For example, a truck express company owns a fleet of trucks and sells its trucks under a regular replacement program. The gross receipts from the sales of the trucks are included in the sales factor.

Gross Receipts From Sales Other Than Sales of Tangible Personal Property

As applied to a corporation engaged in business activity, other than the manufacturing and selling or purchasing and reselling of property, "sales" include gross receipts from the corporation's business activity:

1. If the business activity consists of providing services, such as the operation of an advertising agency, the performance of equipment service contracts, or research and development contracts; "sales" includes gross receipts from the performance of such services including fees, commissions, and similar items.

2. In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, gross receipts includes the entire reimbursed cost, plus the fee.

3. If the business activity is renting of real or tangible personal property, "sales" includes the gross receipts from the rental, lease, or licensing of the property.

4. If the business activity is the sale, assignment, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.

5. The distributive share income received from a partnership that is doing business in Kentucky is included in the numerator of the sales factor and is a "gross receipt" subject to the AMC.

KRS 141.120(8)(c)3. provides that sales, other than sales of tangible personal property, are in this state if the income-producing activity is performed in this state; or the income producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is perform in this state than in any other state, based on costs of performance.

"Income-producing activity" means the act or acts directly engaged in by the corporation for the ultimate purpose of obtaining gains or profit. Such activity does not include activities performed on behalf of a corporation, such as those conducted on its behalf by an independent contractor. Accordingly, the income producing activity includes, but is not limited to the following:

(a) Personal services by employees or the use of tangible and intangible property in performing a service;

(b) The sale, rental, leasing, or licensing or other use of real property;

(c) The rental, leasing, licensing or other use of tangible personal property; and,

(d) The sale or licensing of intangible personal property.

The income producing activity is deemed performed at the situs of real, tangible, and intangible personal property or the place where personal services are rendered. The situs of real and tangible personal property is at its physical location. The situs of intangible personal property is the corporation's commercial domicile unless the property has acquired a "business situs" in: (i) the place where intangible personal property is employed as capital, or (ii) the place where the property is located if possession and control of the property is localized in connection with a trade or business so that substantial use or value attaches to the property. Example: A corporation whose principal business activity is the manufacture and sale of hot water heaters pledges bonds in Kentucky as security for the payment of taxes in connection with its business activities in Kentucky. The property has a business situs in Kentucky; therefore, interest income from such bonds is attributable to Kentucky.

The term **"cost of performance"** means direct costs determined consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the corporation.

Receipts from sales, other than sales of tangible personal property which constitute a principal source of business income, are attributed to Kentucky as follows:

1. Gross receipts from sale, lease, rental or other use of real property are in Kentucky if the real property is located in Kentucky.

2. Gross receipts from rental, lease, licensing or other use of tangible personal property shall be assigned to Kentucky if:

   (a) The property is in Kentucky during the entire period of rental, lease, license or other use; or,

   (b) The property is in Kentucky for more than fifty percent of the time.

3. Gross receipts for the performance of personal services are attributable to Kentucky to the extent such services are performed in Kentucky.

Examples of sales other than sales of tangible personal property that are included in the numerator of the sales factor and are considered gross receipts for purposes of calculating the AMC:

Example 1—A corporation is engaged in the heavy construction business in which it uses cranes, tractors, and earth-moving vehicles. It makes short-term rentals of the equipment when not needed on any project. The corporation rented some of the equipment to X for three (3) weeks. The equipment was used by X for two (2) weeks in Kentucky and (1) week in State Y. The direct costs in connection with the equipment during the rental period were $500 weekly. Accordingly, the greater proportion of such costs was incurred in Kentucky. All of the rental receipts are business income and, for purposes of the sales factor, are included in the numerator and are considered gross receipts for purposes of calculating the AMC.

Example 2—A corporation is in the business of buying commercial properties to rent. The corporation decided to sell one of the properties. Since the property was used in the production of business income, then the gross receipts are included in the numerator of the sales factor and considered gross receipts for purposes of calculating the AMC.

Example 3—A corporation with commercial domicile in Kentucky manufactures and sells industrial chemicals. It owns patents on certain products. The corporation licensed production of the chemicals in foreign countries in return for royalties which are a relatively minor amount of its income. The royalties are business income and are included in the numerator of the sales factor and are considered gross receipts for purposes of calculating the AMC.

Important note regarding assigning receipts in a franchisee/franchisor transaction:

The Department of Revenue has consistently held that the up-front payment received by the franchisor is assigned to the domicile state of the corporate headquarter for sales factor purposes. However, the annual fee which is based on a percentage of the receipts of the franchisee is assigned to the state where the franchisee is physically located. Terms such as "royalty payments," "franchise fess," "service fees," etc. are closely evaluated by the Department to determine the exact composition of the fee prior to assignment for sales factor and AMC purposes. If the franchisor can show that the fee is determined by actual performance of services rendered by the franchisor, rather than a flat percentage of the franchisee's gross or net receipts, then the receipts should be assigned to the state where services are performed instead of the state where the franchisee is located.

Example 4—The corporation, a road show, presents theatrical performances at various locations in State X and in Kentucky during the taxable year. All gross receipts from performances presented in Kentucky are attributed to Kentucky, and are included in the numerator of the sales factor and are considered gross receipts for purposes of calculating the AMC.

AMC in a Consolidated Return Situation

If you are filing a consolidated corporation income tax return, sales between the members of the affiliated group are eliminated in computing the AMC and the numerator of the sales factor.

Gross Profits Computation

"Kentucky gross profits" is defined by KRS 141.010(27) to be Kentucky gross receipts reduced by returns and allowances attributable to Kentucky gross receipts, less the cost of goods sold attributable to Kentucky gross receipts.

"Kentucky gross receipts" for purposes of the AMC based on gross profits means the numerator of the sales factor under the provisions of KRS 141.120(8)(c). The immediately preceding pages discuss "gross receipts" in detail.

Returns and allowances attributable to Kentucky gross receipts shall be determined by separate accounting.

"Cost of goods sold" is defined by KRS 141.010 (26) to be the cost of goods sold calculated using the same method specified by the Internal Revenue Service for the purpose of computing federal income tax. In determining cost of goods sold:

(a) Labor costs shall be limited to direct labor costs as defined in subsection (28) of this section; and,

(b) Bulk delivery costs as defined in subsection (29) of this section may be included;

"Direct labor" is defined by KRS 141.010(28) to be labor that is incorporated into the product sold or is an integral part of the manufacturing process.

"Bulk delivery costs" is defined by KRS 141.010(29) to be the cost of delivering the product to the consumer if the product is delivered in bulk and requires specialized equipment that generally precludes commercial shipping and is taxable under KRS 138.220.

Determining Cost of Goods Sold Attributable to Kentucky Gross Receipts

KRS 141.010(26) provides that cost of goods sold shall be calculated using the same method specified by the Internal Revenue Service for the purpose of computing federal income tax.

Not all businesses compute cost of goods sold in determining their federal income tax liability. The following guidelines specify which types of businesses can determine cost of goods sold for purposes of computing the AMC based on Kentucky gross profits:

1. You must be engaged in a business that makes, buys, or sells goods to produce income in order to compute cost of goods sold. A manufacturer, wholesaler or retailer gets to compute costs of goods sold.

2. The cost of goods sold computation does not apply to a personal service business. Examples of a personal service business include a doctor, lawyer, accountant, carpenter or painter. However, if you work in a personal service business and also sell or charge for the materials and supplies normally used in your business, you may deduct cost of goods sold in relation to the materials and supplies that you charge for.

Cost of goods sold is deducted from gross receipts to figure gross profit for the year. If you include an expense in the cost of goods sold, you cannot deduct that expense item elsewhere on your income tax return as a business expense.

The following is a worksheet to be used in computing cost of goods sold:

1.	Inventory at beginning of year	______
2.	Purchases less cost of items withdrawn for personal use	______
3.	Cost of labor. Do not include any amounts paid to yourself	______
4.	Materials and supplies or additional section 263A costs	______
5.	Other costs	______
6.	Add lines 1 through 5	______
7.	Inventory at end of year	______
8.	**Cost of goods sold.** Subtract line 7 from 6	______

Instructions for the Cost of Goods Sold Worksheet

Line 1 – Inventory at beginning of year—The beginning inventory amount is usually identical to the ending inventory of the previous year. If the beginning inventory is an amount different than the ending inventory amount for the previous year, attach a statement explaining the difference to the Kentucky corporation income tax return. If the corporation is a merchant, beginning inventory is the cost of merchandise on hand at the beginning of the year that you will sell to customers. If you are a manufacturer or producer, it includes the total cost of raw materials, work in process, finished goods, and materials and supplies used in manufacturing the goods.

Line 2 – Purchases—If you are a merchant, use the cost of all merchandise you bought for sale. If you are a manufacturer or producer, this includes the cost of all raw materials or parts purchased for manufacture into a finished product. Freight should be included in the cost of raw materials.

You must use the prices you pay for the merchandise in figuring purchases. Example – An automobile dealer must record the cost of a car in inventory reduced by a manufacturer's rebate that represents a trade discount.

Cash discounts can be deducted from total purchases for the year or they can be credited to a separate discount account. If you credit cash discounts to a separate account, do not reduce your cost of goods sold by the cash discounts.

You must deduct all returns and allowances from your total purchases during the year.

If you withdraw merchandise for your personal or family use, you must exclude this cost from the total amount of merchandise you bought for sale. This can be accomplished by crediting the purchases or sales account with the cost of merchandise you withdraw for personal use. You should charge the amount to your drawing account.

Line 3 – Costs of labor—KRS 141.010(26)(a) limits labor costs to direct labor costs as defined in subsection KRS 141.010(28) of this section. Direct labor is defined by KRS 141.010(28) to be labor that is incorporated into the product sold or is an integral part of the manufacturing process. Direct labor costs include wages paid to employees who spend all their time working directly on the product being manufactured. Direct labor costs also includes wages paid to employees who work directly on the product part time if you can determine that part of their wages. Indirect labor costs should not be included.

Line 4 – Materials and Supplies or Additional Section 263A Costs—Materials and supplies, such as hardware and chemicals used in manufacturing goods are charged to cost of goods sold. For corporations that have elected the simplified production method for federal income tax purposes, additional section 263A costs are generally those costs, other than interest, that were not capitalized under the corporation's method of accounting immediately prior to the effective date of section 263A but are now required to be capitalized under section 263A. For details, see Treasury Regulation 1.263A-2(b). For corporations that have elected the simplified resale method for federal income tax purposes, additional section 263A costs are generally those costs incurred with respect to the following categories:

1. Off-site storage or warehousing.

2. Purchasing; handling, such as processing, assembling repackaging and transporting.

3. General and administrative costs, excluding labor costs.

For details of the simplified resale method, see Treasury Regulation 1.263A-3(d).

Line 5 – Other costs—Freight costs related to merchandise you purchase for sale. Do not include any freight charges on this line that are included on line 2. The costs of containers and packages can be included on this line if they are an integral part of the product manufactured and are a part of the cost of goods sold. Overhead expenses of a manufacturing operation are included on this line, except for labor costs. Examples of overhead costs you can include on this line are rent, heat, light, power, insurance, depreciation, taxes and maintenance, provided that such expenses are direct and necessary expenses of the manufacturing operation.

Line 7 – Inventory at end of year—See Treasury Regulations sections 1.263A-1 through 1.263A-3 for details on figuring the amount of additional section 263A costs to be included in ending inventory. If the corporation accounts for inventoriable items in the same manner as materials and supplies that are not incidental, enter on line 7 the portion of its raw materials and merchandise purchased for resale that is included on line 6 and was not sold during the year.

Once a corporation computes its AMC based on gross receipts and gross profits, the amounts computed must be reflected on PART II—ALTERNATIVE MINIMUM (AMC) on page 1 of the appropriate corporation income tax form.

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Chapter Five – Tax Calculation Based on Taxable Net Income

House Bill 272 enacted major changes in the filing responsibilities for those "corporations" that were not subject to corporation income tax for tax periods beginning prior to January 1, 2005.

Four separate corporation income tax forms have been developed to ease the challenging transition from pass-through entity treatment to entity level taxation. Each form in this chapter is intended to apply to a specific group of "corporations". Exhibit 5-1 reflects which form should be filed by different entity types.

- **Form 720** should be filed by C corporations, including affiliated groups of C corporations that are filing either an elective consolidated return or a nexus consolidated return. Please refer to chapter 3 for a discussion of who is in a nexus consolidated group.

- **Form 765** should be filed by LLC's taxed as partnerships for federal income tax purposes, limited partnerships, limited liability partnerships and real estate mortgage investment conduits.

- **Form 720S** should be filed by S corporations.

- **Form 725** should be filed by disregarded single member LLC's whose single member is an individual.

Important Note: Pursuant to KRS 141.011(2), the net operating loss carryback deduction shall not be allowed for losses incurred for taxable years beginning on or after January 1, 2005.

Exhibit 5-1 - Various Corporation Income Tax Filing Scenarios

Ownership Scenario	Form Required
1. C corporation	**Form 720**
2. Disregarded single member LLC whose single member is a C corporation	**Form 720**
3. Disregarded single member LLC whose single member is an S corporation	**Form 720S**
4. Disregarded single member LLC whose single member is a partnership	**Form 765**
5. Nexus consolidated group of affiliated corporations with a C corporation common parent and LLC affiliates.	**Form 720**
6. Nexus consolidated group of affiliated corporations with a multi-member LLC common parent and LLC affiliates.	**Form 765,** if common parent is taxed as a partnership for federal tax purposes. **Form 720,** if LLC common parent elects to be taxed as a corporation for federal income tax purposes.
7. Nexus consolidated group of affiliated corporations with a single member LLC common parent and LLC affiliates.	**Form 725,** if single member LLC common parent is owned by an individual. **Form 720,** if single member LLC common parent is owned by a C corporation.
8. S corporation	**Form 720S**
9. Disregarded single member LLC whose single member is an individual.	**Form 725**
10. Limited liability partnership with 50/50 partners that are corporations.	**Form 765**
11. Limited partnership	**Form 765**
12. Nexus consolidated group of affiliated corporations with a LLP common parent and LLC affiliates.	**Form 765**
13. General partnership	**Form 765-GP**
14. Publicly traded partnership	**Form 765-GP**
15. Real Estate Investment Trusts	**Form 720**
16. Financial Asset Securitization Investment Trusts	**Form 720**
17. Regulated Investment Companies	**Form 720**
18. Real Estate Mortgage Investment Conduits	**Form 765**

Special Note: *General partnerships will file on form 765–GP, which is a form separate and distinct from form 765.*

Consolidated Income Tax Calculation on Form 720

Elective consolidated groups must file form 720. Nexus consolidated groups composed entirely of C corporations must also file form 720. The following paragraphs describe the specifics of how each type of consolidated group will calculate its net income.

Elective Consolidated Returns—KRS 141.200(4)(b) states: "an affiliated group of corporations still filing an elective consolidated corporation income tax return will be treated for all purposes as a single corporation under the provisions of this chapter. All transactions between corporations included in the consolidated return shall be eliminated in computing net income in accordance with KRS 141.010(13), and in determining the property, payroll, and sales factors in accordance with KRS 141.120." KRS 141.200(2)(b) states: "the determinations and computations required by this chapter shall be made in accordance with the provisions of Section 1502 of the Internal Revenue Code and related regulations, except as required by differences between this chapter and the Internal Revenue Code." Additional guidance on how to compute Kentucky taxable net income for the elective consolidated group can be obtained in Administrative Regulation 103 KAR 16:200.

Since a new election period can begin with a calendar year ended December 31, 2004, it is possible that there is a separate return loss year issue for any separate entity net operating loss carryforwards from separate returns filed for the calendar year ended December 31, 2003 return. 103 KAR 16:200, Section 4 limits the carryover from a separate return period to the amount allowed under Section 1502 of the Internal Revenue Code and related regulations and adjusted for the differences between KRS Chapter 141 and the Internal Revenue Code. A limitation on the loss carryforward is imposed if the loss year is considered a separate return limitation year (SRLY). A SRLY means any loss year for which a separate return was filed, except where the corporation was a member of the affiliated group for the entire year that the separate return loss incurred or the corporation is the parent in the year to which the loss is being carried. The amount of loss incurred in a SRLY that may be deducted in an elective consolidated year cannot exceed that member's contribution to the consolidated taxable income.

An elective consolidated return should include a schedule of gross income and deductions for each member of the affiliated group prepared in columnar form in accordance with Treasury Regulation 1.1502-76. Schedule CR has been developed for this purpose. Schedules of receipts, property and payroll for each member of the affiliated group must also be provided in columnar form.

Nexus Consolidated Returns—The calculation of taxable net income for a nexus consolidated group is similar to the computation for an elective consolidated group. KRS 141.200(9)(f) states: "the determinations and computations required by KRS Chapter 141 shall be made in accordance with the provisions of the Internal Revenue Code and related regulations, except as required by differences between this chapter and the Internal Revenue Code." KRS 141.200(11)(b) states in part: "An affiliated group required to file a consolidated return under this subsection shall be treated for all purposes as a single corporation under the provisions of this chapter. All transactions between corporations included in the consolidated return shall be eliminated in computing net income in accordance with KRS 141.010(13), and in determining the property, payroll, and sales factors in accordance with KRS 141.120."

A nexus consolidated return should include a schedule of gross income and deductions for each member of the affiliated group prepared in columnar form Schedule CR. Schedules of receipts, property and payroll for each member of the affiliated group must also be provided in columnar form.

The big difference between an elective consolidated income calculation and a nexus consolidated income calculation is the treatment of losses. KRS 141.200(11)(b) states in pertinent part: "Includible corporations that have incurred a net operating loss shall not deduct an amount that exceeds, in the aggregate, fifty percent (50%) of the income realized by the remaining includible corporations that did not realize a net operating loss. The portion of any net operating loss limited by the application of this subsection shall be available for carryforward in accordance with KRS 141.011." The loss limitation is a pre-apportionment adjustment in computing Kentucky taxable net income. The pre-apportionment loss deduction for a nexus consolidated group must be taken on line 17 of Part I of Form 720. The pre-apportionment loss deduction is referred to as the current net operating loss adjustment. The nexus affiliated group should add up all the net income amounts from the columnar presentation of gross income less deductions. The net income amounts should reflect differences between Kentucky law and the Internal Revenue Code. The positive (net income) amounts should be added together with the result multiplied by 50%. The negative (net loss) amounts should be added together and if the result is an amount greater than 50% of the total net income amounts, then the loss is limited to the 50% amount. If the negative (net loss) amounts when added together result is an amount lesser than 50% of the total of the net income amounts, then the loss amount is fully deducted on that return. Any total loss amount not utilized in the year it is incurred may be carried forward for a period of up to 20 years. The current net operating loss adjustment must be computed on Schedule NOL (form 41A720NOL). Schedule NOL must be attached to form 720.

The loss amount not utilized in the current year that is carried forward to the next year will be part of the current net operating loss adjustment in the succeeding year.

Example 5-2

YEAR 1

Parent	Sub A	Sub B	Sub C	Sub D	Consolidated	Current NOL Adjustment	Net Income
$100,000	$(25,000)	$ 50,000	$(80,000)	$(25,000)	$ 20,000	$ 55,000	$ 75,000

Total Net Income amount = $150,000
Total Net Loss amount = $(130,000)

Loss limitation is 50% X $150,000 = $75,000

Current NOL Adjustment = Total Loss Amount - Limitation
$130,000 - $75,000 = $55,000

Taxable net income subject to apportionment is $75,000.

NOL carryforward is $55,000.

YEAR 2

Parent	Sub A	Sub B	Sub C	Sub D	NOL Carryforward	Consolidated	Current NOL Adjustment	Net Income
$ 50,000	$10,000	$ 75,000	$ 25,000	$(25,000)	$(55,000)	$ 80,000	$ ---	$ 80,000

Total Net Income amount = $160,000
Total Net Loss amount = $80,000

Loss limitation is 50% X $160,000 = $80,000

Available loss deduction is $(80,000) - - -($55,000 + $25,000)

Taxable net income subject to apportionment is $80,000.

NOL carryforward is $0.

Separate Return Loss Year Rules for a Nexus Consolidated Return

An affiliated group of corporations required to file a nexus consolidated return may be composed of a group of corporations that were all filing separate entity Kentucky returns prior to the enactment of House Bill 272. If any of those separate entity filers had a net operating loss carryforward for the most recent period that began prior to January 1, 2005, that separate entity loss may be carried forward to the first return filed under the nexus consolidated rules, **provided that the affiliate had Kentucky corporation income tax nexus for the separate return periods that generated the loss.** If an affiliate did not have nexus with Kentucky for the separate return periods, then a net operating loss cannot be carried forward to a nexus consolidated return period that begins on or after January 1, 2005.

Important Note: *The term "nexus" used in reference to a separate return loss year that begins prior to January 1, 2005 means the corporation income tax nexus standard in effect prior to the enactment of House Bill 272. The version of KRS 141.040 in effect for tax periods beginning prior to January 1, 2005 provides that a corporation had nexus in Kentucky if it was:*

1. Organized under the laws of this state;

2. Commercially domiciled in this state;

3. A foreign corporation owning or leasing property in this state; or,

4. A foreign corporation with one or more individuals receiving compensation as defined in KRS 141.120(8)(b) in this state.

The "doing business" nexus standard provided in House Bill 272 does apply to the nexus determination for separate return loss years if the separate return period begins on or after January 1, 2005.

Any separate return loss that is allowed as a carryforward may be included in the computation of the current net operating loss adjustment that is subject to the fifty percent limitation rule.

The Department of Revenue recognizes that a conversion from a post-apportionment Kentucky net operating loss calculation to a pre-apportionment nexus consolidated loss calculation is a difficult one. Therefore, we are allowing taxpayers a one-time choice to either carryforward the post-apportionment separate return losses or the pre-apportionment losses computed on a separate company basis. In some cases, the records may no longer be available to reconstruct the separate company losses on a pre-apportionment basis.

An election box is provided on Schedule NOL. You may make an irrevocable election to carryforward the separate company post-apportionment net operating loss instead of re-calculating the loss carryforwards on a pre-apportionment basis. The election must be applied to all separate company losses carried forward to the first return of a nexus consolidated group. You cannot amend this election.

Any separate return loss that is carried forward to a nexus consolidated return must be reflected on Form 720 Schedule NOL, Section B. A supplemental statement must be attached to Schedule NOL that reflects a breakdown of the separate return loss carryforward amounts broken down by subsidiary.

Example 5-3

MANDATORY NEXUS
NOL LIMITATION CALCULATION

There is a $12,000 NOLD carryforward from 2004 that is available to the group.

Year		A	B	C	D	E	KY Consolidated Net Income per 720, line 16
2005		$ 100,000.00	$ 50,000.00	$ (80,000.00)	$ (10,000.00)	$ 12,000.00	$ 72,000.00
2006		$ 40,000.00	$ 60,000.00	$ 30,000.00	$ (40,000.00)	$ (8,000.00)	$ 82,000.00

What is the 2005 NOL limitation adjustment? $9,000 Add Back

What is the 2006 NOL limitation adjustment? $ (17,000.00) Deduction

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720 Kentucky

41A720

Department of Revenue

Kentucky Corporation Income Tax Return

(Pass-Through Corporations Use Applicable Forms)

➤ *See separate instructions.*

2005

Taxable Year Ending

__ __ / __ __
Mo. Yr.

Taxable period beginning ____________, 2005, and ending ____________, 200__.

A *If filing consolidated, check the appropriate box. See instructions.*

Consolidated

☐ Election Made prior to 2005, attach Form 722.

☐ Mandatory Nexus

B Federal Identification Number __ __ - __ __ __ __ __ __ __

C Kentucky Corporation Account Number __ __ __ __ __ __

Name of Corporation or Affiliated Group *(Place preaddressed label here; otherwise print or type.)*

State and Date of Incorporation

Number and Street

Principal Business Activity in KY

City | State | ZIP Code | Telephone Number

NAICS Code Number (Relating to Kentucky Activity) (See www.census.gov)

D Name of Common Parent

Kentucky Corporation Account Number __ __ __ __ __ __

E *Check if applicable:* ☐ No packet required for 2006 ☐ Initial return ☐ Final return *(attach explanation)*
☐ Short-period return *(attach explanation)* ☐ Change of name ☐ Change of address

PART I—TAXABLE INCOME COMPUTATION

1. Federal taxable income (Form 1120, line 28; Form 1120A, line 24)		
ADDITIONS:		
2. Interest income (state and local obligations)		
3. State taxes based on net/gross income		
4. Depreciation adjustment		
5. Deductions attributable to nontaxable income		
6. Related party expenses		
7. Pass-through loss(es) from other corporation(s) subject to Kentucky corporation income tax		
8. Other (attach schedule)		
9. **Total** (add lines 1 through 8)		
SUBTRACTIONS:		
10. Interest income (U.S. obligations)		
11. Dividend income		
12. Federal work opportunity credit		
13. Depreciation adjustment		
14. Pass-through income from other corporation(s) subject to Kentucky corporation income tax		
15. Other (attach schedule)		
16. **Net income** (line 9 less lines 10 through 15)	72,000	00
17. Current net operating loss adjustment (mandatory nexus only)	9,000	00
18. **Kentucky net income** (add lines 16 and 17)	81,000	00
19. **Taxable net income** (attach Schedule A if applicable)		
20. Net operating loss deduction		
21. **Taxable net income** (after NOLD) (line 19 less line 20)		

PART II—ALTERNATIVE MINIMUM (AMC)

Gross Receipts		
1. Kentucky gross receipts (less Kentucky returns and allowances)		
2. Tax (line 1 multiplied by .00095)		
Gross Profits		
3. Kentucky gross receipts		
(a) Less Kentucky returns and allowances		
(b) Less Kentucky cost of goods sold		
4. Gross profit (subtract lines 3(a) and 3(b) from line 3)		
5. Tax (line 4 multiplied by .0075)		

PART III—TAX COMPARISON

1. Income tax from Part I (multiply line 21 by rates) (see instructions)		
2. Alternative minimum (AMC) (lesser of Part II, line 2 or line 5)		

PART IV—TAX COMPUTATION

1. **Tax liability** (Part III, greater of line 1, line 2 or $175 minimum)		
2. Recycling/composting equipment tax credit recapture		
3. **Total** (add lines 1 and 2) (if $175 minimum, skip lines 4 through 15 and enter on line 16)		
4. Economic development tax credits		
5. Historic preservation restoration tax credit		
6. Unemployment tax credit		
7. Recycling/composting equipment tax credit		
8. Coal conversion tax credit		
9. Enterprise zone tax credit		
10. Kentucky investment fund tax credit		
11. Coal incentive tax credit		
12. Qualified research facility tax credit		
13. GED incentive tax credit		
14. Voluntary environmental remediation tax credit (Brownfields)		
15. Biodiesel tax credit		
16. **Net tax liability** (line 3 less lines 4 through 15) ($175 minimum)		
17. Estimated tax payments		
18. Extension tax payment		
19. Prior year's credit		
20. **Tax due** (line 16 less lines 17 through 19)		
21. **Tax overpayment**		
22. Credited to 2006		
23. **Amount to be refunded** (line 21 less line 22)		

TAX PAYMENT SUMMARY (Round to Nearest Dollar)

TAX *(check applicable box)* ☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Profits ☐ Minimum $175

Tax ____________

Penalty ____________

Interest ____________

TOTAL (Including Penalty and Interest) ➤ ____________

Make check(s) payable to: **Kentucky State Treasurer.**
Mail return with payment to: **Kentucky Department of Revenue, Frankfort, Kentucky 40620.**

➤ **Federal Form 1120, pages 1, 2 and 4, or 1120A, pages 1 and 2, and any supporting schedules must be attached.**

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SCHEDULE NOL

41A720NOL (10-05)

Commonwealth of Kentucky
DEPARTMENT OF REVENUE

NET OPERATING LOSS SCHEDULE

Attach to Form 720.

Taxable Year Ending 12 / 05 (Mo. / Yr.)

☐ **If irrevocable election is made to carry NOL carryforward as an apportioned NOL, check here.**

PART I—MANDATORY NEXUS CONSOLIDATION

Section A—Current Net Operating Loss Adjustment

Name	Kentucky Corporation Account Number	Includible Corporations A: Kentucky Net Income	B: Kentucky Net Losses (Enter as a Positive)	C: Total Losses (Enter as a Positive)
1. Common Parent A		100,000		
2. **Subsidiaries**				
B		50,000		
C			80,000	
D			10,000	
E		12,000		
3. Totals (add Columns A and B)		162,000	90,000	
4. Limitation (line 3, Column A, multiplied by 50%)		81,000		
5. Prior year NOL carryforward				12,000
6. Total (add line 5, Column C and line 3, Column B)				102,000
7. Disallowed loss. If Line 3, Column B is greater than Line 4, Column A, enter the difference here and on Form 720, Part I, line 17. If amount entered, skip to Section B, line 1 (see instructions)		9,000		
8. Additional NOLD. Enter as a negative amount on Form 720, Part I, line 17 (see instructions)				

DRAFT 10-26-05

Section B—Current Year Loss Disallowed and NOL Carryforward

1. Current year loss disallowed (see instructions)	21,000
2. Prior year(s) NOL carryforward(s)	12,000
3. Prior year(s) NOL carryforward used this year (see instructions)	12,000
4. Total NOL carryforward (line 1 plus line 2 minus line 3)	21,000

PART II—SEPARATE ENTITY AND ELECTIVE CONSOLIDATED FILERS

Section A—NOL Carryforward

1. Carryforward from prior year(s)	
2. Net operating loss (current year) from Form 720, Part I, line 21	
3. Net operating loss deduction from Form 720, Part I, line 20	
4. Total NOL carryforward (line 1 plus line 2 minus line 3)	

NET OPERATING LOSS SCHEDULE

INSTRUCTIONS

Purpose of This Schedule—This schedule is to be used by corporations that are required to file a mandatory nexus consolidated return in order to determine the loss limitation. It is also to be used by corporations filing a separate entity return, an elective consolidated return or mandatory nexus return to track the NOL carryforward.

The includible corporations of the mandatory consolidated nexus return that have earned a net operating loss shall not deduct an amount that exceeds, in the aggregate, 50 percent of the income realized by the remaining includible corporations that did not realize a net operating loss.

Part I—Mandatory Nexus Consolidation

General Instructions—This is only for mandatory nexus returns filed in accordance with KRS 141.200(8-14).

The 50 percent limitation, net operating loss(es) and net operating loss carryforwards are determined prior to the application of the apportionment factor. If one or more of the "includible corporations" brings an NOL carryforward to the mandatory consolidated group, the common parent may make an irrevocable election to carry all NOL carryforwards as an apportioned NOL. Otherwise, the NOL carryforward for each member of the consolidated group must be recomputed to a preapportioned amount.

An "includible corporation" that brings its NOL carryforward from another consolidated group will determine its NOL based upon Section 1502 of the Internal Revenue Code and related regulations, adjusted for differences between KRS Chapter 141 and the Internal Revenue Code.

Any NOL carryforward is utilized first in meeting its 50 percent limitation.

Section A—Enter the name and Kentucky corporation account number of the common parent and includible subsidiaries.

Section A

Column A—Enter only Kentucky net income from includible corporations, Schedule KCR (Form 720), Line 19.

Column B—Enter only Kentucky net losses from includible corporations, Schedule KCR (Form 720), Line 19. **Enter as a positive amount.**

Line 3—Enter the totals for Column A and Column B. Column B should reflect a positive amount.

Line 4—Multiply Line 3, Column A by 50 percent. This is the limitation that the amount on Line 6, Column C cannot exceed.

Line 5—Enter the prior year NOL carryforward as a positive amount.

Line 7—The amount on Line 7 is the amount of the net operating loss(es) of the includible corporation(s) that exceeds the 50 percent loss limitation. It is an addback in computing Kentucky net income. If an amount is entered, skip to Section B, Line 1. If Line 3, Column B is less than Line 4, Column A, leave blank and go to Line 8.

Line 8—If Line 4, Column A is greater than Line 3, Column B, enter the lesser of **this difference** or Line 5, Column C. (**This difference** is Line 4, Column A less Line 3, Column B.) Otherwise, leave blank. This is the amount of additional loss(es) from the includible corporation(s) that can be used to meet the 50 percent loss limitation. It is a deduction in computing Kentucky net income.

Section B

Current year loss disallowed is the amount of Kentucky losses from Line 3, Column B that are disallowed due to first using prior year NOL carryforward(s) to meet the 50 percent limitation. It is available for carryforward.

Line 1—If Line 4, Column A, is greater than or equal to Line 5, Column C, enter the difference of Line 6, Column C less Line 4, Column A. If this difference is less than zero, enter -0-.

If Line 5, Column C is greater than Line 4, Column A, enter the amount from Line 3, Column B.

Line 3—Enter the lesser of Part I, Section A, Line 4, Column A or Part I, Section A, Line 5, Column C. If equal, enter amount from Part I, Section A, Line 5, Column C.

Part II—Separate Entity and Elective Consolidated Filers

General Instructions—This section is to be used only by separate entity and elective consolidated filers in order to calculate the available NOL carryforward. Follow the instructions as indicated on Lines 1 through 4.

720 Kentucky
41A720
Department of Revenue

Kentucky Corporation Income Tax Return

(Pass-Through Corporations Use Applicable Forms)

➤ *See separate instructions.*

2006

Taxable Year Ending

__ __ / __ __
Mo. Yr.

Taxable period beginning ____________, 2005, and ending ____________, 200__.

A *If filing consolidated, check the appropriate box. See instructions.*

Consolidated

☐ Election Made prior to 2005, attach Form 722.

☐ Mandatory Nexus

B Federal Identification Number __ __ – __ __ __ __ __ __ __

C Kentucky Corporation Account Number __ __ __ __ __ __

Name of Corporation or Affiliated Group *(Place preaddressed label here; otherwise print or type.)*

State and Date of Incorporation

Number and Street

Principal Business Activity in KY

City | State | ZIP Code | Telephone Number

NAICS Code Number (Relating to Kentucky Activity) (See **www.census.gov**)

D Name of Common Parent

Kentucky Corporation Account Number __ __ __ __ __ __

E *Check if applicable:* ☐ No packet required for 2006 ☐ Initial return ☐ Final return *(attach explanation)*
☐ Short-period return *(attach explanation)* ☐ Change of name ☐ Change of address

PART I—TAXABLE INCOME COMPUTATION

1. Federal taxable income (Form 1120, line 28; Form 1120A, line 24)		
ADDITIONS:		
2. Interest income (state and local obligations)		
3. State taxes based on net/gross income		
4. Depreciation adjustment		
5. Deductions attributable to nontaxable income		
6. Related party expenses		
7. Pass-through loss(es) from other corporation(s) subject to Kentucky corporation income tax		
8. Other (attach schedule)		
9. **Total** (add lines 1 through 8)		
SUBTRACTIONS:		
10. Interest income (U.S. obligations)		
11. Dividend income		
12. Federal work opportunity credit		
13. Depreciation adjustment		
14. Pass-through income from other corporation(s) subject to Kentucky corporation income tax		
15. Other (attach schedule)		
16. **Net income** (line 9 less lines 10 through 15)	82,000	00
17. Current net operating loss adjustment (mandatory nexus only)	(17,000	00)
18. **Kentucky net income** (add lines 16 and 17)	65,000	00
19. **Taxable net income** (attach Schedule A if applicable)		
20. Net operating loss deduction		
21. **Taxable net income** (after NOLD) (line 19 less line 20)		

PART II—ALTERNATIVE MINIMUM (AMC)

Gross Receipts		
1. Kentucky gross receipts (less Kentucky returns and allowances)		
2. Tax (line 1 multiplied by .00095)		
Gross Profits		
3. Kentucky gross receipts		
(a) Less Kentucky returns and allowances		
(b) Less Kentucky cost of goods sold		
4. Gross profit (subtract lines 3(a) and 3(b) from line 3)		
5. **Tax** (line 4 multiplied by .0075)		

PART III—TAX COMPARISON

1. Income tax from Part I (multiply line 21 by rates) (see instructions)		
2. Alternative minimum (AMC) (lesser of Part II, line 2 or line 5)		

PART IV—TAX COMPUTATION

1. **Tax liability** (Part III, greater of line 1, line 2 or $175 minimum)		
2. Recycling/composting equipment tax credit recapture		
3. **Total** (add lines 1 and 2) (if $175 minimum, skip lines 4 through 15 and enter on line 16)		
4. Economic development tax credits		
5. Historic preservation restoration tax credit		
6. Unemployment tax credit		
7. Recycling/composting equipment tax credit		
8. Coal conversion tax credit		
9. Enterprise zone tax credit		
10. Kentucky investment fund tax credit		
11. Coal incentive tax credit		
12. Qualified research facility tax credit		
13. GED incentive tax credit		
14. Voluntary environmental remediation tax credit (Brownfields)		
15. Biodiesel tax credit		
16. **Net tax liability** (line 3 less lines 4 through 15) ($175 minimum)		
17. Estimated tax payments		
18. Extension tax payment		
19. Prior year's credit		
20. **Tax due** (line 16 less lines 17 through 19)		
21. **Tax overpayment**		
22. Credited to 2006		
23. **Amount to be refunded** (line 21 less line 22)		

TAX PAYMENT SUMMARY (Round to Nearest Dollar)

TAX *(check applicable box)* ☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Profits ☐ Minimum $175

Tax __________

Penalty __________

Interest __________

TOTAL (Including Penalty and Interest) ➤ __________

Make check(s) payable to: **Kentucky State Treasurer.**
Mail return with payment to: **Kentucky Department of Revenue**
Frankfort, Kentucky 40620.

➤ **Federal Form 1120, pages 1, 2 and 4, or 1120A, pages 1 and 2, and any supporting schedules must be attached.**

BLANK

SCHEDULE NOL

41A720NOL (10-05)

Commonwealth of Kentucky
DEPARTMENT OF REVENUE

NET OPERATING LOSS SCHEDULE

Attach to Form 720.

Taxable Year Ending 12 / 06
Mo. Yr.

☐ If irrevocable election is made to carry NOL carryforward as an apportioned NOL, check here.

PART I—MANDATORY NEXUS CONSOLIDATION

DRAFT 10-26-05

Section A—Current Net Operating Loss Adjustment

Name	Kentucky Corporation Account Number	Includible Corporations A Kentucky Net Income	B Kentucky Net Losses (Enter as a Positive)	C Total Losses (Enter as a Positive)
1. Common Parent A		40,000		
2. **Subsidiaries**				
B		60,000		
C		30,000		
D			40,000	
E			8,000	
3. Totals (add Columns A and B)		130,000	48,000	
4. Limitation (line 3, Column A, multiplied by 50%)		65,000		
5. Prior year NOL carryforward				21,000
6. Total (add line 5, Column C and line 3, Column B)				69,000
7. Disallowed loss. If Line 3, Column B is greater than Line 4, Column A, enter the difference here and on Form 720, Part I, line 17. If amount entered, skip to Section B, line 1 (see instructions)				
8. Additional NOLD. Enter as a negative amount on Form 720, Part I, line 17 (see instructions)		17,000		

Section B—Current Year Loss Disallowed and NOL Carryforward

1. Current year loss disallowed (see instructions)	4,000
2. Prior year(s) NOL carryforward(s)	21,000
3. Prior year(s) NOL carryforward used this year (see instructions)	21,000
4. Total NOL carryforward (line 1 plus line 2 minus line 3)	4,000

PART II—SEPARATE ENTITY AND ELECTIVE CONSOLIDATED FILERS

Section A—NOL Carryforward

1. Carryforward from prior year(s)	
2. Net operating loss (current year) from Form 720, Part I, line 21	
3. Net operating loss deduction from Form 720, Part I, line 20	
4. Total NOL carryforward (line 1 plus line 2 minus line 3)	

NET OPERATING LOSS SCHEDULE

INSTRUCTIONS

Purpose of This Schedule—This schedule is to be used by corporations that are required to file a mandatory nexus consolidated return in order to determine the loss limitation. It is also to be used by corporations filing a separate entity return, an elective consolidated return or mandatory nexus return to track the NOL carryforward.

The includible corporations of the mandatory consolidated nexus return that have earned a net operating loss shall not deduct an amount that exceeds, in the aggregate, 50 percent of the income realized by the remaining includible corporations that did not realize a net operating loss.

Part I—Mandatory Nexus Consolidation

General Instructions—This is only for mandatory nexus returns filed in accordance with KRS 141.200(8-14).

The 50 percent limitation, net operating loss(es) and net operating loss carryforwards are determined prior to the application of the apportionment factor. If one or more of the "includible corporations" brings an NOL carryforward to the mandatory consolidated group, the common parent may make an irrevocable election to carry all NOL carryforwards as an apportioned NOL. Otherwise, the NOL carryforward for each member of the consolidated group must be recomputed to a preapportioned amount.

An "includible corporation" that brings its NOL carryforward from another consolidated group will determine its NOL based upon Section 1502 of the Internal Revenue Code and related regulations, adjusted for differences between KRS Chapter 141 and the Internal Revenue Code.

Any NOL carryforward is utilized first in meeting its 50 percent limitation.

Section A—Enter the name and Kentucky corporation account number of the common parent and includible subsidiaries.

Section A

Column A—Enter only Kentucky net income from includible corporations, Schedule KCR (Form 720), Line 19.

Column B—Enter only Kentucky net losses from includible corporations, Schedule KCR (Form 720), Line 19. **Enter as a positive amount.**

Line 3—Enter the totals for Column A and Column B. Column B should reflect a positive amount.

Line 4—Multiply Line 3, Column A by 50 percent. This is the limitation that the amount on Line 6, Column C cannot exceed.

Line 5—Enter the prior year NOL carryforward as a positive amount.

Line 7—The amount on Line 7 is the amount of the net operating loss(es) of the includible corporation(s) that exceeds the 50 percent loss limitation. It is an addback in computing Kentucky net income. If an amount is entered, skip to Section B, Line 1. If Line 3, Column B is less than Line 4, Column A, leave blank and go to Line 8.

Line 8—If Line 4, Column A is greater than Line 3, Column B, enter the lesser of **this difference** or Line 5, Column C. (**This difference** is Line 4, Column A less Line 3, Column B.) Otherwise, leave blank. This is the amount of additional loss(es) from the includible corporation(s) that can be used to meet the 50 percent loss limitation. It is a deduction in computing Kentucky net income.

Section B

Current year loss disallowed is the amount of Kentucky losses from Line 3, Column B that are disallowed due to first using prior year NOL carryforward(s) to meet the 50 percent limitation. It is available for carryforward.

Line 1—If Line 4, Column A, is greater than or equal to Line 5, Column C, enter the difference of Line 6, Column C less Line 4, Column A. If this difference is less than zero, enter -0-.

If Line 5, Column C is greater than Line 4, Column A, enter the amount from Line 3, Column B.

Line 3—Enter the lesser of Part I, Section A, Line 4, Column A or Part I, Section A, Line 5, Column C. If equal, enter amount from Part I, Section A, Line 5, Column C.

Part II—Separate Entity and Elective Consolidated Filers

General Instructions—This section is to be used only by separate entity and elective consolidated filers in order to calculate the available NOL carryforward. Follow the instructions as indicated on Lines 1 through 4.

Example 5-4

This example depicts a separate return loss year carryforward example.

Example 5-4

This example depicts a separate return loss year carryforward.

Year		A	B	C	D	KY Consolidated Net Income per 720, line 16
Separate Return Loss Year 12/31/2004			$ (50,000)	$ (25,000)		N/A
12/31/2005		$ 100,000	$ (25,000)	$ (20,000)	$ 50,000	$ 105,000

The 12/31/2005 adjustment for Form 720, line 17 is $75,000 - $25,000 - $20,000 = $(30,000) deduction

Loss limitation for 12/31/2005 is ($100,000 + $50,000) * 50% = $75,000

NOL carryforward to 12/31/2006 is $75,000 - $120,000 = $(45,000)

Total Losses available for 12/31/2005 is $50,000 + $25,000 + $25,000 + $ 20,000 = $120,000

Carryforward of an Elective Consolidated Loss to a Nexus Consolidated Return Period

If a consolidated net operating loss carryforward exists for the last return filed by an affiliated group of corporations that filed a consolidated Kentucky return under a ninety-six month election period, the loss may be carried forward to the first return of a nexus consolidated group. Chapter 3 of this book describes the differences between an elective and nexus consolidated group. Any loss carryforward from the last return of an elective consolidated group must be computed under the provisions of Section 1502 of the Internal Revenue Code and related regulations and be adjusted for the differences between KRS Chapter 141 and the Internal Revenue Code. A Kentucky NOL carryforward will only exist in this situation if there is a consolidated Kentucky NOL carryforward reflected on the last elective consolidated return.

The loss carryforward from the last return of an elective consolidated group must be reported on Form 720 Schedule NOL, as part of the current net operating loss adjustment on a nexus consolidated return. The loss carryforward amount must be on a pre-apportionment basis unless an election is made on Schedule NOL to carryforward a post-apportionment loss.

In some cases, an expiring ninety-six month elective consolidated group may be survived by more than one nexus consolidated group. If a consolidated net operating loss carryforward exists for the last return of the elective consolidated group, and the Kentucky nexus affiliates are split up into more than one nexus consolidated group, then the following rules apply:

1. Compute on a separate company basis, the pre-apportionment loss for each affiliate that was included as part of the consolidated NOL computation on the last return filed by the elective consolidated group. The columnar schedule that should be included with a consolidated return should reflect this computation. Schedule KCR has been developed for this purpose. The separate company loss should reflect adjustments for the differences between KRS Chapter 141 and the Internal Revenue Code.

2. If the records don't exist to reconstruct the separate company losses on a pre-apportionment basis, then an election can be made on Schedule NOL to carryforward a proportionate share of the post-apportionment consolidated loss.

3. Add all the separately computed losses together. Divide each loss affiliate's separate loss amount by the total consolidated loss amount. Multiple the resultant percentage by the consolidated NOL carryforward.

4. Carry the loss computed in number 3 above to the nexus consolidated return in which the former elective consolidated parent or subsidiary is an includible corporation under the provisions of KRS 141.200(9) through (14) and related regulations.

5. Include the NOL carryforward as part of the current year net operating loss adjustment on Form 720, Schedule NOL for the first return due under the nexus consolidated rules.

Losses for an elective consolidated group shall not be carried forward to a nexus consolidated return unless the loss affiliates had Kentucky corporation income tax nexus.

Example 5-5

This example depicts the carryforward of a post-apportionment elective consolidated loss to the returns filed by two separate nexus consolidated groups.

This example depicts the carryforward of an elective consolidated loss to the returns filed by two separate nexus consolidated groups.

Final Elective Consolidated Return - 12/31/05

Income/Loss After Appointment	A	B	C	D	Consolidated
	$(100,000)	$50,000	$(25,000)	$5,000	$(70,000)

Consolidated Kentucky NOL carryforward is $(70,000)

Nexus Group 1 - 12/31/06

Net Income	A	B	Share of Consolidated NOL	Consolidated
	$100,000	$50,000	$(56,000)	$94,000

NOL Limitation = $150,000 X 50% = 75,000

Share of the elective consolidated loss = $56,000

$\frac{100{,}000}{125{,}000}$ X 70,000 = $56,000

All of the loss can be deducted on the 12/31/06 return.

Nexus Group 2 - 12/31/06

Net Income	C	D	Share of Consolidated NOL	Consolidated
	$50,000	$25,000	$(14,000)	$61,000

NOL Limitation = $75,000 X 50% = 37,500

Share of the elective consolidated loss = $14,000

$\frac{25{,}000}{125{,}000}$ X 70,000 = $14,000

All of the loss can be deducted on the 12/31/06 return

Carryforward of an Elective Consolidated Loss to a Separate Return

If a consolidated net operating loss carryforward exists for the last return filed by an affiliated group of corporations that filed a consolidated Kentucky return under a ninety-six month election period, the loss may be carried forward to separate Kentucky returns that are required to be filed because a nexus consolidated return situation doesn't exist. The following rules apply to this situation:

1. Compute on a separate company basis, the post-apportionment Kentucky loss for each affiliate that was included as part of the consolidated NOL computation on the last return filed by the elective consolidated group. The columnar schedule that should be included with a consolidated return should reflect this computation. Schedule KCR has been developed for this purpose. The separate company loss should reflect adjustments for the differences between KRS Chapter 141 and the Internal Revenue Code.

2. Carry the separate company loss computed in number 1 above to the first separate return due after the expiration of the ninety-six month election period.

3. Deduct the applicable amount on line 20, part I of Form 720.

Nexus Consolidated NOL Carryforward to a Separate Return Period

If an affiliated group filing under the nexus consolidated rules ceases to exist and a Kentucky consolidated net operating loss carryforward exists, a loss may be carried forward to separate Kentucky returns that are required to be filed. The following rules apply to this situation;

1. Compute on a separate company basis, the post-apportionment Kentucky loss for each affiliate that was included as part of the consolidated NOL computation on the last return filed by the nexus consolidated group. The separate company loss should reflect adjustments for the differences between KRS Chapter 141 and the Internal Revenue Code.

2. Carry the separate company loss computed in number 1 above to the first separate return due after the nexus consolidated group ceases to exist.

3. Deduct the applicable amount on line 20, part I of Form 720.

Computation of a C Corporation's Distributive Share Income Received from a General Partnership on Form 720

A C corporation that is a partnership in a general partnership that does business within and without Kentucky is considered to be doing business in Kentucky under KRS 141.010(25) and is subject to corporation income tax. The C corporation partner shall file form 720 and compute its Kentucky taxable net income under the provisions of KRS 141.010(14)(b). KRS 141.010(14)(b) provides that the corporation will apportion and allocate its net income using the three factor apportionment formula provided by KRS 141.120. All of the C corporation's net income will be apportionable or allocable to Kentucky, not just the distributive share income of the partnership. The distributive share income received by the C corporation will go in the numerator and denominator of the receipts factor. The sales, property and payroll of the general partnership are not included in the apportionment factor of the C corporation partner.

BLANK

720
41A720
Department of Revenue

Kentucky Corporation Income Tax Return

(Pass-Through Corporations Use Applicable Forms)

➤ *See separate instructions.*

2005

Taxable Year Ending
__ __ / __ __
Mo. Yr.

Taxable period beginning ____________, 2005, and ending ____________, 200__.

A *If filing consolidated, check the appropriate box. See instructions.*
Consolidated
☐ Election Made prior to 2005, attach Form 722.
☐ Mandatory Nexus

B Federal Identification Number __ __ – __ __ __ __ __ __ __

C Kentucky Corporation Account Number __ __ __ __ __ __

Name of Corporation or Affiliated Group *(Place preaddressed label here; otherwise print or type.)*

State and Date of Incorporation

Number and Street

Principal Business Activity in KY

City | State | ZIP Code | Telephone Number

NAICS Code Number (Relating to Kentucky Activity) (See **www.census.gov**)

D Name of Common Parent — Kentucky Corporation Account Number __ __ __ __ __ __

E *Check if applicable:* ☐ No packet required for 2006 ☐ Initial return ☐ Final return *(attach explanation)*
☐ Short-period return *(attach explanation)* ☐ Change of name ☐ Change of address

PART I—TAXABLE INCOME COMPUTATION

1. Federal taxable income (Form 1120, line 28; Form 1120A, line 24)		
ADDITIONS:		
2. Interest income (state and local obligations)		
3. State taxes based on net/gross income		
4. Depreciation adjustment		
5. Deductions attributable to nontaxable income		
6. Related party expenses		
7. Pass-through loss(es) from other corporation(s) subject to Kentucky corporation income tax		
8. Other (attach schedule)		
9. **Total** (add lines 1 through 8)		
SUBTRACTIONS:		
10. Interest income (U.S. obligations)		
11. Dividend income		
12. Federal work opportunity credit		
13. Depreciation adjustment		
14. Pass-through income from other corporation(s) subject to Kentucky corporation income tax		
15. Other (attach schedule)		
16. **Net income** (line 9 less lines 10 through 15)		
17. Current net operating loss adjustment (mandatory nexus only)		
18. **Kentucky net income** (add lines 16 and 17)		
19. **Taxable net income** (attach Schedule A if applicable)		
20. Net operating loss deduction		
21. **Taxable net income** (after NOLD) (line 19 less line 20)		

PART II—ALTERNATIVE MINIMUM (AMC)

Gross Receipts		
1. Kentucky gross receipts (less Kentucky returns and allowances)		
2. Tax (line 1 multiplied by .00095)		
Gross Profits		
3. Kentucky gross receipts		
(a) Less Kentucky returns and allowances		
(b) Less Kentucky cost of goods sold		
4. Gross profit (subtract lines 3(a) and 3(b) from line 3)		
5. Tax (line 4 multiplied by .0075)		

PART III—TAX COMPARISON

1. Income tax from Part I (multiply line 21 by rates) (see instructions)		
2. Alternative minimum (AMC) (lesser of Part II, line 2 or line 5)		

PART IV—TAX COMPUTATION

1. **Tax liability** (Part III, greater of line 1, line 2 or $175 minimum)		
2. Recycling/composting equipment tax credit recapture		
3. **Total** (add lines 1 and 2) (if $175 minimum, skip lines 4 through 15 and enter on line 16)		
4. Economic development tax credits		
5. Historic preservation restoration tax credit		
6. Unemployment tax credit		
7. Recycling/composting equipment tax credit		
8. Coal conversion tax credit		
9. Enterprise zone tax credit		
10. Kentucky investment fund tax credit		
11. Coal incentive tax credit		
12. Qualified research facility tax credit		
13. GED incentive tax credit		
14. Voluntary environmental remediation tax credit (Brownfields)		
15. Biodiesel tax credit		
16. **Net tax liability** (line 3 less lines 4 through 15) ($175 minimum)		
17. Estimated tax payments		
18. Extension tax payment		
19. Prior year's credit		
20. **Tax due** (line 16 less lines 17 through 19)		
21. **Tax overpayment**		
22. Credited to 2006		
23. **Amount to be refunded** (line 21 less line 22)		

TAX PAYMENT SUMMARY (Round to Nearest Dollar)

TAX *(check applicable box)* ☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Profits ☐ Minimum $175

Tax ____________
Penalty ____________
Interest ____________
TOTAL (Including Penalty and Interest) ➤ ____________

Make check(s) payable to: **Kentucky State Treasurer.**
Mail return with payment to: **Kentucky Department of Revenue Frankfort, Kentucky 40620.**

➤ **Federal Form 1120, pages 1, 2 and 4, or 1120A, pages 1 and 2, and any supporting schedules must be attached.**

SCHEDULE Q—KENTUCKY CORPORATION QUESTIONNAIRE

IMPORTANT: Questions 4—13 must be completed by all corporations. If this is the corporation's initial return or if the corporation did not file a return under the same name and same federal I.D. number for the preceding year, questions 1, 2 and 3 must be answered. **Failure to do so may result in a request for a delinquent return.**

1. Indicate whether: (a) ☐ new business; (b) ☐ successor to previously existing business which was organized as: (1) ☐ corporation; (2) ☐ partnership; (3) ☐ sole proprietorship; or (4) ☐ other ______________________

   If successor to previously existing business, give name, address and federal I.D. number of the previous business organization.
   ____

2. List the following ***Kentucky*** account numbers. Enter N/A for any number not applicable.
   Employer Withholding ______________
   Sales and Use Tax Permit ______________
   Consumer Use Tax ______________
   Unemployment Insurance ______________
   Coal Severance and/or Processing Tax ______________
3. If a foreign corporation, enter the date qualified to do business in Kentucky. __ __ / __ __ / __ __
4. The corporation's books are in care of: (name and address)
   ____
5. Is the corporation a partner in a general partnership(s) doing business in Kentucky? ☐ Yes ☐ No.
   If yes, attach schedule listing name, federal I.D. and Kentucky account number of the general partnership(s).
   ____
   Was the corporation doing business in Kentucky, outside of its interest in a general partnership? ☐ Yes ☐ No
6. Are related party costs made to related members as defined in KRS 141.205(1)(l) included in this return? ☐ Yes ☐ No.
   If yes, list name, federal I.D. and/or Kentucky corporation account number of the individual or entity. ______________
7. Is the net distributive income (loss) received from a corporation subject to the tax imposed by KRS 141.040 included in this return? ☐ Yes ☐ No. If yes, list name, federal I.D. and Kentucky account number of the corporation.
   ____

Caution: *If the corporation elected to file a consolidated income tax return for tax years beginning prior to January 1, 2005, skip questions 8 and 9 and go to question 10.*

8. Did the corporation at any time during the taxable year do business in Kentucky and own 80 percent or more of the voting stock of another corporation doing business in Kentucky? ☐ Yes ☐ No. If yes, list name, address and federal I.D. number of the entity. ______________
9. Was 80 percent or more of the corporation's voting stock owned by any corporation doing business in Kentucky at any time of the year? ☐ Yes ☐ No. If yes, list name, address and federal I.D. number of the entity. ______________
10. Was this return prepared on: (a) ☐ cash basis, (b) ☐ accrual basis, (c) ☐ other ______________
11. Is the corporation a public service corporation subject to taxation under KRS 136.120? ☐ Yes ☐ No
12. Did the corporation file a Kentucky tangible personal property tax return for January 1, 2006? ☐ Yes ☐ No
13. Is the corporation currently under audit by the Internal Revenue Service? ☐ Yes ☐ No. If yes, enter years under audit ______________
    If the Internal Revenue Service has made final and unappealable adjustments to the corporation's taxable income which have not been reported to this department, check here ☐ and file Form 720X or Form 720XX, whichever is applicable, for each year adjusted and attach a copy of the final determination.

OFFICER INFORMATION (Failure to Provide Requested Information May Result in a Penalty)

Attach a schedule listing the name, home address and Social Security number of the vice president, secretary and treasurer.

Has this officer information attached changed from the last return filed? ☐ Yes ☐ No

President's Name ______________ President's Home Address ______________

President's Social Security Number ______________

I, the undersigned, declare under the 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.

✍ ______________________ Signature of principal officer or chief accounting officer ______________ Date

______________________ Name and Social Security or federal identification number of person or firm preparing return

May the Department of Revenue discuss this return with the preparer? ☐ Yes ☐ No

E-mail Address:

www.revenue.ky.gov

FORM 851-K

41A851-K (10-05)

Department of Revenue

KENTUCKY AFFILIATIONS AND PAYMENT SCHEDULE

➤ **File with the consolidated income tax return (Form 720) and extension request (Form 41A720SL).**

Taxable Year Ending

M M Y Y

List the parent corporation and all subsidiaries subject to Kentucky corporation income tax.

Name of Corporation	Kentucky Corporation Account Number	**Current Payments (Round to Nearest Dollar)** *(See Instructions on Reverse)*		
		Income Tax	Penalty and Interest	Total
Common parent corporation:				
Subsidiary corporations:				

DRAFT 9-30-05

➤ A COPY OF FEDERAL FORM 851, AFFILIATIONS SCHEDULE, MUST BE ATTACHED TO FORM 720.

FORM 851-K—KENTUCKY AFFILIATIONS AND PAYMENT SCHEDULE INSTRUCTIONS

Purpose of the Form—This form must be completed and submitted with the consolidated income tax return (Form 720) and with the request for extension of time to file for a consolidated income tax return (Kentucky Form 41A720SL or copy of federal Form 7004). The information requested on this form (1) identifies the common parent of the affiliated group and each subsidiary that is filing a Kentucky consolidated return and (2) prevents requests by the Department of Revenue for delinquent income tax returns for those corporations included in the consolidated Kentucky income tax return.

Listing of Subsidiaries—List each subsidiary corporation included in the consolidated income tax return. Enter the six-digit Kentucky Corporation Account Number located in the upper right portion of the address label on the Kentucky corporation income tax return packet received by the subsidiary.

Current Payment(s)—Enter the payment amount. This is the income tax for the consolidated group.

SCHEDULE A

41A720A (10-05)

Commonwealth of Kentucky
DEPARTMENT OF REVENUE

APPORTIONMENT AND ALLOCATION

(For corporations taxable both within and without Kentucky.)

See instructions on reverse.

Attach to Form 720, Form 720S, Form 725, Form 765 or Form 765-GP.

Taxable Year Ending
__ __ / __ __
Mo. Yr.

Name of Corporation	Federal Identification Number	Kentucky Corporation Account Number
	__ __ - __ __ __ __ __ __ __	__ __ __ __ __ __

If apportionment method other than statutory formula is used:

- ***Attach*** a copy of letter requiring or granting permission to use an alternative method or statement making election in accordance with KRS 141.120(9)(b)(1) or (2); and
- ***Indicate*** the method used: ☐ separate accounting ☐ alternative.

SECTION I. COMPUTATION OF APPORTIONMENT FRACTION

1.	Kentucky sales		
2.	Total sales		
3.	Line 1 divided by line 2	%	
4.	Sales factor (line 3 multiplied by 2)		%
5.	Average value of Kentucky real/tangible property (Section III)		
6.	Average value of total real/tangible property (Section IV)		
7.	Property factor (line 5 divided by line 6)		%
8.	Kentucky payrolls		
9.	Total payrolls		
10.	Payroll factor (line 8 divided by line 9)		%
11.	Total (lines 4, 7 and 10)		%
12.	Apportionment fraction—line 11 divided by 4 or number of factors present (sales representing 2 factors)		%

SECTION II. APPORTIONMENT AND ALLOCATION OF INCOME

1.	Net income (from Form 720, Part I, line 18; Form 720S, Part I, line 23; Form 725, Part I, line 12; or Form 765, Part I, line 25)		
2.	Deduct nonbusiness income (if applicable):		
	(a) Interest		
	(b) Rents		
	(c) Royalties		
	(d) Net gain or loss on sale or exchange of capital assets		
	(e) Total (lines (a) through (d))		
	(f) Less related expenses (attach schedule)	( )	
3.	Net nonbusiness income		
4.	Business income (line 1 less line 3)		
5.	Business income apportioned to Kentucky (line 4 multiplied by line 12, Section I)		
6.	Add Kentucky nonbusiness income (if applicable):		
	(a) Interest		
	(b) Rents		
	(c) Royalties		
	(d) Net gain or loss on sale or exchange of capital assets		
	(e) Total (lines (a) through (d))		
	(f) Less Kentucky related expenses (attach schedule)	( )	
7.	Kentucky net nonbusiness income		
8.	Taxable net income (line 5 plus line 7) (enter here and on Form 720, Part I, line 19; Form 720S, Part I, line 24; Form 725, Part I, line 13; or Form 765, Part I, line 26)		

SECTION III. KENTUCKY REAL/TANGIBLE PROPERTY

PROPERTY	A. Beginning of Year	B. End of Year
1. Inventories		
2. Buildings		
3. Machinery and equipment		
4. Land		
5. Other tangible assets		
6. Total (lines 1 through 5)		
7. Average value of real/tangible property owned in Kentucky, total of line 6, columns A and B divided by 2		
8. Leased property (Eight times the annual rental rate less subrentals)		
9. Total (lines 7 and 8) (enter on line 5, Section I)		

SECTION IV. TOTAL REAL/TANGIBLE PROPERTY

PROPERTY	A. Beginning of Year	B. End of Year
1. Inventories		
2. Buildings		
3. Machinery and equipment		
4. Land		
5. Other tangible assets		
6. Total (lines 1 through 5)		
7. Average value of real/tangible property owned everywhere, total of line 6, columns A and B divided by 2		
8. Leased property (Eight times the annual rental rate less subrentals)		
9. Total (lines 7 and 8) (enter on line 6, Section I)		

Schedule A—Apportionment and Allocation Instructions

General—A corporation doing business both within and without Kentucky shall apportion and allocate net income to Kentucky in accordance with KRS 141.120. The three-factor apportionment formula of sales, property and payroll provided by KRS 141.120(8) is substantially the same as the Uniform Division of Income for Tax Purposes Act (UDITPA) written by the National Conference of Commissioners on Uniform State Law, except that for Kentucky purposes the sales factor is double weighted. Public service companies (defined in KRS 136.120) and financial organizations shall apportion and allocate net income in accordance with KRS 141.120(10) and Regulations 103 KAR 16:100 through 103 KAR 16:150.

A corporation must use the statutory formula unless the corporation has been required or granted approval in writing by the Department of Revenue to use a method other than the formula provided by KRS 141.120(9)(a) or the corporation qualifies for and elects an alternative apportionment method provided by KRS 141.120(9)(b). A copy of the letter from the Department of Revenue requiring or granting approval to use a method other than the statutory formula or a statement electing an alternative apportionment method in accordance with KRS 141.120(9)(b)(1) or (2) must be attached to the return when filed.

Consolidated Return—An affiliated group filing a consolidated return is treated as a single corporation. All transactions between members of the affiliated group shall be eliminated in determining the sales, property and payroll factors. **Attach a columnar spreadsheet to Schedule A reflecting the computation of the consolidated factors.**

COMPUTATION OF APPORTIONMENT FRACTION

The business apportionment factors shall be computed as follows:

Sales—Total sales include all gross receipts other than nonbusiness receipts. Sales of real or tangible personal property are assigned to Kentucky if the property is located in Kentucky or is shipped or delivered to a purchaser in Kentucky. Sales of tangible personal property to the U.S. government are assigned to Kentucky if the property is shipped from Kentucky.

KRS 141.120(8)(c)(3) provides that sales other than sales of tangible personal property are assigned to Kentucky if the income-producing activity is performed entirely within Kentucky or if the income-producing activity is performed both within and without Kentucky and a greater portion of the income-producing activity is performed in Kentucky than in any other state based on cost of performance. The following are general guidelines for assigning these receipts to Kentucky but should not be considered all inclusive:

A. Receipts from intangibles are assigned to Kentucky if the corporation's commercial domicile is in Kentucky or the intangible has acquired a Kentucky business situs. Examples of receipts from intangibles which are deemed to have acquired a Kentucky business situs are franchise fees from a franchisee located in Kentucky and a corporation's Kentucky distributive share of net income from a partnership doing business in Kentucky.

B. Rents or royalties from real or tangible personal property are assigned to Kentucky if the property is located in Kentucky or in the case of mobile property the rent is assigned to Kentucky if the lessee's base of operations for the property is in Kentucky.

C. Receipts from the performance of services are assigned to Kentucky if the services are performed entirely in Kentucky or the services are performed both within and without Kentucky but a greater portion is performed in Kentucky than in any other state based on cost of performance.

If the corporation is a partner in a general partnership doing business within and without this state, the Kentucky receipts are determined by the corporation's distributive share of income, loss and deductions multiplied by the apportionment fraction of the partnership as prescribed in KRS 141.206(9).

Property—Total property includes all real and tangible personal property owned or rented and used during the taxable year. Property owned is valued at original cost. Leased property is valued at eight times the annual rental rate less any nonbusiness subrentals. Real and tangible personal properties are assigned to Kentucky if owned or rented and used in Kentucky. Exclude (a) construction in progress and (b) property which has been certified by Kentucky as a pollution control facility and is owned or leased by the corporation. Safe harbor lease property must be included in the factor of the seller/lessee at cost and excluded from the property factor of the purchaser/lessor.

Payroll—Total payroll includes all payroll reported on federal Form 940 before adjustments or exclusions. Kentucky payroll is total payroll subject to Kentucky unemployment insurance tax (before adjustments or exclusions to determine payroll actually taxed for unemployment insurance). A fiscal year taxpayer must adjust the unemployment insurance payroll from a calendar year basis to a fiscal year basis.

Apportionment Fraction—To compute the apportionment fraction, the sales factor must be multiplied by two and the property and payroll factors must each be multiplied by one and the total divided by four. A corporation which does not have sales, property or payroll must average only the factors which are present to determine the weighted apportionment fraction.

APPORTIONMENT AND ALLOCATION OF INCOME

Business income arises from transactions and activities in the regular course of the corporation's trade or business, and includes income from tangible and intangible property if the acquisition, management or disposition of the property constitutes integral parts of the corporation's trade or business.

Classifying income by categories (such as interest, rents, royalties and capital gains) does not determine whether income is business or nonbusiness. For example, gain or loss recognized on the sale of property may be business income or nonbusiness income depending upon its relationship to the corporation's trade or business.

Nonbusiness income includes all income not properly classified as business income less all direct or indirect expenses attributable to the production of this income. Nonbusiness income is allocated to Kentucky if (a) the corporation's commercial domicile (the principal place from which the trade or business is managed) is located in Kentucky, or (b) property creating the nonbusiness income is utilized in Kentucky. Generally, tangible personal property is utilized in Kentucky if it is physically located in Kentucky; intangible property, such as patents and copyrights, is utilized in Kentucky if it is actually used in Kentucky.

SCHEDULE NOL

41A720NOL (10-05)

Commonwealth of Kentucky
DEPARTMENT OF REVENUE

NET OPERATING LOSS SCHEDULE

Attach to Form 720.

Taxable Year Ending

__ __ / __ __
Mo. Yr.

☐ **If irrevocable election is made to carry NOL carryforward as an apportioned NOL, check here.**

PART I—MANDATORY NEXUS CONSOLIDATION

DRAFT 10-26-05

Section A—Current Net Operating Loss Adjustment		Includible Corporations		
		A	B	C
Name	Kentucky Corporation Account Number	Kentucky Net Income	Kentucky Net Losses (Enter as a Positive)	Total Losses (Enter as a Positive)
1. Common Parent				
2. **Subsidiaries**				
3. Totals (add Columns A and B)				
4. Limitation (line 3, Column A, multiplied by 50%)				
5. Prior year NOL carryforward				
6. Total (add line 5, Column C and line 3, Column B)				
7. Disallowed loss. If Line 3, Column B is greater than Line 4, Column A, enter the difference here and on Form 720, Part I, line 17. If amount entered, skip to Section B, line 1 (see instructions)				
8. Additional NOLD. Enter as a negative amount on Form 720, Part I, line 17 (see instructions)				

Section B—Current Year Loss Disallowed and NOL Carryforward

1. Current year loss disallowed (see instructions)	
2. Prior year(s) NOL carryforward(s)	
3. Prior year(s) NOL carryforward used this year (see instructions)	
4. Total NOL carryforward (line 1 plus line 2 minus line 3)	

PART II—SEPARATE ENTITY AND ELECTIVE CONSOLIDATED FILERS

Section A—NOL Carryforward

1. Carryforward from prior year(s)	
2. Net operating loss (current year) from Form 720, Part I, line 21	
3. Net operating loss deduction from Form 720, Part I, line 20	
4. Total NOL carryforward (line 1 plus line 2 minus line 3)	

NET OPERATING LOSS SCHEDULE

INSTRUCTIONS

Purpose of This Schedule—This schedule is to be used by corporations that are required to file a mandatory nexus consolidated return in order to determine the loss limitation. It is also to be used by corporations filing a separate entity return, an elective consolidated return or mandatory nexus return to track the NOL carryforward.

The includible corporations of the mandatory consolidated nexus return that have earned a net operating loss shall not deduct an amount that exceeds, in the aggregate, 50 percent of the income realized by the remaining includible corporations that did not realize a net operating loss.

Part I—Mandatory Nexus Consolidation

General Instructions—This is only for mandatory nexus returns filed in accordance with KRS 141.200(8-14).

The 50 percent limitation, net operating loss(es) and net operating loss carryforwards are determined prior to the application of the apportionment factor. If one or more of the "includible corporations" brings an NOL carryforward to the mandatory consolidated group, the common parent may make an irrevocable election to carry all NOL carryforwards as an apportioned NOL. Otherwise, the NOL carryforward for each member of the consolidated group must be recomputed to a preapportioned amount.

An "includible corporation" that brings its NOL carryforward from another consolidated group will determine its NOL based upon Section 1502 of the Internal Revenue Code and related regulations, adjusted for differences between KRS Chapter 141 and the Internal Revenue Code.

Any NOL carryforward is utilized first in meeting its 50 percent limitation.

Section A—Enter the name and Kentucky corporation account number of the common parent and includible subsidiaries.

Section A

Column A—Enter only Kentucky net income from includible corporations, Schedule KCR (Form 720), Line 19.

Column B—Enter only Kentucky net losses from includible corporations, Schedule KCR (Form 720), Line 19. **Enter as a positive amount.**

Line 3—Enter the totals for Column A and Column B. Column B should reflect a positive amount.

Line 4—Multiply Line 3, Column A by 50 percent. This is the limitation that the amount on Line 6, Column C cannot exceed.

Line 5—Enter the prior year NOL carryforward as a positive amount.

Line 7—The amount on Line 7 is the amount of the net operating loss(es) of the includible corporation(s) that exceeds the 50 percent loss limitation. It is an addback in computing Kentucky net income. If an amount is entered, skip to Section B, Line 1. If Line 3, Column B is less than Line 4, Column A, leave blank and go to Line 8.

Line 8—If Line 4, Column A is greater than Line 3, Column B, enter the lesser of **this difference** or Line 5, Column C. (**This difference** is Line 4, Column A less Line 3, Column B.) Otherwise, leave blank. This is the amount of additional loss(es) from the includible corporation(s) that can be used to meet the 50 percent loss limitation. It is a deduction in computing Kentucky net income.

Section B

Current year loss disallowed is the amount of Kentucky losses from Line 3, Column B that are disallowed due to first using prior year NOL carryforward(s) to meet the 50 percent limitation. It is available for carryforward.

Line 1—If Line 4, Column A, is greater than or equal to Line 5, Column C, enter the difference of Line 6, Column C less Line 4, Column A. If this difference is less than zero, enter -0-.

If Line 5, Column C is greater than Line 4, Column A, enter the amount from Line 3, Column B.

Line 3—Enter the lesser of Part I, Section A, Line 4, Column A or Part I, Section A, Line 5, Column C. If equal, enter amount from Part I, Section A, Line 5, Column C.

Part II—Separate Entity and Elective Consolidated Filers

General Instructions—This section is to be used only by separate entity and elective consolidated filers in order to calculate the available NOL carryforward. Follow the instructions as indicated on Lines 1 through 4.

SCHEDULE KCR
Form 720
41A720KCR (10-05)
Department of Revenue

KENTUCKY
CONSOLIDATED RETURN SCHEDULE
(Attach All Applicable Schedules)

Taxable Year Ending
__ __ / __ __
Mo. Yr.

Common Parent Corporation	Kentucky Corporation Account Number
	__ __ __ __ __ __

	Parent	Name ____ FEIN ____ KY Corp. Acct. No.	Name ____ FEIN ____ KY Corp. Acct. No.	Name ____ FEIN ____ KY Corp. Acct. No.	Name ____ FEIN ____ KY Corp. Acct. No.
1. Federal taxable income (Sch. CR or Sch. CR-C, line 28) ...					
Additions					
2. Interest income (state and local obligations)					
3. State taxes based on net/gross income					
4. Depreciation adjustment					
5. Deductions attributable to nontaxable income					
6. Related party expenses					
7. Pass-through loss(es) from other corporation(s) subject to Kentucky corporation income tax .					
8. Other (attach schedule)					
9. Total (add lines 1 through 8)					
Subtractions					
10. Interest income (U.S. obligations)					
11. Dividend income					
12. Federal work opportunity credit .					
13. Depreciation adjustment					
14. Pass-through income from other corporation(s) subject to Kentucky corporation income tax .					
15. Other (attach schedule)					
16. Net income (line 9 less lines 10 through 15)					
17. Less nonbusiness income net of related expenses					
18. Add Kentucky nonbusiness income net of related expenses ..					
19. Kentucky net income					

DRAFT 10-24-05

Schedule KCR – Kentucky Consolidated Return Schedule

GENERAL INSTRUCTIONS

Purpose of Form—This schedule must be completed and submitted with the consolidated income tax return (Form 720) to show the statutory adjustments for each member of the affiliated group.

Specific Instructions—For each subsidiary, enter the name, FEIN and Kentucky corporation account number. If there are more than four subsidiaries in the affiliated group, use Schedule KCR-C, Kentucky Consolidated Return Schedule Continuation Sheet. For each line item 1 through 16, the total of the Parent plus each subsidiary shall equal the corresponding line item on Form 720. Enter on Line 17, the amount from Schedule A, Section II, Line 3. Enter on Line 18, the amount from Schedule A, Section II, Line 7. Combine the amounts on Lines 16 through 18 and enter on Line 19. This form can be duplicated as needed.

SCHEDULE KCR-C
Form 720
41A720KCR-C (10-05)
Department of Revenue

KENTUCKY
CONSOLIDATED RETURN SCHEDULE
Continuation Sheet
(Attach All Applicable Schedules)

Taxable Year Ending
__ __ / __ __
Mo. Yr.

Common Parent Corporation	Kentucky Corporation Account Number
	_ _ _ _ _ _

	Name FEIN KY Corp. Acct. No.	Name FEIN KY Corp. Acct. No.	Name FEIN KY Corp. Acct. No.	Name FEIN KY Corp. Acct. No.	Name FEIN KY Corp. Acct. No.
1. Federal taxable income (Sch CR-C, line 28)					
Additions					
2. Interest income (state and local obligations)					
3. State taxes based on net/gross income					
4. Depreciation adjustment					
5. Deductions attributable to nontaxable income					
6. Related party expenses					
7. Pass-through loss(es) from other corporation(s) subject to Kentucky corporation income tax					
8. Other (attach schedule)					
9. Total (add lines 1 through 8)					
Subtractions					
10. Interest income (U.S. obligations)					
11. Dividend income					
12. Federal work opportunity credit					
13. Depreciation adjustment					
14. Pass-through income from other corporation(s) subject to Kentucky corporation income tax					
15. Other (attach schedule)					
16. Net income (line 9 less lines 10 through 15)					
17. Less nonbusiness income net of related expenses					
18. Add Kentucky nonbusiness income net of related expenses					
19. Kentucky net income					

BLANK

SCHEDULE CR
Form 720
41A720CR (10-05)
Department of Revenue

PRO FORMA FEDERAL CONSOLIDATED RETURN SCHEDULE
(Attach All Applicable Schedules)

Taxable Year Ending
__ __ / __ __
Mo. Yr.

Common Parent Corporation

Kentucky Corporation Account Number
_ _ _ _ _ _

	Consolidated Total	Intercompany Eliminations	Parent	Name ____ FEIN ____ KY Corp. Acct. No.	Name ____ FEIN ____ KY Corp. Acct. No.
1. (a) Gross receipts or sales					
(b) Less returns and allowances					
(c) Balance					
2. Cost of goods sold					
3. Gross profit					
4. Dividends					
5. Interest					
6. Gross rents					
7. Gross royalties					
8. Capital gain net income					
9. Net gain or (loss) from Form 4797					
10. Other income					
11. Total income					
12. Compensation of officers					
13. Salaries and wages					
14. Repairs and maintenance					
15. Bad debts					
16. Rents					
17. Taxes and licenses					
18. Interest					
19. Charitable contributions					
20. (a) Depreciation					
(b) Less depreciation claimed elsewhere on return					
(c) Balance					
21. Depletion					
22. Advertising					
23. Pension, profit-sharing, etc., plans					
24. Employee benefit programs					
25. Domestic production activities deduction					
26. Other deductions					
27. Total deductions					
28. Taxable income before NOL and special deductions					

Schedule CR

Pro Forma Federal Consolidated Return Schedule

GENERAL INSTRUCTIONS

Purpose of Form

This schedule must be completed and submitted with the consolidated income tax return (Form 720) to show the federal gross income and deductions for each member of the affiliated group.

Specific Instructions

For each subsidiary, enter the name, FEIN and Kentucky corporation account number. If there are more than two subsidiaries in the affiliated group, use Schedule CR-C, Pro Forma Federal Consolidated Return Schedule Continuation Sheet. The ConsolidatedTotal column is the total for each line adjusted for intercompany elimination(s). This form can be duplicated as needed.

SCHEDULE CR-C
Form 720
41A720CR-C (10-05)
Department of Revenue

PRO FORMA FEDERAL CONSOLIDATED RETURN SCHEDULE
Continuation Sheet
(Attach All Applicable Schedules)

Taxable Year Ending
___ ___ / ___ ___
Mo. Yr.

Common Parent Corporation

Kentucky Corporation Account Number
— — — — — —

	Name FEIN KY Corp. Acct. No.	Name FEIN KY Corp. Acct. No.	Name FEIN KY Corp. Acct. No.	Name FEIN KY Corp. Acct. No.	Name FEIN KY Corp. Acct. No.
1. (a) Gross receipts or sales					
(b) Less returns and allowances					
(c) Balance					
2. Cost of goods sold					
3. Gross profit					
4. Dividends					
5. Interest					
6. Gross rents					
7. Gross royalties					
8. Capital gain net income					
9. Net gain or (loss) from Form 4797					
10. Other income					
11. Total income					
12. Compensation of officers					
13. Salaries and wages					
14. Repairs and maintenance					
15. Bad debts					
16. Rents					
17. Taxes and licenses					
18. Interest					
19. Charitable contributions					
20. (a) Depreciation					
(b) Less depreciation claimed elsewhere on return					
(c) Balance					
21. Depletion					
22. Advertising					
23. Pension, profit-sharing, etc., plans					
24. Employee benefit programs					
25. Domestic production activities deduction					
26. Other deductions					
27. Total deductions					
28. Taxable income before NOL and special deductions					

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Computation of a Partnership's Net Income on Form 765

All partnerships that are subject to corporation income tax are required to file form 765, Kentucky partnership income tax return. LLC's that are taxed as partnerships for federal income tax purposes will use form 765 to compute its Kentucky taxable net income. The purpose of this form is to transition federal partnership ordinary income to Kentucky corporation taxable net income. "Corporations" filing on this form will pay corporation income tax on the greater of:

1. The tax due on Taxable Net Income.

2. The Alternative Minimum calculation.

3. A minimum of $175.

Important highlights of the net income calculation for a partnership filing form 765 are:

- Partnerships will follow the federal partnership rules in calculating ordinary income except for differences between Kentucky corporation income tax law and federal law;

- Partnerships will follow the federal partnership rules that apply to the separately stated items on schedule K except:

  1. Where statutory differences between Kentucky corporation income tax law and federal law exist; and,

  2. The Section 179 expense deduction will be taken on the corporation income tax return (form 765) and the deduction will pass-through to the partners.

  3. Charitable contributions will be taken as a deduction on the corporation income tax return using the federal corporation rules. Each individual partner will receive their distributive share of the contribution deduction as computed under the federal partnership rules.

  4. Contributions by a partnership to a pension plan will be taken on the corporation income tax return (form 765) using the federal corporation rules. Individual partners will follow the same pre-tax treatment as before.

  5. Medical insurance premiums paid on behalf of the partners are deductible if the premiums paid are not deducted as guaranteed payments in computing the partnership's ordinary income.

- Dividend income is excluded from the definition of a corporation's gross income under the provisions of KRS 141.010(12)(b).

- Guaranteed payments to partners will not be taxed on the corporation income tax return of the partnership. Guaranteed payments will be a deduction at the entity level in figuring ordinary income. Guaranteed payments will continue to be a distributive share item and taxed at the partner level.

Apportionment of a Partnership's Net Income

A partnership required to file form 765 must apportion its net income to Kentucky if the corporation is taxable in this state and taxable in another state under the provisions of KRS 141.010(14)(b) which states:

> "A corporation is taxable in another state if, in any state other than Kentucky, the corporation is required to file a return for or pay a net income tax, franchise tax measured by net income, franchise tax for the privilege of doing business or corporate stock tax."

If a corporation is taxable in this state and taxable in another state, then the corporation must apportion and allocate its net income to Kentucky based on the provisions of KRS 141.120. Before the apportionment fraction is computed, the corporation must determine its business income and nonbusiness income. "Business income" is defined by (KRS 141.120(1)(a) to be "income arising from transactions and activity in the regular course of a trade or business of the corporation and includes income from tangible and intangible property if the acquisition, management, or disposition of the property constitutes integral parts of the corporation's regular trade or business operations."

"Nonbusiness income" means all income other than business income (KRS 141.120(1)(e).

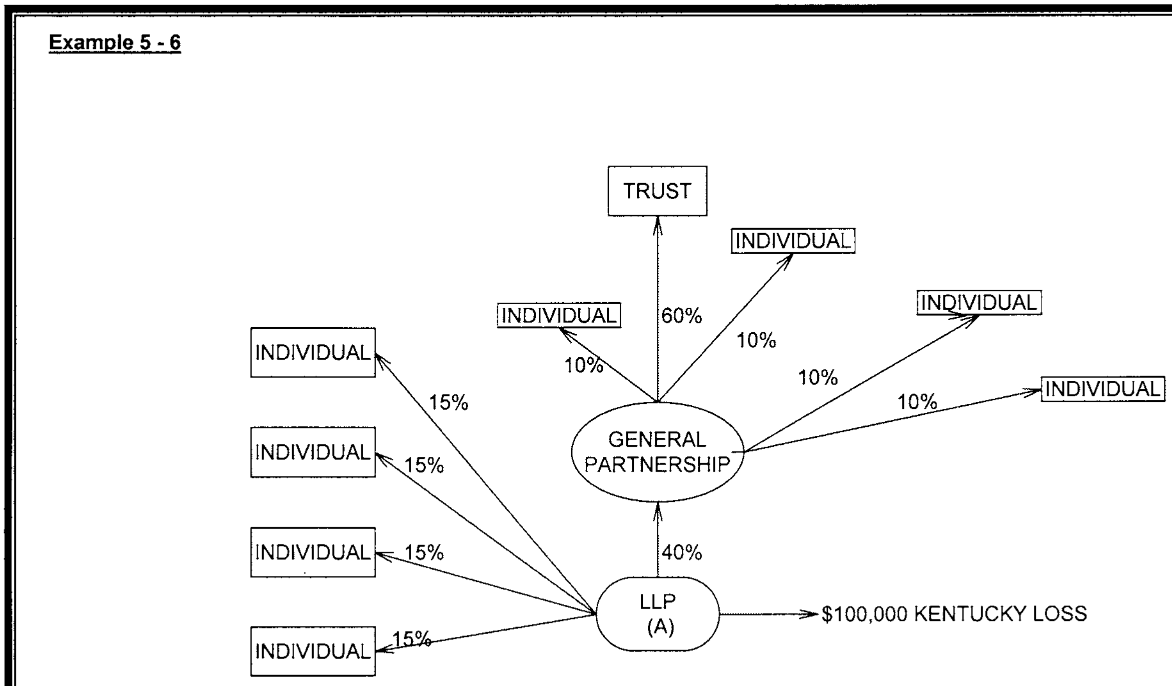
Business income is apportioned to Kentucky using a fraction composed of a double weighted sales factor, a property factor and payroll factor. The apportionment fraction and the calculation of business and nonbusiness income is reflected on Schedule A, Apportionment and Allocation.

For further guidance on business and nonbusiness income, please refer to Administrative Regulation 103 KAR 16:060.

Net Operating Losses

Partnerships owned by other pass-through entities will be able to take a net operating loss deduction on their corporation income tax return for loss carryforwards at the entity level. A loss does not pass through to another corporation for purposes of computing the other corporation's Kentucky corporation net income. This rule will apply to losses generated for tax periods beginning on or after January 1, 2005. If a multi-tiered pass through entity is owned by individuals, a loss will flow through to the individuals and the amount passed through will be subtracted from any NOL carryforward amount for the partnership. Please see example 5-6 that depicts how the loss computation works for a multi-tiered partnership owned exclusively by individuals.

Example 5-6

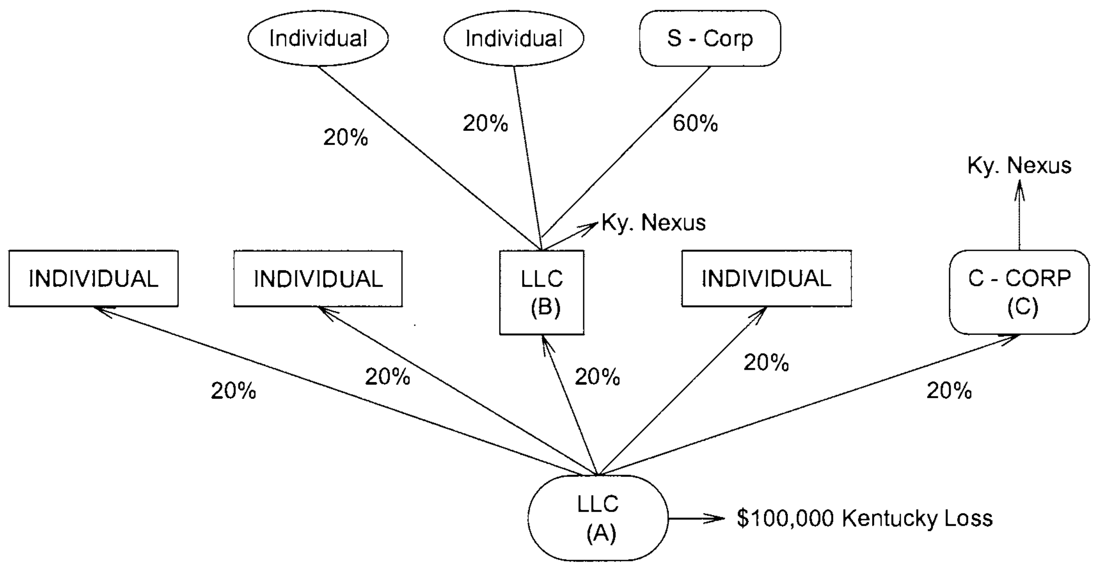


The $100,000 Kentucky loss generated by LLP (A) would be distributed in the following manner: $15,000 would be distributed to each individual partner since they each have 15% ownership (total of $60,000). The remaining $40,000 would be distributed to the general partnership which would factor the loss based upon the sales, property, and payroll of the general partnership. The resulting KNOL would be distributed to the individual general partners based upon their ownership percentages. The Trust would also receive 60% of the apportioned Kentucky loss since it is taxable as an individual.

Example 5-7

This example depicts how the loss computation works for a multi-tiered partnership owned by both individuals and other corporations.

Example 5 - 7



LLC (A) has taxing nexus in the state of Kentucky and files Form 765 to compute and pay tax on corporate income. This LLC generates a $100,000 Kentucky loss. The loss would be distributed in the following manner $100,000 x 20% (Individual partner ownership percentage) x 3 (individual partners)= $60,000.

For taxable years beginning on or after January 1, 2005, the net operating loss carryforward deduction of a corporation shall be reduced by the amount of distributive share income, loss, and deduction distributed to an individual or general partnership as defined in KRS 141.206. (KRS 141.011(4)

The net operating loss carryforward for LLC (A) would be $40,000. $100,000 less $60,000 of loss distributed to individual partners. This loss would be carried forward to offset future income of LLC (A).

If LLC (B) generated a $100,000 Kentucky loss, $40,000 of the loss would be distributed to the individual partners and the remaining $60,000 would be carried forward to offset future Kentucky taxable income of LLC (B).

Consolidated Returns Filed on Form 765

Please refer to chapter 3 of this manual for details regarding which entities should file a consolidated return. A nexus consolidated return will be required on form 765 if a multi-member LLC is the common parent corporation of an affiliated group of corporations that is doing business in this state. In that case, the affiliated group will have to compute its consolidated Kentucky taxable net income under the provisions of KRS 141.200(9) through (14).

Pursuant to KRS 141.200(9)(f), the determinations and computations required by KRS Chapter 141 shall be made in accordance with the provisions of the Internal Revenue Code and related regulations, except as required by differences between this chapter and the Internal Revenue Code. KRS 141.200(11)(b) states in part: "An affiliated group required to file a consolidated return under this subsection shall be treated for all purposes as a single corporation under the provisions of this chapter. All transactions between corporations included in the consolidated return shall be eliminated in computing net income in accordance with KRS 141.010(13), and in determining the property, payroll, and sales factors in accordance with KRS 141.120."

A nexus consolidated return should include a schedule of gross income and deductions for each member of the affiliated group prepared in columnar form. Form 765 KCR provides the columnar format. Form 851-N – Kentucky Affiliations and Payments Schedule must also be attached.

Pass-Through Corporation Income Tax Credits to Individuals

If the partnership is owned by individual partners, a nonrefundable credit will pass through to the individual partners. KRS 141.420(3) authorizes the credit. The credit is the individual partner's proportionate share of the tax due from the corporation as determined under KRS 141.040 before the application of any credits identified in KRS 141.0205(4) and reduced by the required minimum imposed by KRS 141.040(6). The credit may be used against the individual income tax imposed by KRS 141.020.

Also, a refundable credit is available to individual partners for taxable years beginning after December 31, 2004, and before January 1, 2007. The refundable credit is the portion of the nonrefundable credit described in the previous paragraph that exceeds the credit that would have been utilized if the corporation's income were taxed at the rates in KRS 141.020. The refundable portion of the credit shall be the individual partners' proportionate share of the amount computed by multiplying the amount the corporation's income exceeds two hundred sixteen thousand six hundred dollars ($216,600) by one percent (1%). In other words, the refundable credit makes up for the difference between the top corporation income tax rate (7%) and the top individual income tax rate (6%). For tax periods beginning on or after January 1, 2007, the top individual and corporation income tax rates are the same (6%).

The individual income tax portion of this manual provides detailed instructions on how to claim the pass through credits on an individual income tax return.

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Department of Revenue

KENTUCKY PARTNERSHIP INCOME TAX RETURN

(LLC, LLP and LP TAXED AS A CORPORATION)

➤ *See separate instructions.*

2005

Taxable Year Ending

__ __ / __ __
Mo. Yr.

Taxable period beginning ______________, 2005, and ending ______________, 200__.

A Number of Partners (Attach K-1s) ➤ ________

B Federal Identification Number __ __ – __ __ __ __ __ __ __

C Kentucky Corporation Account Number __ __ __ __ __ __

Name of Partnership *(Place preaddressed label here; otherwise print or type.)*

State and Date of Organization

Principal Business Activity in KY

Number and Street

NAICS Code Number (Relating to Kentucky Activity) (See www.census.gov)

City | State | ZIP Code | Telephone Number

D Type of Return

☐ Separate Return

☐ Nexus Consolidation

E *Check if applicable:* ☐ LLC ☐ LP ☐ LLP ☐ Initial return ☐ Final return *(attach explanation)*
☐ Amended return ☐ Short-period return *(attach explanation)* ☐ Change of name ☐ Change of address

PART I—TAXABLE INCOME COMPUTATION

1.	Kentucky ordinary income (loss) (from Schedule K, Section I, line 1)	
2.	Net income (loss) from rental real estate activities	
3.	Net income (loss) from other rental activities	
4.	Interest income	
5.	Royalty income	
6.	Net short-term capital gain	
7.	Net long-term capital gain	
8.	Other portfolio income (loss)	
9.	Section 1231 net gain (loss) (other than due to casualty or theft)	
10.	Other income (loss)	
11.	Total additions (add lines 1 through 10)	
12.	Other income (loss) (KRS 141.010(12)):	
	(a) Related party expenses (KRS 141.205)	
	(b) Deductions attributable to nontaxable income	
	(c) Add net distributable loss from corporations	
	(d) Subtract net distributable income from corporations	
	(e) Other	
13.	**Total income after adjustments** (add lines 11 and 12)	
14.	Charitable contributions (see instructions)	
15.	Section 179 expense deduction (Kentucky Form 4562)	
16.	Deductions related to portfolio income (loss)	
17.	Other deductions	
18.	Section 59(e)(2) expenses	
19.	Total deductions (add lines 14 through 18)	
20.	Oil and gas depletion	
21.	Other adjustments (KRS 141.010(13))	
22.	Total deductions (add lines 19 through 21)	
23.	**Net income (loss)** (line 13 less line 22)	
24.	Current net operating loss adjustment	
25.	Income (loss) after NOL limitation (add lines 23 and 24)	
26.	**Taxable net income (loss)** (amount from line 25 or Schedule A)	

PART II—ALTERNATIVE MINIMUM (AMC)

	Gross Receipts	
1.	Kentucky gross receipts (less Kentucky returns and allowances)	
2.	Tax (line 1 multiplied by .00095)	
	Gross Profits	
3.	Kentucky gross receipts	
	(a) Less Kentucky returns and allowances	
	(b) Less Kentucky cost of goods sold	
4.	Gross profit (subtract lines 3(a) and 3(b) from line 3)	
5.	Tax (line 4 multiplied by .0075)	

PART III—TAX COMPARISON

1.	Regular income tax (see instructions)	
2.	Alternative minimum (AMC) (lesser of Part II, line 2 or line 5)	

PART IV—TAX COMPUTATION

1.	**Tax liability** (Part III, greater of line 1, line 2 or $175 minimum)	
	ADDITIONS	
2.	Recycling/composting equipment tax credit recapture	
3.	Total (add lines 1 and 2)	
	SUBTRACTIONS	
4.	Total nonrefundable credits from page 2, Part V	
5.	**Net tax liability** (greater of line 3 less line 4 or $175)	
6.	Estimated tax payments	
7.	Extension tax payment	
8.	Prior year's tax credit	
9.	**Tax due**	
10.	**Tax overpayment**	
11.	Credited to 2006	
12.	**Amount to be refunded**	

Make check(s) payable to Kentucky State Treasurer and mail return with payment to Kentucky Department of Revenue, Frankfort, Kentucky 40620.

TAX PAYMENT SUMMARY (Round to Nearest Dollar)

☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Profits ☐ Minimum $175

Tax ________________ Interest ________________

Penalty ________________ TOTAL (Including Penalty and Interest) ________________

☐ *No packet required for 2006.*

➤ **Attach a complete copy of the federal return.**

DRAFT

PART V—SCHEDULE OF TAX CREDITS

1. Economic development tax credits	1		
2. Historic preservation restoration tax credit	2		
3. Unemployment tax credit	3		
4. Recycling/composting equipment tax credit	4		
5. Coal conversion tax credit	5		
6. Enterprise zone tax credit	6		
7. Kentucky investment fund tax credit	7		
8. Coal incentive tax credit	8		
9. Qualified research facility tax credit	9		
10. GED incentive tax credit	10		
11. Voluntary environmental remediation tax credit (Brownfields)	11		
12. Biodiesel tax credit	12		
13. Total credits (enter on page 1, Part IV, line 4)	13		

PART VI—CORPORATION INCOME TAX CREDIT

1. Tax due (page 1, Part IV, line 1)	1		
2. Minimum tax	2	175	00
3. Corporation income tax (non-individual partners)	3		
4. Corporation income tax credit (individual partners)	4		
5. Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3))	5		
6. Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c))	6		

PART VI—CORPORATION INCOME TAX CREDIT

Line 1—Enter the amount from Part IV, Line 1.

Line 2—Enter minimum tax of $175.

Line 3—Enter non-individual partners' distributive share of the corporation income tax. Line 1 less Line 2 multiplied by the total of the non-individual shareholders' percentages.

Line 4—Line 1 less Lines 2 and 3 (individual partners' corporation income tax credit to be distributed). The credit determined under KRS 141.420(3)(b)shall be the members', shareholders', or partners' proportionate share of the tax due from the corporation as defined in KRS 141.040, before the application of any credits identified in subsection (4) of KRS 141.0205 and reduced by the required minimum imposed by subsection (6) of KRS 141.040. **KRS 141.420(3)**

Lines 5 and 6—If taxable net income (Part I, Line 26) is greater than $216,600, multiply the excess by 1 percent and by the total individual partners' ownership percentage and enter this amount on Line 6.

Determine the individual partners' proportionate share of the tax credit (page 2, Part VI, Line 4) less the amount entered on Line 6, and enter on Line 5.

SCHEDULE Q—KENTUCKY PARTNERSHIP QUESTIONNAIRE

IMPORTANT: Questions 4—13 must be completed by all partnerships. If this is the partnerships's initial return or if the partnership did not file a return under the same name and same federal I.D. number for the preceding year, questions 1, 2 and 3 must be answered. **Failure to do so may result in a request for a delinquent return.**

1. Indicate whether: (a) ☐ new business; (b) ☐ successor to previously existing business which was organized as: (1) ☐ corporation; (2) ☐ partnership; (3) ☐ sole proprietorship; or (4) ☐ other ____________

   If successor to previously existing business, give name, address and federal I.D. number of the previous business organization.

   ____

2. List the following ***Kentucky*** account numbers. Enter N/A for any number not applicable.
   - Employer Withholding ____________
   - Sales and Use Tax Permit ____________
   - Consumer Use Tax ____________
   - Unemployment Insurance ____________
   - Coal Severance and/or Processing Tax ____________
3. If a foreign partnership, enter the date qualified to do business in Kentucky. __ __ / __ __ / __ __

4. The partnerships's books are in care of: (name and address)

   ____

5. Is the partnership a partner in a general partnership doing business in Kentucky? ☐ Yes ☐ No
   If yes, list name, federal I.D. and Kentucky account number of the general partnership(s). ____________

   Was the partnership doing business in Kentucky, other than the interest held in a general partnership doing business in Kentucky? ☐ Yes ☐ No

6. Is the net distributive income (loss) received from a partnership subject to the tax imposed by KRS 141.040 included in this return? ☐ Yes ☐ No. If yes, list name, federal I.D. and Kentucky account number of the partnership.

   ____

7. Are related party costs made to related members as defined in KRS 141.205(1)(i) included in this return? ☐ Yes ☐ No. If yes, list name, federal I.D. and/or Kentucky corporation account number of the individual or entity. ____________

8. Did the partnership at any time during the taxable year own 80 percent or more of the voting power of all classes of ownership interest in an entity, other than a general partnership, which is not included in this return because it did not do business in Kentucky? ☐ Yes ☐ No. If yes, list name and federal I.D. number of all such entities. ____________

9. Did any corporation, individual, partnership, trust or association at any time during the taxable year own 80 percent of the voting power of all classes of ownership interest of the partnership? ☐ Yes ☐ No. If yes, list name and federal I.D. number of all such entities.

   ____

10. Was this return prepared on: (a) ☐ cash basis, (b) ☐ accrual basis, (c) ☐ other ____________
11. Is the partnership a public service corporation subject to taxation under KRS 136.120? ☐ Yes ☐ No
12. Did the partnership file a Kentucky tangible personal property tax return for January 1, 2006? ☐ Yes ☐ No
13. Is the partnership currently under audit by the Internal Revenue Service? ☐ Yes ☐ No. If yes, enter years under audit ____________

    If the Internal Revenue Service has made final and unappealable adjustments to the partnership's taxable income which have not been reported to this department, check here ☐ and file Form 765, Amended Kentucky Partnership Income Tax Return, for each year adjusted and attach a copy of the final determination.

I, the undersigned, declare under the penalties of perjury, that I have examined these returns, including all accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct and complete.

✍ ____________

Signature of partner or member	Identification number of partner or member	Date
Typed or printed name of preparer other than taxpayer	Identification number of preparer	Date

May the Department of Revenue discuss this return with the preparer? ☐ Yes ☐ No

SCHEDULE OI—ORDINARY INCOME (LOSS) COMPUTATION

1. Federal ordinary income (loss) (see instructions)	1	
ADDITIONS		
2. State taxes	2	
3. Federal depreciation (do not include Section 179 expense deduction)	3	
4. Other (attach schedule)	4	
5. Total (add lines 1 through 4)	5	
SUBTRACTIONS		
6. Federal work opportunity credit	6	
7. Kentucky depreciation (do not include Section 179 expense deduction)	7	
8. Other (attach schedule)	8	
9. **Kentucky ordinary income (loss)** (line 5 less lines 6 through 8)	9	

SCHEDULE K—PARTNERS' SHARES OF INCOME, CREDITS, DEDUCTIONS, ETC. (See Specific Instructions for Each Line Item)

SECTION I (a) Distributive Share Items				(b) Total Amount
Income (Loss) and Deductions				
1. Kentucky ordinary income (loss) from trade or business activities (Schedule OI, line 9)			1	
2. Net income (loss) from rental real estate activities (attach federal Form 8825)			2	
3. (a) Gross income from other rental activities	3(a)			
(b) Less expenses from other rental activities (attach schedule)	(b)			
(c) Net income (loss) from other rental activities (line 3a less line 3b)			(c)	
4. Portfolio income (loss):				
(a) Interest income			4(a)	
(b) Dividend income			(b)	
(c) Royalty income			(c)	
(d) Net short-term capital gain (loss) (attach federal Schedule D and Kentucky Schedule D if applicable)			(d)	
(e) Net long-term capital gain (loss) (attach federal Schedule D and Kentucky Schedule D if applicable)			(e)	
(f) Other portfolio income (loss) (attach schedule)			(f)	
5. Guaranteed payments to partners			5	
6. Section 1231 net gain (loss) (other than due to casualty or theft) (attach federal and Kentucky Forms 4797)			6	
7. Other income (loss) (attach schedule)			7	
8. Charitable contributions (attach schedule) and housing for homeless deduction (attach Schedule HH)			8	
9. IRC Section 179 expense deduction (attach Federal Form 4562 and Kentucky Revised Form 4562)			9	
10. Deductions related to portfolio income (loss) (attach schedule)			10	
11. Other deductions (attach schedule)			11	
Investment Interest				
12. (a) Interest expense on investment debts			12(a)	
(b) (1) Investment income included on lines 4(a), 4(b), 4(c) and 4(f) above			(b)(1)	
(2) Investment expenses included on line 10 above			(2)	
Other Items				
13. (a) Type of Section 59(e)(2) expenditures ➤			13(a)	
(b) Amount of Section 59(e)(2) expenditures			(b)	
14. Tax-exempt interest income			14	
15. Other tax-exempt income			15	
16. Nondeductible expenses			16	
17. Total property distributions (including cash)			17	
18. Other items and amounts required to be reported separately to partners (attach schedule)			18	

SECTION II—Kentucky Distributable Corporation Income and Tax Credits

1. Taxable net income (loss) taxed under KRS 141.040 (page 1, Part I, line 26)	1	
2. Individual partners' share of net distributable income (loss) taxed under KRS 141.040	2	
3. Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3)) (page 2, Part VI, line 5)	3	
4. Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c)) (page 2, Part VI, line 6)	4	

KENTUCKY SCHEDULE K-1
FORM 765
Commonwealth of Kentucky
DEPARTMENT OF REVENUE

PARTNER'S SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.

For calendar year 2005 or fiscal year
beginning ____________ 2005, and ending ____________, 2006.

2005

Partner's identifying number ➤

Partner's name, address and ZIP code

Partnership's FEIN ➤

Partnership's name, address and ZIP code

A This partner is a ☐ general partner ☐ limited partner
☐ limited liability company member.

B Partner's share of liabilities:
Nonrecourse .... $ ________
Qualified nonrecourse financing .... $ ________
Other .... $ ________

C What type of entity is this partner? .... ➤ ________

E Enter partner's percentage of:

	(i) Before change or termination	(ii) End of year
Profit sharing	%	%
Loss sharing	%	%
Ownership of capital	%	%

D Partner's taxable percentage of partnership's distributive share items below (see instructions)
(1) Resident partner 100%
(2) Nonresident partner (see Schedule A, Section I, line 12) .... ➤ ____ %

☐ Final K-1
☐ Amended K-1

	(a) Distributive Share Items		(b) Amount
Income (Loss)	1. Ordinary income (loss) from trade or business activities	1	
	2. Net income (loss) from rental real estate activities	2	
	3. Net income (loss) from other rental activities	3	
	4. Portfolio income (loss):		
	(a) Interest	4(a)	
	(b) Dividends	(b)	
	(c) Royalties	(c)	
	(d) Net short-term capital gain (loss)	(d)	
	(e) Net long-term capital gain (loss)	(e)	
	(f) Other portfolio income (loss) (attach schedule)	(f)	
	5. Guaranteed payments to partners	5	
	6. Net gain (loss) under Section 1231 (other than due to casualty or theft)	6	
	7. Other income (loss) (attach schedule)	7	
Deductions	8. Charitable contributions (attach schedule) and housing for homeless deduction (attach Schedule HH)	8	
	9. IRC Section 179 expense deduction (attach Federal Form 4562 and Kentucky Revised Form 4562)	9	
	10. Deductions related to portfolio income (loss) (attach schedule)	10	
	11. Other deductions (attach schedule)	11	
Investment Interest	12. (a) Interest expense on investment debts	12(a)	
	(b) (1) Investment income included on lines 4(a), 4(b), 4(c) and 4(f) above	(b)(1)	
	(2) Investment expenses included on line 10 above	(2)	
Other Items	13. (a) Type of Section 59(e)(2) expenditures ➤	13(a)	
	(b) Amount of Section 59(e)(2) expenditures	(b)	
	14. Tax-exempt interest income	14	
	15. Other tax-exempt income	15	
	16. Nondeductible expenses	16	
	17. Property distributions (including cash)	17	
	18. Supplemental information required to be reported to each partner (attach schedules)	18	
Credits	19. Individual partners' net distributable share of taxable income taxed under KRS 141.040	19	
	20. Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3))	20	
	21. Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c))	21	
Resident Shareholder Adjustment	22. Combination of Kentucky Schedule K-1, lines 1 through 6, 9 and portions of lines 7 and 11. Add income amounts and subtract (loss) and deduction amounts (see instructions)	22	
	23. Combination of federal Schedule K-1, lines 1 through 10, 12 and portions of lines 11 and 13. Add income amounts and subtract (loss) and deduction amounts (see instructions)	23	
	24. Enter difference of lines 22 and 23 here and on appropriate line on Schedule M (see instructions)	24	

PARTNER'S INSTRUCTIONS FOR SCHEDULE K-1 (FORM 765)

Who Must File—Although the partnership is subject to corporation income tax, the partners are also liable for tax on their share of the partnership income, whether or not distributed, and must include their share on the individual income tax return.

If you were a Kentucky resident for the entire year, your filing requirement depends upon the amount of adjusted gross income, age and whether you or your spouse are considered to be blind.

Any person with gross receipts from self-employment exceeding the threshold amount determined under KRS 141.066 must file a Form 740 regardless of the amount of adjusted gross income or the number of tax credits claimed. Generally, all income of Kentucky residents, regardless of where it was earned, is subject to Kentucky income tax. See Form 740 Instructions.

Nonresidents with income from Kentucky sources and part-year residents receiving income while a Kentucky resident or from Kentucky sources while a nonresident must file a Kentucky return. **Partnership income is not exempted by reciprocal agreements between Kentucky and any other state.** Form 740-NP must be filed by an individual with income from Kentucky sources and a combined gross income from all sources exceeding the threshold amount determined under KRS 141.066. Full-year nonresidents must report all income from Kentucky sources and from property located in Kentucky. Persons moving into Kentucky must report income received from Kentucky sources prior to becoming residents and income received from all sources after becoming Kentucky residents. Residents moving out of Kentucky during the year must report income from all sources while a resident and from Kentucky sources while a nonresident.

When to Report—Include your share of the partnership's income or (loss), credits, deductions, etc., as shown by your Schedule K-1 (Form 765) on your Kentucky income tax return for the year in which the tax year of the partnership ends. For example, if you, the partner, are on a calendar year, and the partnership's tax year ends January 31, 2005, you must take the items listed on Schedule K-1 (Form 765) into account on your tax return for calendar year 2005.

At-Risk Limitations—Generally, if you have a loss from any activity carried on as a trade or business or for the production of income by the partnership and you, the partner, have amounts invested in that activity for which you are not at risk, you will be required to complete federal Form 6198, At-Risk Limitations, to figure the allowable loss to report on your Kentucky income tax return. Your deductible loss from each activity for the tax year generally is limited to the amount you are at risk for the activity at the end of the partnership's tax year or the amount of the loss, whichever is less. To help you complete Form 6198, if required, the partnership has provided a schedule showing your share of income, expenses, etc., for each at-risk activity.

NOTE: Form 740 filers see Form 740 instructions for Schedule M, Line 5 and/or Line 15.

Passive Activity Limitations—The passive activity limitations in IRC Section 469 are figured at the partner level and may apply to any loss reported on Lines 1, 2 or 3 and any other related items of income, loss and deductions reported on Schedule K-1 (Form 765). Refer to the federal Partner's Instructions for Schedule K-1 (Form 1065) to determine if the passive activity limitations apply to your share of loss(es) reported on Schedule K-1 (Form 765), and if you must file Form 8582-K, Kentucky Passive Activity Loss Limitations.

SPECIFIC INSTRUCTIONS

Kentucky Resident Partners (Form 740 Filers)—To determine the net difference between the federal Schedule K-1 amounts and the Kentucky Schedule K-1 amounts, complete Lines 22, 23, 24 and 25. This will adjust the items of income, loss and deductions used to compute your federal adjusted gross income to the Kentucky amounts shown in Column (b), Schedule K-1.

Line 23—Include on this line, the Kentucky Schedule K-1 amounts from Lines 1 through 6 and 9. Also include the amounts from Lines 7 and 11 that do not pass through to Schedule A as itemized deductions.

Line 24—Include on this line, the federal Schedule K-1 amounts from Lines 1 through 10 and 12. Also include the amounts from Lines 11 and 13 that do not pass through to Schedule A as itemized deductions.

NOTE: If Form 8582-K is required, adjust the amounts entered on Lines 23 and 24 to exclude any income, loss, deduction or expense related to a passive activity. Complete the passive activities adjustment worksheet (Form 8582-K, page 2) to determine additions to or subtractions from federal adjusted gross income. **See Form 740 instructions for Schedule M, Line 3 and/or Line 13.**

If amounts on Lines 4(d) and 4(e) are subject to the capital loss limitations, do not include on Lines 23 and 24. Complete federal Schedule D using Kentucky amounts to determine additions to or subtractions from federal adjusted gross income.

Line 25—Enter difference of Lines 22 and 23 less Line 24. If Lines 22 and 23 are greater than Line 24, enter the difference as an addition to federal adjusted gross income on Schedule M, Line 3. If Line 24 is greater than Line 22 and 23, enter the difference as a subtraction on Schedule M, Line 13.

Caution: If the net amount of Lines 22 and 23 is a (loss) and Line 24 is a (loss), the smaller amount of the (loss) is the greater amount, and to determine the difference subtract the smaller dollar amount from the larger dollar amount. If the net amount of Lines 22 and 23 is an income amount and Line 24 is a (loss), or if Line 24 is an income amount and the net amount of Lines 22 and 23 is a (loss), the income amount is the greater amount and to determine the difference add the two amounts.

Nonresident Individual Partners (Form 740-NP Filers)—If you are a nonresident individual needing to file Form 740-NP, in order to take advantage of the graduated withholding rates on income withheld by the partnership, follow the directions below. The nonresident individual may also need to file Form 740-NP to take advantage of capital loss, net operating loss and credit carryforwards.

Nonresident partners must report their distributive share of income by multiplying the percentage reported on Item D(2) by all items of income (loss) reported on the Kentucky Schedule K-1, Column (b). If the percentage shown in Item D(2) is 100%, you must enter on the appropriate lines of Form 740-NP and related schedules the amounts shown on Lines 1 through 6 and 8, portions of Lines 7, 11 and 12(a), and the portion of Line 13(b) actually deducted for the current year. If the percentage shown in Item D(2) is less than 100 percent, the amounts on Lines 1 through 6 and 8, the portions of Lines 7, 11 and 12(a) which do not pass through to Schedule A and the portion of Line 13(b) actually deducted for the current year must be multiplied by this percentage and entered on the appropriate lines of the Nonresident or Part-Year Resident Income Tax Return, Form 740-NP, and related schedules. Lines 8 and 10, and the portions of Lines 7, 11 and 12(a) which pass through to Schedule A should not be multiplied by the percentage in Item D(2).

Lines 1 through 3—Enter on federal Schedule E using Kentucky amounts or Form 8582-K, if applicable.

Line 4(a)—Enter on Form 740-NP, Section D, Line 3.

Line 4(b)—Enter on Form 740-NP, Section D, Line 4

Line 4(c)—Enter on federal Schedule E using Kentucky amounts.

Lines 4(d) and (e)—Enter on federal Schedule D using Kentucky amounts or Form 8582-K, if applicable.

Line 4(f)—Enter on applicable lines of your return (see federal Partner's Instructions for Schedule K-1 (Form 1065)).

Line 5—Enter on applicable line of your tax return (see federal Partner's Instructions for Schedule K-1 (Form 1065)).

Line 6—Enter on federal Form 4797.

Line 7—Enter on applicable lines of your return (see federal Partner's Instructions for Schedule K-1 (Form 1065)).

Line 8—Enter on Schedule A, Form 740-NP.

Line 9—Enter on federal Schedule E using Kentucky amounts.

Line 10—Enter on Schedule A, Form 740-NP.

Line 11—Enter on applicable form or schedule (see federal Partner's Instructions for Schedule K-1 (Form 1065)).

For Partners

Lines 12, 13(a), 13(b), 14, 15, 16, 17 and 18—See federal Partner's Instructions for Schedule K-1 (Form 1065).

For Individual Partners

Line 19—Enter on Line 2 of the Kentucky Corporation Tax Credit Worksheet located in the instructions under Business Incentive Credits.

Line 20—Enter on Line 7 of the Kentucky Corporation Tax Credit Worksheet located in the instructions under Business Incentive Credits.

Line 21—Enter on Forms 740, Form 741 or Form 740-NP, Line 30(c).

Estates and Trusts (Form 741 Filers)—Estates or trusts report the amounts shown in Column (b) on Form 741, Kentucky Fiduciary Income Tax Return, and related schedules. See federal Partner's Instructions for Schedule K-1 (Form 1065).

FORM **851-N**

41A851-N (10-05)

Department of Revenue

KENTUCKY AFFILIATIONS AND PAYMENT SCHEDULE

➤ **File with the nexus consolidation income tax return (Form 725 or 765) and extension request (Form 40A102 or 41A720SL).**

Taxable Year Ending

M M Y Y

If a Kentucky consolidated corporation income tax return was filed for the previous taxable year and the members of the affiliated group subject to Kentucky income tax (KRS 141.040(1)) have changed due to nexus consolidation, check this box ☐.

List the parent corporation and all subsidiaries subject to Kentucky income tax.

Name of Corporation	Kentucky Account Number	**Current Payments (Round to Nearest Dollar)** *(See Instructions on Reverse)*			
		Prior Year's Credit	Estimated Payments	Extension Payments	Total
Common parent corporation:					
Subsidiary corporations:					
		Total Payment ➤			

FORM 851-N
KENTUCKY AFFILIATIONS AND PAYMENT SCHEDULE
INSTRUCTIONS

Purpose of the Form—This form must be completed and submitted with the nexus consolidated income tax return (Form 725 or 765) and the request for extension of time to file a Kentucky income tax return (applicable Kentucky Form 40A102 or 41A720SL) or copy of applicable federal form (Form 7004, Form 8736 or Form 8800) for a nexus consolidated income tax return. The information requested on this form (1) identifies the common parent of the affiliated group and each includible corporation included in the consolidated Kentucky nexus tax return; (2) provides the Kentucky Department of Revenue information of includible corporations in the consolidated return which precludes delinquent tax return notices; and (3) ensures accurate processing of payment(s).

Listing of Includible Corporations of a Affiliated Group—List each includible corporation included in the consolidated income tax return which is subject to Kentucky income tax as provided by KRS 141.040. An "affiliated group" means one or more chains of includible corporations connected through stock ownership, membership interest, or partnership interest with a common parent corporation provided the ownership interest and value of any corporation meets the 80 percent requirements as provided in KRS 141.200(9). An "includible corporation" includes, but is not limited to: (a) being organized under the laws of this state; (b) having a commercial domicile in this state; (c) owning or leasing property in this state; (d) having one or more individuals performing services in this state; (e) maintaining an interest in a general partnership doing business in this state; (f) deriving income from or attributable to sources within this state, including deriving income directly or indirectly from a trust doing business in this state; or (g) directing activities at Kentucky customers for the purpose of selling them goods or services.

Enter the six-digit Kentucky Account Number for each includible corporation. The Kentucky Account Number is located in the upper right portion of the address label on the Kentucky corporation income tax packet.

Form 851-N Filed With Form 725 or 765—Enter in the Prior Year's Credit column the prior year's credit applied to the current year by each includible corporation. Enter in the Estimated Payments column the estimated payments made by each includible corporation. Enter in the Extension Payments column the extension payment made with the applicable Kentucky or federal form. Enter the total of payments made by each includible corporation in the Total column. Total Payment (sum of the Total column) should equal the total amount reflected in the Tax Payment Summary of the consolidated income tax return.

Form 851-N Filed With Form 41A720SL—If the affiliated group is submitting a payment with the application for extension, the total amount entered in the Extension Payment column of Form 851-N should equal the total amount shown on Form 41A720SL.

SCHEDULE NOL

Form 725 or 765

41A725NOL (10-05)

Department of Revenue

NET OPERATING LOSS SCHEDULE

Pass-Through Entities

Taxable Year Ending

__ __ / __ __
Mo. Yr.

PART I—MANDATORY NEXUS CONSOLIDATION

DRAFT 9-12-05

Section A—Current Net Operating Loss Adjustment		Includible Corporations A	Includible Corporations B
Name	Kentucky Corporation Account Number	Kentucky Net Income	Kentucky Net Losses **(Enter as Positive Amount)**
1. Common Parent			
2. **Includible Corporations**			
3. Totals (add Columns A and B)			
4. Limitation (line 3, Column A, multiplied by 50%)			
5. If line 3, Column B, is greater than line 4, enter the difference here; on Section B, line 1; and as a positive amount on Form 725, Part I, line 11; or Form 765, Part I, line 24. If line 3, Column B, is less than line 4, enter -0- on Section B, line 1, and on Form 725, Part I, line 11; or Form 765, Part I, line 24			

Section B—NOL Carryforward

1. Current year disallowed carryforward from Part I, Section A, line 5	
2. If no entry on line 3, Column A, enter amount from line 3, Column B	
3. Enter the amount from line 1 or line 2	
4. Less Kentucky net loss distributed to individuals	
5. Total NOL carryforward (line 3 less line 4)	

PART II—SINGLE ENTITY FILERS

Section A—Kentucky NOL Carryforward

1. Carryforward from prior year(s)	
2. Net operating loss (current year) from Form 725, Part I, line 13; or Form 765 Part I, line 26	
3. Total of lines 1 and 2	
4. Less Kentucky net loss distributed to individuals	
5. Total Kentucky NOL carryforward (line 3 less line 4)	

INSTRUCTIONS FOR SCHEDULE NOL
(FORM 725 OR 765)

Purpose of this Form—This form must be completed and submitted with the income tax return (Form 725 and 765) when a corporation has a current year net operating loss or a net operating loss carryforward.

Part I of this form must be completed and submitted with a nexus consolidated tax return if the parent or any includible subsidiary has a current year net operating loss or a nexus net operating loss carryforward. A nexus net operating loss carryforward will not apply for the year 2005 as this is the first year for the new corporate entities. KRS 141.200(11)(b) provides that includible corporations that have incurred a net operating loss shall not deduct an amount that exceeds, in aggregate, 50 percent of the income realized by the remaining includible corporations that did not realize a net operating loss. The portion of any net operating loss limited by the application of this subsection shall be available for carryforward in accordance with the provisions of KRS 141.011.

Part II of this form must be completed by a corporation filing a separate return and having a current year net operating loss or a net operating loss carryforward. A net operating loss carryforward will not apply to 2005 as this is the first year for the new corporate entities.

LINE-BY-LINE INSTRUCTIONS

PART I-MANDATORY NEXUS CONSOLIDATION

Section A—Current Net Operating Loss Adjustment

Line 1—Enter the name and Kentucky Corporation Account Number of the parent corporation filing the return. In Column A, enter the Kentucky net income of the parent corporation or enter in Column B the Kentucky net loss of the parent corporation. The net loss must be entered as a positive number.

Line 2—Enter the name and Kentucky Corporation Account Number of each includible corporation included in the consolidated tax return. In Column A, enter the net income or enter in Column B the net loss of each subsidiary included in the consolidated return. A net loss must be entered as a positive number.

Line 3—Enter the total of Column A and Column B.

Line 4—Enter the amount of Line 3, Column A multiplied by 50 percent.

Line 5—If Line 3, Column B is greater than Line 4, Column A, enter the difference here; on Section B, Line 1; and on Form 725, Part I, Line 11; or Form 765, Part I, Line 24. If Line 3, Column B is less than Line 4, Column A, enter -0- on Section B, Line 1; and on Form 725, Part I, Line 11; or Form 765, Part I, Line 24.

Section B—NOL Carryforward

Line 1—Enter the amount from Part I, Section A, Line 5.

Line 2—If no entry on Part I, Section A, Line 5, enter the amount, if any, from Part I, Section A, Line 3, Column B.

Line 3—Enter the greater of Line 1 or Line 2.

Line 4—Enter the amount from Line 3 multiplied by the total of the individuals' stock or ownership percentages. KRS 141.011(4) provides that for taxable years beginning on or after January 1, 2005, the net operating loss carryforward deduction of a corporation shall be reduced by the amount of distributive share income, loss, and deduction distributed to an individual.

Line 5—Enter the amount of Line 3 less Line 4.

PART II—SEPARATE ENTITY FILERS

Section A—Kentucky NOL Carryforward

Line 1—Enter the Kentucky net operating loss carryforward from prior years, only if you did not file a nexus consolidated tax return. This will not apply for the 2005 year as this is first year of filing for new corporate entities.

Line 2-Enter net operating loss from Form 725, Part I, Line 13; or Form 765, Part I, Line 26, only if you did not file a consolidated nexus tax return.

Line 3—Enter the amount of Line 1 plus Line 2.

Line 4—Enter the amount of Line 3 multiplied by the total of individuals' stock or ownership percentages. KRS 141.011(4) provides that for taxable years beginning on or after January 1, 2005, the net operating loss carryforward deduction of a corporation shall be reduced by the amount of distributive share income, loss, and deduction distributed to an individual.

Line 5—Enter the amount of Line 3 less Line 4.

SCHEDULE KCR (Form 765)
41A765KCR (10-05)
Department of Revenue

KENTUCKY NEXUS CONSOLIDATED RETURN SCHEDULE

(Attach All Applicable Schedules)

Taxable Year Ending
__ __ / __ __
Mo. Yr.

Common Parent Corporation

Kentucky Corporation Account Number
__ __ __ __ __ __

	Parent	Name ______ FEIN ______ KY Corp. Acct. #	Name ______ FEIN ______ KY Corp. Acct. #	Combined Total	Intercompany Eliminations	Consolidated Total
1. Kentucky ordinary income (loss) (from Schedule OI, line 9)						
2. Net income (loss) from rental real estate activities						
3. Net income (loss) from other rental activities						
4. Interest income						
5. Royalty income						
6. Net short-term capital gain						
7. Net long-term capital gain						
8. Other portfolio income (loss)						
9. Section 1231 net gain (loss) (other than due to casualty or theft)						
10. Other income (loss)						
11. Total additions (add lines 1 through 10)						
12. Other income (loss) (KRS 141.010(12)): (a) Related party expenses (KRS 141.205)						
(b) Expenses related to nontaxable income						
(c) Add net distributable loss from corporations						
(d) Subtract net distributable income from corporations						
(e) Other						
13. **Total income after adjustments** (add lines 11 and 12)						
14. Charitable contributions (see instructions)						
15. Section 179 expense deduction (Kentucky Form 4562)						
16. Deductions related to portfolio income (loss)						
17. Other deductions						
18. Section 59(e)(2) expenses						
19. Total deductions (add lines 14 through 18)						
20. Oil and gas depletion						
21. Other adjustments (KRS 141.010(13))						
22. Total deductions (add lines 19 through 21)						
23. **Net income (loss)** (line 13 less line 22)						

Schedule KCR

Kentucky Nexus Consolidated Return Schedule

GENERAL INSTRUCTIONS

Purpose of Form—This schedule must be completed and submitted with the consolidated income tax return (Form 765) to show the statutory adjustments for each member of the affiliated group.

Specific Instructions—For each subsidiary, enter the name, FEIN and Kentucky corporation account number. If there are more than two subsidiaries in the affiliated group, use Schedule KCR-C, Kentucky Nexus Consolidated Return Schedule Continuation Sheet. This form can be duplicated as needed.

SCHEDULE KCR-C (Form 765)
41A765KCR-C (10-05)
Department of Revenue

KENTUCKY NEXUS CONSOLIDATED RETURN SCHEDULE
Continuation Sheet
(Attach All Applicable Schedules)

Taxable Year Ending
__ __ / __ __
Mo. Yr.

Common Parent Corporation

Kentucky Corporation Account Number
__ __ __ __ __ __

	Name ____ FEIN ____ KY Corp. Acct. #	Name ____ FEIN ____ KY Corp. Acct. #	Name ____ FEIN ____ KY Corp. Acct. #	Name ____ FEIN ____ KY Corp. Acct. #	Name ____ FEIN ____ KY Corp. Acct. #
1. Kentucky ordinary income (loss) (from Schedule OI, line 9)					
2. Net income (loss) from rental real estate activities					
3. Net income (loss) from other rental activities					
4. Interest income					
5. Royalty income					
6. Net short-term capital gain					
7. Net long-term capital gain					
8. Other portfolio income (loss)					
9. Section 1231 net gain (loss) (other than due to casualty or theft)					
10. Other income (loss)					
11. Total additions (add lines 1 through 10)					
12. Other income (loss) (KRS 141.010(12)):					
(a) Related party expenses (KRS 141.205)					
(b) Expenses related to nontaxable income					
(c) Add net distributable loss from corporations					
(d) Subtract net distributable income from corporations					
(e) Other					
13. **Total income after adjustments** (add lines 11 and 12)					
14. Charitable contributions (see instructions)					
15. Section 179 expense deduction (Kentucky Form 4562)					
16. Deductions related to portfolio income (loss)					
17. Other deductions					
18. Section 59(e)(2) expenses					
19. Total deductions (add lines 14 through 18)					
20. Oil and gas depletion					
21. Other adjustments (KRS 141.010(13))					
22. Total deductions (add lines 19 through 21)					
23. **Net income (loss)** (line 13 less line 22)					

DRAFT 9-9-05

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Computation of an S Corporation's Net Income on Form 720S

All S Corporations that are subject to corporation income tax are required to file form 720S, Kentucky S Corporation Income Tax Return. LLC's that are taxed as S Corporations for federal income tax purposes will use form 720S to compute Kentucky taxable net income. The purpose of this form is to transition federal S Corporation ordinary income to Kentucky corporation taxable net income. "Corporations" filing on this form will pay corporation income tax on the greater of:

- The tax due on Taxable Net Income.
- The AMC.
- A minimum of $175.

S Corporations will follow the federal S corporation rules in computing ordinary income and separately stated distributive share items except:

1. Where statutory differences between Kentucky corporation income tax law and federal law exist; and,
2. The Section 179 expense deduction will be taken on the corporation income tax return and the deduction will pass-through to the shareholders.

S Corporation Retains it Pass-Through Function

KRS 141.420(1)(b) states: "For a corporation filing a return under paragraph (a) of this subsection, the individual partner's, member's, or shareholder's distributive share of net income, gain, loss, or deduction shall be computed as nearly as practicable in a manner identical to that required for federal income tax purposes except to the extent required by differences between this chapter and the federal income tax law and regulations."

Apportionment of an S Corporation's Net Income

An S corporation required to file form 720S must apportion its taxable net income to Kentucky if the corporation is taxable in this state and taxable in another state under the provisions of KRS 141.010(14)(b) which states:

> "A corporation is taxable in another state if, in any state other than Kentucky, the corporation is required to file a return for or pay a net income tax, franchise tax measured by net income, franchise tax for the privilege of doing business or corporate stock tax."

If a corporation is taxable in this state and taxable in another state, then the corporation must apportion and allocate its net income to Kentucky based on the provisions of KRS 141.120. Before the apportionment fraction is computed, the corporation must determine its business income and nonbusiness income. "Business income" is defined by (KRS 141.120(1)(a) to be "income arising from transactions and activity in the regular course of a trade or business of the corporation and includes income from tangible and intangible property if the acquisition, management, or disposition of the property constitutes integral parts of the corporation's regular trade or business operations."

"Nonbusiness income" means all income other than business income (KRS 141.120(1)(e).

Business income is apportioned to Kentucky using a fraction composed of a double weighted sales factor, a property factor and payroll factor. The apportionment fraction and the calculation of business and nonbusiness income is reflected on Schedule A, Apportionment and Allocation.

For further guidance on business and nonbusiness income, please refer to Administrative Regulation 103 KAR 16:060.

Pass-Through Corporation Income Tax Credits to Individual Shareholders of an S Corporation

A nonrefundable credit will pass through to the individual shareholders of an S Corporation. KRS 141.420(3) authorizes the credit. The credit is the individual shareholder's proportionate share of the tax due from the corporation as determined under KRS 141.040 before the application of any credits identified in KRS 141.0205(4) and reduced by the required minimum imposed by KRS 141.040(6). The credit may be used against the individual income tax imposed by KRS 141.020.

Also, a refundable credit is available to S corporation shareholders for taxable years beginning after December 31, 2004, and before January 1, 2007. The refundable credit is the portion of the nonrefundable credit described in the previous paragraph that exceeds the credit that would have been utilized if the corporation's income were taxed at the rates in KRS 141.020. The refundable portion of the credit shall be the individual shareholders' proportionate share of the amount computed by multiplying the amount the corporation's income exceeds two hundred sixteen thousand six hundred dollars ($216,600) by one percent (1%). In other words, the refundable credit makes up for the difference between the top corporation income tax rate (7%) and the top individual income tax rate (6%). For tax periods beginning on or after January 1, 2007, the top individual and corporation income tax rates are the same (6%).

Special Note: If a trust is an S Corporation shareholder, the trust shall be treated as an individual for the purpose of distributing income, loss and the pass-through credits.

The individual income tax portion of this manual provides detailed instructions on how to claim the pass through credits on an individual income tax return.

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720S
41A720S
Department of Revenue

Kentucky

Kentucky S Corporation Income Tax Return

➤ *See separate instructions.*

2005

Taxable Year Ending

___ / ___
Mo. Yr.

Taxable period beginning ____________, 2005, and ending ____________, 200__.

A Number of Shareholders (Attach K-1s) ➤ ________

B Federal Identification Number __ __ - __ __ __ __ __ __ __

C Kentucky Corporation Account Number __ __ __ __ __ __

Name of S Corporation *(Place preaddressed label here; otherwise print or type.)*

State and Date of Incorporation

Principal Business Activity in KY

D Number of QSSSs Included in This Return (Attach Schedule) ➤ ________

Number and Street

NAICS Code Number (Relating to Kentucky Activity) (See www.census.gov)

City | State | ZIP Code | Telephone Number

E *Check if applicable:* ☐ LLC ☐ Initial return ☐ Final return *(attach explanation)* ☐ Amended return
☐ Short-period return *(attach explanation)* ☐ Change of name ☐ Change of address

PART I—TAXABLE INCOME COMPUTATION

1. Kentucky ordinary income (loss) (from Schedule K, Section I, line 1)		
2. Net income (loss) from rental real estate activities		
3. Net income (loss) from other rental activities		
4. Interest income		
5. Royalty income		
6. Net short-term capital gain		
7. Net long-term capital gain		
8. Other portfolio income (loss)		
9. Section 1231 net gain (loss) (other than due to casualty or theft)		
10. Other income (loss)		
11. Total additions (add lines 1 through 10)		
12. Other income (loss) (KRS 141.010(12)):		
(a) Related party expenses (KRS 141.205)		
(b) Deductions attributable to nontaxable income		
(c) Add net distributable loss from corporations		
(d) Subtract net distributable income from corporations		
(e) Other		
13. **Total income after adjustments** (add lines 11 and 12)		
14. Charitable contributions (see instructions)		
15. Section 179 expense deduction (Kentucky Form 4562)		
16. Deductions related to portfolio income (loss)		
17. Other deductions		
18. Section 59(e)(2) expenses		
19. Total deductions (add lines 14 through 18)		
20. Oil and gas depletion		
21. Other adjustments (KRS 141.010(13))		
22. Total deductions (add lines 19 through 21)		
23. **Net income (loss)** (line 13 less line 22)		
24. **Taxable net income (loss)** (amount from line 23 or Schedule A)		

PART II—ALTERNATIVE MINIMUM (AMC)

Gross Receipts		
1. Kentucky gross receipts (less Kentucky returns and allowances)		
2. Tax (line 1 multiplied by .00095)		
Gross Profits		
3. Kentucky gross receipts		
(a) Less Kentucky returns and allowances		
(b) Less Kentucky cost of goods sold		
4. Gross profit (subtract lines 3(a) and 3(b) from line 3)		
5. Tax (line 4 multiplied by .0075)		

PART III—TAX COMPARISON

1. Regular income tax (see instructions)		
2. Alternative minimum (AMC) (lesser of Part II, line 2 or line 5)		

PART IV—TAX COMPUTATION

1. **Tax liability** (Part III, greater of line 1, line 2 or $175 minimum)		
ADDITIONS		
2. Recycling/composting equipment tax credit recapture		
3. Total (add lines 1 and 2)		
SUBTRACTIONS		
4. Total nonrefundable credits from page 2, Part V		
5. **Net tax liability** (greater of line 3 less line 4 or $175)		
6. Estimated tax payments		
7. Extension tax payment		
8. Prior year's tax credit		
9. **Tax due**		
10. **Tax overpayment**		
11. Credited to 2006		
12. **Amount to be refunded**		

TAX PAYMENT SUMMARY (Round to Nearest Dollar)

TAX *(check applicable box)* ☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Profits ☐ Minimum $175

Tax ________

Penalty ________

Interest ________

TOTAL (Including Penalty and Interest) ➤ ________

Make check(s) payable to: Kentucky State Treasurer.
Mail return with payment to: Kentucky Department of Revenue, Frankfort, Kentucky 40620.

☐ *No packet required for 2006.* ➤ **Federal Form 1120S, pages 1, 2, 3 and 4, and any supporting schedules must be attached.**

PART V—SCHEDULE OF TAX CREDITS

1.	Economic development tax credits	1		
2.	Historic preservation restoration tax credit	2		
3.	Unemployment tax credit	3		
4.	Recycling/composting equipment tax credit	4		
5.	Coal conversion tax credit	5		
6.	Enterprise zone tax credit	6		
7.	Kentucky investment fund tax credit	7		
8.	Coal incentive tax credit	8		
9.	Qualified research facility tax credit	9		
10.	GED incentive tax credit	10		
11.	Voluntary environmental remediation tax credit (Brownfields)	11		
12.	Biodiesel tax credit	12		
13.	Total credits (enter on page 1, Part IV, line 4)	13		

PART VI—CORPORATION INCOME TAX CREDIT

1.	Tax due (page 1, Part IV, line 1)	1		
2.	Minimum tax	2	175	00
3.	Corporation income tax credit	3		
4.	Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3))	4		
5.	Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c))	5		

PART VI—CORPORATION INCOME TAX CREDIT

Line 1—Enter the amount from Part IV, Line 1.

Line 2—Enter minimum tax of $175.

Line 3—Line 1 less Line 2 (individual shareholders corporation income tax credit to be distributed). The credit determined under KRS 141.420(3)(b)shall be the members', shareholders', or partners' proportionate share of the tax due from the corporation as defined in KRS 141.040, before the application of any credits identified in subsection (4) of KRS 141.0205 and reduced by the required minimum imposed by subsection (6) of KRS 141.040. **KRS 141.420(3)**

Lines 4 and 5—If taxable net income (Part I, Line 24) is greater than $216,600, multiply the excess by 1 percent and by the total individual shareholders' ownership percentage and enter this amount on Line 5.

Determine the individual shareholders' proportionate share of the tax credit (page 2, Part VI, Line 3) less the amount entered on Line 5, and enter on Line 4.

SCHEDULE Q—KENTUCKY S CORPORATION QUESTIONNAIRE

IMPORTANT: Questions 4—13 must be completed by all S corporations. If this is the S corporation's initial return or if the S corporation did not file a return under the same name and same federal I.D. number for the preceding year, questions 1, 2 and 3 must be answered. **Failure to do so may result in a request for a delinquent return.**

1. Indicate whether: (a) ☐ new business; (b) ☐ successor to previously existing business which was organized as: (1) ☐ corporation; (2) ☐ partnership; (3) ☐ sole proprietorship; or (4) ☐ other ______

   If successor to previously existing business, give name, address and federal I.D. number of the previous business organization.

2. List the following ***Kentucky*** account numbers. Enter N/A for any number not applicable.
   - Employer Withholding ______
   - Sales and Use Tax Permit ______
   - Consumer Use Tax ______
   - Unemployment Insurance ______
   - Coal Severance and/or Processing Tax ______
3. If a foreign S corporation, enter the date qualified to do business in Kentucky. __ __ / __ __ / __ __
4. The S corporation's books are in care of: (name and address)
5. Is the S corporation a partner in a general partnership doing business in Kentucky? ☐ Yes ☐ No
   If yes, list name, federal I.D. and Kentucky account number of the general partnership(s). ______

   Was the S corporation doing business in Kentucky, other than the interest held in a general partnership doing business in Kentucky? ☐ Yes ☐ No
6. Is the net distributive income (loss) received from a corporation subject to the tax imposed by KRS 141.040 included in this return? ☐ Yes ☐ No. If yes, list name, federal I.D. and Kentucky account number of the corporation.
7. Are related party costs made to related members as defined in KRS 141.205(1)(l) included in this return? ☐ Yes ☐ No. If yes, list name, federal I.D. and/or Kentucky corporation account number of the individual or entity. ______
8. Did the S corporation at any time during the taxable year own 80 percent or more of the voting power of all classes of ownership interest in an entity, other than a general partnership, which is not included in this return because it did not do business in Kentucky? ☐ Yes ☐ No. If yes, list name and federal I.D. number of all such entities. ______
9. Did any S corporation, individual, partnership, trust or association at any time during the taxable year own 80 percent of the voting power of all classes of ownership interest of the corporation? ☐ Yes ☐ No. If yes, list name and federal I.D. number of all such entities. ______
10. Was this return prepared on: (a) ☐ cash basis, (b) ☐ accrual basis, (c) ☐ other ______
11. Is the S corporation a public service corporation subject to taxation under KRS 136.120? ☐ Yes ☐ No
12. Did the S corporation file a Kentucky tangible personal property tax return for January 1, 2006? ☐ Yes ☐ No
13. Is the S corporation currently under audit by the Internal Revenue Service? ☐ Yes ☐ No. If yes, enter years under audit ______
    If the Internal Revenue Service has made final and unappealable adjustments to the corporation's taxable income which have not been reported to this department, check here ☐ and file an amended Form 720S, Kentucky S Corporation Income Tax and License Tax Return, for each year adjusted and attach a copy of the final determination.

OFFICER INFORMATION (Failure to Provide Requested Information May Result in a Penalty)

Has the officer information entered below changed from the last return filed? ☐ Yes ☐ No

President's Name: ______	Treasurer's Name: ______
President's Home Address: ______	Treasurer's Home Address: ______
President's Social Security Number: ______	Treasurer's Social Security Number: ______
Vice President's Name: ______	Secretary's Name: ______
Vice President's Home Address: ______	Secretary's Home Address: ______
Vice President's Social Security Number: ______	Secretary's Social Security Number: ______

I, the undersigned, declare under the penalties of perjury, that I have examined these returns, including all accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct and complete.

______ Signature of principal officer or chief accounting officer ______ Date

______ Name and Social Security or federal identification number of person or firm preparing return

May the Department of Revenue discuss this return with the preparer? ☐ Yes ☐ No

SCHEDULE OI—ORDINARY INCOME (LOSS) COMPUTATION

1. Federal ordinary income (loss) (see instructions)	1	
ADDITIONS		
2. State taxes	2	
3. Federal depreciation (do not include Section 179 expense deduction)	3	
4. Other (attach schedule)	4	
5. Total (add lines 1 through 4)	5	
SUBTRACTIONS		
6. Federal work opportunity credit	6	
7. Kentucky depreciation (do not include Section 179 expense deduction)	7	
8. Other (attach schedule)	8	
9. **Kentucky ordinary income (loss)** (line 5 less lines 6 through 8)	9	

SCHEDULE K—SHAREHOLDERS' SHARES OF INCOME, CREDITS, DEDUCTIONS, ETC. (See Specific Instructions for Each Line Item)

SECTION I — (a) Pro Rata Share Items		(b) Total Amount
Income (Loss) and Deductions		
1. Kentucky Ordinary income (loss) from trade or business activities (Schedule OI, line 9)	1	
2. Net income (loss) from rental real estate activities (attach federal Form 8825)	2	
3. (a) Gross income from other rental activities .... 3(a)		
(b) Less expenses from other rental activities (attach schedule) .... (b)		
(c) Net income (loss) from other rental activities (line 3a less line 3b)	(c)	
4. Portfolio income (loss):		
(a) Interest income	4(a)	
(b) Dividend income	(b)	
(c) Royalty income	(c)	
(d) Net short-term capital gain (loss) (attach federal Schedule D and Kentucky Schedule D if applicable)	(d)	
(e) Net long-term capital gain (loss) (attach federal Schedule D and Kentucky Schedule D if applicable)	(e)	
(f) Other portfolio income (loss) (attach schedule)	(f)	
5. Section 1231 net gain (loss) (other than due to casualty or theft) (attach federal and Kentucky Forms 4797)	5	
6. Other income (loss) (attach schedule)	6	
7. Charitable contributions (attach schedule) and housing for homeless deduction (attach Schedule HH)	7	
8. IRC Section 179 expense deduction (attach Federal Form 4562 and Kentucky Revised Form 4562)	8	
9. Deductions related to portfolio income (loss) (attach schedule)	9	
10. Other deductions (attach schedule)	10	
Investment Interest		
11. (a) Interest expense on investment debts	11(a)	
(b) (1) Investment income included on lines 4(a), 4(b), 4(c) and 4(f) above	(b)(1)	
(2) Investment expenses included on line 10 above	(2)	
Other Items		
12. (a) Type of Section 59(e)(2) expenditures ➤	12(a)	
(b) Amount of Section 59(e)(2) expenditures	(b)	
13. Tax-exempt interest income	13	
14. Other tax-exempt income	14	
15. Nondeductible expenses	15	
16. Total property distributions (including cash) other than dividends reported on line 18 below	16	
17. Other items and amounts required to be reported separately to shareholders (attach schedule)	17	
18. Total dividend distributions paid from accumulated earnings and profits	18	

SECTION II—Kentucky Distributable Corporation Income and Tax Credits

1. Taxable net income (loss) taxed under KRS 141.040 (page 1, Part I, line 24)	1	
2. Individuals' share of net distributable income (loss) taxed under KRS 141.040	2	
3. Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3)) (page 2, Part VI, line 4)	3	
4. Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c)) (page 2, Part VI, line 5)	4	

SCHEDULE K-1
(Form 720S)
Department of Revenue

KENTUCKY SHAREHOLDER'S SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.

2005

Taxable period beginning ____________, 2005, ending ____________, 200__

Shareholder's identifying number ➤	**S Corporation's identifying number ➤**
Shareholder's name, address and ZIP code	S Corporation's name, address and ZIP code

A. Shareholder's percentage of stock ownership for tax year ➤ ______ %
B. (1) Resident shareholder's taxable percentage of pro rata share items ➤ 100%
(2) Nonresident shareholder's taxable percentage of pro rata share items (see Schedule A, Section I, line 12) ➤ ______ %
C. What type of entity is this shareholder? ____________
D. Check if applicable: (1) ☐ Final K-1 (2) ☐ Amended K-1

IMPORTANT: Refer to Shareholder's Instructions for Schedule K-1 before entering information from Schedule K-1 on your tax return.

	(a) Pro Rata Share Items		(b) Amount
Income (Loss)	1. Ordinary income (loss) from trade or business activities	1	
	2. Net income (loss) from rental real estate activities	2	
	3. Net income (loss) from other rental activities	3	
	4. Portfolio income (loss):		
	(a) Interest	4(a)	
	(b) Dividends	(b)	
	(c) Royalties	(c)	
	(d) Net short-term capital gain (loss)	(d)	
	(e) Net long-term capital gain (loss)	(e)	
	(f) Other portfolio income (loss) (attach schedule)	(f)	
	5. Net gain (loss) under Section 1231 (other than due to casualty or theft)	5	
	6. Other income (loss) (attach schedule)	6	
Deductions	7. Charitable contributions (attach schedule) and housing for homeless deduction (attach Schedule HH)	7	
	8. IRC Section 179 expense deduction (attach Federal Form 4562 and Kentucky Revised Form 4562)	8	
	9. Deductions related to portfolio income (loss) (attach schedule)	9	
	10. Other deductions (attach schedule)	10	
Investment Interest	11. (a) Interest expense on investment debts	11(a)	
	(b) (1) Investment income included on lines 4(a), 4(b), 4(c) and 4(f) above	(b)(1)	
	(2) Investment expenses included on line 10 above	(2)	
Other Items	12. (a) Type of Section 59(e)(2) expenditures ➤	12(a)	
	(b) Amount of Section 59(e)(2) expenditures	(b)	
	13. Tax-exempt interest income	13	
	14. Other tax-exempt income	14	
	15. Nondeductible expenses	15	
	16. Property distributions (including cash) other than dividend distributions reported to you on Form 1099-DIV	16	
	17. Supplemental information required to be reported to each shareholder (attach schedules)	17	
	18. Total dividend distributions paid from accumulated earnings and profits	18	
Credits	19. Individual shareholder's net distributable share of taxable income taxed under KRS 141.040	19	
	20. Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3))	20	
	21. Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c))	21	
Resident Shareholder Adjustment	22. Combination of Kentucky Schedule K-1, lines 1 through 5, 8 and portions of lines 6 and 10. Add income amounts and subtract (loss) and deduction amounts (see instructions)	22	
	23. Combination of federal Schedule K-1, lines 1 through 9, 11 and portions of lines 10 and 12. Add income amounts and subtract (loss) and deduction amounts (see instructions)	23	
	24. Enter the difference of lines 22 and 23 here and on appropriate line on Schedule M (see instructions)	24	

SHAREHOLDER'S INSTRUCTIONS FOR SCHEDULE K-1 (FORM 720S)

PURPOSE—Although the S corporation is subject to Kentucky corporation income tax, you, the shareholder, are liable for Kentucky income tax on your pro rata share of the S corporation's income, whether or not distributed, and you must include your share on your Kentucky income tax return for the year in which the tax year of the S corporation ends. The S corporation uses Schedule K-1 (Form 720S) to report to you your share of the S corporation's income (reduced by any federal tax the S corporation paid on the income), loss, credits, deductions, etc. Please keep it for your records.

GENERAL INSTRUCTIONS—Schedule K-1 (Form 720S) will help when preparing your Kentucky income tax return. Where "(attach schedule)" appears next to a line on Schedule K-1, it means the S corporation will have attached a statement to Schedule K-1 to show information for the line item, if applicable. If you believe the S corporation has made an error on your Schedule K-1 (Form 720S), notify the S corporation and ask for a corrected schedule. Do not change any item on your copy.

Schedule K-1 (Form 720S) does not show the amount of actual dividend distributions the S corporation paid to you. The S corporation must report such amounts to you on Form 1099-DIV. You report actual dividend distributions on federal Schedule B (Form 1040). Refer to the shareholder instructions you received for federal Schedule K-1 (Form 1120S) for information concerning your basis in corporate stock, elections to be made by you separately on your income tax return and not by the S corporation, etc.

Every individual, including estates and trusts, who is a resident of Kentucky and is a shareholder in an S corporation is required to report 100 percent of his or her share of income (loss), credits, deductions, etc., for Kentucky individual income tax purposes. **A nonresident shareholder must report the portion of his or her share of income attributable to the S corporation's business in Kentucky.** A **resident** is an individual domiciled within Kentucky or an individual who is not domiciled in Kentucky but maintains a place of abode in Kentucky and spends in the aggregate more than 183 days of the taxable year in Kentucky. A **nonresident** is any individual not a resident of Kentucky.

At-Risk Limitations—Generally, if you have a loss from any activity carried on as a trade or business or for the production of income by the S corporation and you, the shareholder, have amounts invested in that activity for which you are not at risk, you will be required to complete federal Form 6198, At-Risk Limitations, to figure the allowable loss to report on your Kentucky income tax return. Your deductible loss from each activity for the tax year generally is limited to the amount you could actually lose in the activity. To help you complete Form 6198, if required, the S corporation has provided a schedule showing your share of income, expenses, etc., for each at-risk activity.

Passive Activity Limitations—The passive activity limitations in IRC Section 469 are figured at the shareholder level and may apply to any loss reported on Lines 1, 2 or 3 and any other related items of income, loss and deductions reported on Schedule K-1 (Form 720S). Refer to the federal Shareholder's Instructions for Schedule K-1 (Form 1120S) to determine if the passive activity limitations apply to your share of loss(es) reported on Schedule K-1 (Form 720S), and if you must file Form 8582-K, Kentucky Passive Activity Loss Limitations. When applicable, the passive activity limitations on losses are applied after the limitations on losses for a shareholder's at-risk amount.

SPECIFIC INSTRUCTIONS—Kentucky Resident Shareholders (Form 740 Filers)—You, as the shareholder, will need to determine the net difference between your federal Schedule K-1 amounts and your Kentucky Schedule K-1 amounts. This will adjust the items of income, loss and deductions used to compute your federal adjusted gross income to the Kentucky amounts shown in Column (b), Schedule K-1. To determine this difference, complete Lines 23 through 25.

Line 23—Include on this line, the Kentucky Schedule K-1 amounts from Lines 1 through 5 and 8. Also include the amounts from Lines 6 and 10 that do not pass through to Schedule A as itemized deductions.

Line 24—Include on this line, the federal Schedule K-1 amounts from Lines 1 through 9 and 11. Also include the amounts from Lines 10 and 12 that do not pass through to Schedule A as itemized deductions.

NOTE: If Form 8582-K is required, adjust the amounts entered on Lines 23, 24 and 25 to exclude any income, loss, deduction or expense related to a passive activity. Complete the passive activities adjustment worksheet (Form 8582-K, page 2) to determine additions to or subtractions from federal adjusted gross income. **See Form 740 instructions for Schedule M, Line 3 and/or Line 13.**

If amounts on Lines 4(d) and 4(e) are subject to the capital loss limitations, do not include on Lines 23 and 24. Complete federal Schedule D using Kentucky amounts to determine additions to or subtractions from federal adjusted gross income.

Line 25—Enter difference of Lines 22 and 23 less Line 24. If Lines 22 and 23 are greater than Line 24, enter the difference as an addition to federal adjusted gross income on Schedule M, Line 3. If Line 24 is greater than Lines 22 and 23, enter the difference as a subtraction on Schedule M, Line 13.

Caution: If the net amount of Lines 22 and 23 is a (loss) and Line 24 is a (loss), the smaller dollar amount of (loss) is the greater amount, and to determine the difference subtract the smaller dollar amount from the larger dollar amount. If the net of Lines 22 and 23 is a (loss) and Line 24 is an income amount, or the net of Lines 22 and 23 is an income amount and Line 24 is a (loss), the income amount is the greater amount, and to determine the difference add the two amounts.

Nonresident Shareholders (Form 740-NP Filers)—If you are a nonresident individual shareholder needing to file Form 740-NP, in order to take advantage of the graduated withholding rates on income withheld by the S corporation, follow the directions below. The nonresident individual may also need to file Form 740-NP to take advantage of capital loss, net operating loss and credit carryforwards.

If the percentage shown in Item B(2) is "100%," you must enter on the appropriate lines of Form 740-NP and related schedules the amounts shown on Lines 1 through 5 and 8, portions of Lines 6, 10 and 11(a), and the portion of Line 12(b) actually deducted for the current year.

If the percentage shown in Item B(2) is less than 100 percent, the amounts on Lines 1 through 5 and 8, the portions of Lines 6, 10 and 11(a) which do not pass through to Schedule A, and the portion of Line 12(b) actually deducted for the current year must be multiplied by this percentage and entered on the appropriate lines of the Nonresident or Part-Year Resident Income Tax Return, Form 740-NP, and related schedules. Lines 7 and 9, and the portions of Lines 6, 10 and 11(a) which pass through to Schedule A should not be multiplied by the percentage in Item B(2) since they will be prorated by the percentage on Line 63 of Form 740-NP.

Refer to specific instructions below and federal Shareholder's Instructions for Schedule K-1 (Form 1120S).

Lines 1 through 3—Enter on federal Schedule E using Kentucky amounts or on Form 8582-K, if applicable.

Line 4(a)—Enter on Form 740-NP, Section D, Line 3.

Line 4(b)—Enter on Form 740-NP, Section D, Line 4.

Line 4(c)—Enter on federal Schedule E using Kentucky amounts.

Lines 4(d) and (e)—Enter on federal Schedule D using Kentucky amounts or Form 8582-K, if applicable.

Line 4(f)—Enter on applicable lines of your return (see federal Shareholder's Instructions for Schedule K-1 (Form 1120S)).

Line 5—Enter on federal Form 4797.

Line 6—Enter on applicable lines of your return (see federal Shareholder's Instructions for Schedule K-1 (Form 1120S)).

Line 7—Enter on Schedule A, Form 740-NP.

Line 8—Enter on federal Schedule E using Kentucky amounts.

Line 9—Enter on Schedule A, Form 740-NP.

Line 10—Enter on Schedule A, Form 740-NP.

For All Shareholders

Lines 11 and 12 through 18—See federal Shareholder's Instructions for Lines 12, 16 and 17, Schedule K-1 (Form 1120S).

Line 19—Enter on Line 2 of the Kentucky Corporation Tax Credit Worksheet located in the instructions under Business Incentive Credits.

Line 20—Enter on Line 7 of the Kentucky Corporation Tax Credit Worksheet located in the instructions under Business Incentive Credits.

Line 21—Enter on Form 740, Form 741 or Form 740-NP, Line 30(c).

Estates and Trusts (Form 741 Filers)—Estates or trusts report the amounts shown in Column (b) on Form 741, Kentucky Fiduciary Income Tax Return, and related schedules. See federal Shareholder's Instructions for Schedule K-1 (Form 1120S).

Single Member Limited Liability Companies Filing on Form 725

Form 725 is to be used by single member LLC's whose member is an individual. For taxable years beginning on or after January 1, 2005, all single member LLC's that are doing business in Kentucky are subject to Kentucky's corporation income tax unless otherwise exempt from the tax under the provisions of KRS 141.040(1). The purpose of this form is to transition federal income of a disregarded individually owned single member LLC from federal schedules C, E or F to Kentucky corporation taxable net income. Single member LLC's filing on this form will pay corporation income tax on the greater of:

- The tax due on Taxable Net Income.
- The AMC.
- A minimum of $175.

The Department of Revenue recognizes that many business owners own multiple single member LLC's. Therefore, to avoid having to file a separate corporation income tax return for each single member LLC, an individual may file one form 725 and attach a completed schedule CP, Kentucky Single Member LLC Composite Return Schedule.

Apportionment of a Single Member LLC's Net Income on Form 725

A single member LLC required to file form 725 must apportion its taxable net income to Kentucky if the corporation is taxable in this state and taxable in another state under the provisions of KRS 141.010(14)(b) which states:

> "A corporation is taxable in another state if, in any state other than Kentucky, the corporation is required to file a return for or pay a net income tax, franchise tax measured by net income, franchise tax for the privilege of doing business or corporate stock tax."

If a corporation is taxable in this state and taxable in another state, then the corporation must apportion and allocate its net income to Kentucky based on the provisions of KRS 141.120. Before the apportionment fraction is computed, the corporation must determine its business income and nonbusiness income. "Business income" is defined by (KRS 141.120(1)(a) to be "income arising from transactions and activity in the regular course of a trade or business of the corporation and includes income from tangible and intangible property if the acquisition, management, or disposition of the property constitutes integral parts of the corporation's regular trade or business operations."

"Nonbusiness income" means all income other than business income (KRS 141.120(1)(e).

Business income is apportioned to Kentucky using a fraction composed of a double weighted sales factor, a property factor and payroll factor. The apportionment fraction and the calculation of business and nonbusiness income is reflected on Schedule A, Apportionment and Allocation.

For further guidance on business and nonbusiness income, please refer to Administrative Regulation 103 KAR 16:060.

Nexus Consolidated Returns Filed on Form 725

An individually owned single member LLC that is itself the owner of another single member LLC will have to file a nexus consolidated return that includes the consolidated income of both LLC's.

In the case of a consolidated return filed on form 725, the affiliated group will have to compute its consolidated Kentucky taxable net income under the provisions of KRS 141.200(9) through (14).

Pursuant to KRS 141.200(9)(f), the determinations and computations required by KRS Chapter 141 shall be made in accordance with the provisions of the Internal Revenue Code and related regulations, except as required by differences between this chapter and the Internal Revenue Code. KRS 141.200(11)(b) states in part: "An affiliated group required to file a consolidated return under this subsection shall be treated for all purposes as a single corporation under the provisions of this chapter. All transactions between corporations included in the consolidated return shall be eliminated in computing net income in accordance with KRS 141.010(13), and in determining the property, payroll, and sales factors in accordance with KRS 141.120."

A nexus consolidated return should include a schedule of gross income and deductions for each member of the affiliated group prepared in columnar form. Form 725 KCR provides the columnar format. The 50% loss limitation rules for a nexus consolidated return will apply to the affiliated group filing on form 725.

Pass-Through Corporation Income Tax Credits to Individual Owners of a Single Member LLC

A nonrefundable credit will pass through to the individual member of a single member LLC. KRS 141.420(3) authorizes the credit. The credit is the individual shareholder's proportionate share of the tax due from the corporation as determined under KRS 141.040 before the application of any credits identified in KRS 141.0205(4) and reduced by the required minimum imposed by KRS 141.040(6). The credit may be used against the individual income tax imposed by KRS 141.020.

Also, a refundable credit is available to an individual member of a single member LLC for taxable years beginning after December 31, 2004, and before January 1, 2007. The refundable credit is the portion of the nonrefundable credit described in the previous paragraph that exceeds the credit that would have been utilized if the corporation's income were taxed at the rates in KRS 141.020. The refundable portion of the credit shall be the individual member's proportionate share of the amount computed by multiplying the amount the corporation's income exceeds two hundred sixteen thousand six hundred dollars ($216,600) by one percent (1%). In other words, the refundable credit makes up for the difference between the top corporation income tax rate (7%) and the top individual income tax rate (6%). For tax periods beginning on or after January 1, 2007, the top individual and corporation income tax rates are the same (6%).

Special Note: *If a trust is the single member of a single member LLC, the trust shall be treated as an individual for the purpose of distributing income, loss and the pass-through credits.*

The individual income tax portion of this manual provides detailed instructions on how to claim the pass through credits on an individual income tax return.

Tax Rates for Net Income Calculation

For taxable years beginning on or after January 1, 2005 and prior to January 1, 2007, the tax rates are:

- 4% of the first $50,000
- 5% of the next $50,000
- 7% of the amount over $100,000

For taxable years beginning on or after January 1, 2007, the tax rates are:

- 4% of the first $50,000
- 5% of the next $50,000
- 6% of the amount over $100,000

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Department of Revenue

➤ See separate instructions.

Kentucky Single Member LLC Individually Owned Corporation Income Tax Return

2005

Taxable Year Ending __ __ / __ __ Mo. Yr.

Taxable period beginning ____________, 2005, and ending ____________, 200__.

A Check applicable box.

☐ Composite Return

☐ Nexus Consolidation

☐ Single Return

B Federal Identification Number ___ ___ - ___ ___ ___ ___ ___ ___ ___

Social Security Number ___ ___ ___ - ___ ___ - ___ ___ ___ ___

C Kentucky Corporation Account Number ___ ___ ___ ___ ___ ___

Name of LLC *(Place preaddressed label here; otherwise print or type.)*

State and Date of Organization

Name of Owner *(Place preaddressed label here; otherwise print or type.)*

Principal Business Activity in KY

Number and Street

NAICS Code Number (Relating to Kentucky Activity) (See www.census.gov)

City | State | ZIP Code | Telephone Number

D *Check if applicable:* ☐ Initial return ☐ Final return *(attach explanation)* ☐ Amended return ☐ Short-period return *(attach explanation)* ☐ Change of name ☐ Change of address

PART I—TAXABLE INCOME COMPUTATION

1. Ordinary income (loss)		
2. Other income (loss) (attach schedule)		
3. **Total federal income (loss)** (add lines 1 and 2)		
4. Charitable contributions		
5. Other deductions (attach schedule)		
6. Total (line 3 less lines 4 and 5)		
7. Federal depreciation and Section 179 expense deduction from Form 4562		
8. Kentucky depreciation and Section 179 expense deduction from Form 4562		
9. Kentucky statutory differences (KRS 141.010(12) and (13)) (attach schedule)		
10. **Kentucky net income (loss)** (add lines 6, 7 and 9 less line 8)		
11. Current net operating loss adjustment		
12. Income (loss) after NOL limitation (add lines 10 and 11)		
13. **Taxable net income (loss)** (amount from line 12 or Schedule A)		

PART II—ALTERNATIVE MINIMUM (AMC)

Gross Receipts		
1. Kentucky gross receipts (less Kentucky returns and allowances)		
2. Tax (line 1 multiplied by .00095)		
Gross Profits		
3. Kentucky gross receipts		
(a) Less Kentucky returns and allowances		
(b) Less Kentucky cost of goods sold		
4. Gross profit (subtract lines 3(a) and 3(b) from line 3)		
5. Tax (line 4 multiplied by .0075)		

PART III—TAX COMPARISON

1. Regular income tax (see instructions)		
2. Alternative minimum (AMC) (lesser of Part II, line 2 or line 5)		

PART IV—TAX COMPUTATION

1. **Tax liability** (Part III, greater of line 1, line 2 or $175 minimum)		
ADDITIONS		
2. Recycling/composting equipment tax credit recapture		
3. Total (add lines 1 and 2)		
SUBTRACTIONS		
4. Total nonrefundable credits from Part V		
5. **Net tax liability** (greater of line 3 less line 4 or $175)		
6. Estimated tax payments		
7. Extension tax payment		
8. Prior year's tax credit		
9. **Tax due**		
10. **Tax overpayment**		
11. Credited to 2006		
12. **Amount to be refunded**		

PART V—SCHEDULE OF TAX CREDITS

1. Economic development tax credits		
2. Other credits (see instructions)		
3. Total credits (enter on Part IV, line 4)		

PART VI—CORPORATION INCOME TAX CREDIT

1. Tax due (Part IV, line 1)		
2. Minimum tax	175	00
3. Corporation income tax credit (line 1 less line 2)		
4. Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3))		
5. Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c))		

Make check(s) payable to: **Kentucky State Treasurer**

Mail return with payment to: **Kentucky Department of Revenue Frankfort, Kentucky 40620.**

TAX PAYMENT SUMMARY (Round to Nearest Dollar)

☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Profits ☐ Minimum $175

Tax ____________ Interest ____________

Penalty ____________ TOTAL (Including Penalty and Interest) ____________

☐ *No packet required for 2006.*

➤ **Federal Schedules C, E and F, and any other supporting schedules must be attached.**

SCHEDULE Q—LIMITED LIABILITY COMPANY QUESTIONNAIRE

IMPORTANT: Questions 1—10 must be completed by the limited liability company.

1. Single member's (owner) name, address and Social Security number or federal I.D. number

2. List the following ***Kentucky*** account numbers. Enter N/A for any number not applicable.
   Employer Withholding ______
   Sales and Use Tax Permit ______
   Consumer Use Tax ______
   Unemployment Insurance ______
   Coal Severance and/or Processing Tax ______

3. If a foreign limited liability company, enter the date qualified to do business in Kentucky. __ __ / __ __ / __ __

4. The limited liability company's books are in care of: (name and address)

5. Is the limited liability company a partner in a general partnership doing business in Kentucky? ☐ Yes ☐ No
   If yes, list name, federal I.D. and Kentucky account number of the general partnership(s).

   Was the limited liability company doing business in Kentucky, other than the interest held in a general partnership doing business in Kentucky? ☐ Yes ☐ No

6. Are related party costs made to related members as defined in KRS 141.205(1)(l) included in this return? ☐ Yes ☐ No. If yes, list name, federal I.D. and/or Kentucky corporation account number of the individual or entity. ______

7. Was this return prepared on: (a) ☐ cash basis, (b) ☐ accrual basis, (c) ☐ other ______

8. Is the limited liability company a public service corporation subject to taxation under KRS 136.120? ☐ Yes ☐ No

9. Did the limited liability company file a Kentucky tangible personal property tax return for January 1, 2006? ☐ Yes ☐ No

10. Is the corporation currently under audit by the Internal Revenue Service? ☐ Yes ☐ No. If yes, enter years under audit ______

    If the Internal Revenue Service has made final and unappealable adjustments to the limited liability company's taxable income which have not been reported to this department, check here ☐ and file Form 740X, Amended Kentucky Individual Income Tax Return, or Form 740-XP, Amended Kentucky Individual Income Tax Return for Tax Years 2002, 2003, 2004, whichever is applicable, for each year adjusted and attach a copy of the final determination.

I, the undersigned, declare under the penalties of perjury, that I have examined these returns, including all accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct and complete.

✍ ______
Signature of member (owner) | Identification number of member (owner) | Date

______
Typed or printed name of preparer other than taxpayer | Identification number of preparer | Date

May the Department of Revenue discuss this return with the preparer? ☐ Yes ☐ No

SCHEDULE CP
Form 725
41A725CP
Department of Revenue

Kentucky Single Member LLC Individually Owned Composite Return Schedule

2005

Taxable Year Ending __/__ Mo. Yr.

Taxable period beginning ____________, 2005, and ending ____________, 200__.

Name of Owner Soc. Sec. #	Name ______ FEIN ______ KY Corp. Acct. #	Name ______ FEIN ______ KY Corp. Acct. #	Name ______ FEIN ______ KY Corp. Acct. #	Name ______ FEIN ______ KY Corp. Acct. #
Part I Taxable Income Computation				
1. Ordinary income (loss)				
2. Other income (loss) (attach schedule)				
3. **Total federal income (loss)** (add lines 1 and 2)				
4. Charitable contributions				
5. Other deductions (attach schedule)				
6. Total (line 3 less lines 4 and 5) .				
7. Federal depreciation and Section 179 expense deduction from Form 4562				
8. Kentucky depreciation and Section 179 expense deduction from Form 4562				
9. Kentucky statutory differences (KRS 141.010(12) and (13)) (attach schedule)				
10. **Kentucky net income (loss)** (add lines 6, 7 and 9 less line 8)				
11. Current net operating loss adjustment				
12. Income (loss) after NOL limitation (add lines 10 and 11)				
13. **Taxable net income (loss)** (amount from line 12 or Schedule A)				
Part II—Alternative Minimum (AMC)				
1. Kentucky gross receipts (less Kentucky returns and allowances)				
2. Tax (line 1 multiplied by .00095)				
Gross Profits				
3. Kentucky gross receipts				
(a) Less Kentucky returns and allowances				
(b) Less Kentucky cost of goods sold				
4. Gross profit (subtract lines 3(a) and 3(b) from line 3)				
5. Tax (line 4 multiplied by .0075)				
Part III—Tax Comparison				
1. Regular income tax				
2. Alternative minimum (AMC) (lesser of Part II, line 2 or line 5)				

Form 725CP (2005) Page 2

Name of Owner	Name	Name	Name	Name
	FEIN	FEIN	FEIN	FEIN
Soc. Sec. #	KY Corp. Acct. #	KY Corp. Acct. #	KY Corp. Acct. #	KY Corp. Acct. #
Part IV—Tax Computation				
1. **Tax liability** (Part III, greater of line 1, line 2 or $175 minimum)				
2. Recycling/composting equipment tax credit recapture				
3. Total (add lines 1 and 2)				
4. Total nonrefundable credits				
5. **Net tax liability** (greater of line 3 less line 4 or $175)				
6. Estimated tax payments				
7. Extension tax payment				
8. Prior year's tax credit				
9. **Tax due**				
10. **Tax overpayment**				
11. Credited to 2006				
12. **Amount to be refunded**				
Part V—Schedule of Tax Credits				
1. Economic development tax credits				
2. Other credits (see instructions)				
3. Total credits (enter on Part IV, line 4)				
Part VI—Corporation Income Tax Credit				
1. Tax due (Part IV, line 1)				
2. Minimum tax				
3. Corporation income tax credit (line 1 less line 2)				
4. Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3))				
5. Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c))				
Indicate the filing status of LLC. If a nexus consolidation, attach Form 851-N, Schedule KCR (Form 725), and if needed, Schedule KCR-C (Form 725)	☐ Nexus Consolidation ☐ Single Return	☐ Nexus Consolidation ☐ Single Return	☐ Nexus Consolidation ☐ Single Return	☐ Nexus Consolidation ☐ Single Return
TAX PAYMENT SUMMARY				
Tax				
Interest				
Penalty				
TOTAL				
Check Applicable Box	☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Profits ☐ Minimum $175	☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Profits ☐ Minimum $175	☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Profits ☐ Minimum $175	☐ Income ☐ AMC Gross Receipts ☐ AMC Gross Receipts ☐ Minimum $175

FORM **851-N**

41A851-N (10-05)

Department of Revenue

KENTUCKY AFFILIATIONS AND PAYMENT SCHEDULE

➤ File with the nexus consolidation income tax return (Form 725 or 765) and extension request (Form 40A102 or 41A720SL).

Taxable Year Ending

M M Y Y

If a Kentucky consolidated corporation income tax return was filed for the previous taxable year and the members of the affiliated group subject to Kentucky income tax (KRS 141.040(1)) have changed due to nexus consolidation, check this box ☐.

List the parent corporation and all subsidiaries subject to Kentucky income tax.

Name of Corporation	Kentucky Account Number	Current Payments (Round to Nearest Dollar) *(See Instructions on Reverse)*			
		Prior Year's Credit	Estimated Payments	Extension Payments	Total
Common parent corporation:					
Subsidiary corporations:					
		Total Payment ➤			

FORM 851-N
KENTUCKY AFFILIATIONS AND PAYMENT SCHEDULE
INSTRUCTIONS

Purpose of the Form—This form must be completed and submitted with the nexus consolidated income tax return (Form 725 or 765) and the request for extension of time to file a Kentucky income tax return (applicable Kentucky Form 40A102 or 41A720SL) or copy of applicable federal form (Form 7004, Form 8736 or Form 8800) for a nexus consolidated income tax return. The information requested on this form (1) identifies the common parent of the affiliated group and each includible corporation included in the consolidated Kentucky nexus tax return; (2) provides the Kentucky Department of Revenue information of includible corporations in the consolidated return which precludes delinquent tax return notices; and (3) ensures accurate processing of payment(s).

Listing of Includible Corporations of a Affiliated Group—List each includible corporation included in the consolidated income tax return which is subject to Kentucky income tax as provided by KRS 141.040. An "affiliated group" means one or more chains of includible corporations connected through stock ownership, membership interest, or partnership interest with a common parent corporation provided the ownership interest and value of any corporation meets the 80 percent requirements as provided in KRS 141.200(9). An "includible corporation" includes, but is not limited to: (a) being organized under the laws of this state; (b) having a commercial domicile in this state; (c) owning or leasing property in this state; (d) having one or more individuals performing services in this state; (e) maintaining an interest in a general partnership doing business in this state; (f) deriving income from or attributable to sources within this state, including deriving income directly or indirectly from a trust doing business in this state; or (g) directing activities at Kentucky customers for the purpose of selling them goods or services.

Enter the six-digit Kentucky Account Number for each includible corporation. The Kentucky Account Number is located in the upper right portion of the address label on the Kentucky corporation income tax packet.

Form 851-N Filed With Form 725 or 765—Enter in the Prior Year's Credit column the prior year's credit applied to the current year by each includible corporation. Enter in the Estimated Payments column the estimated payments made by each includible corporation. Enter in the Extension Payments column the extension payment made with the applicable Kentucky or federal form. Enter the total of payments made by each includible corporation in the Total column. Total Payment (sum of the Total column) should equal the total amount reflected in the Tax Payment Summary of the consolidated income tax return.

Form 851-N Filed With Form 41A720SL—If the affiliated group is submitting a payment with the application for extension, the total amount entered in the Extension Payment column of Form 851-N should equal the total amount shown on Form 41A720SL.

SCHEDULE NOL

Form 725 or 765

41A725NOL (10-05)

Department of Revenue

NET OPERATING LOSS SCHEDULE

Pass-Through Entities

Taxable Year Ending

__ __ / __ __
Mo. Yr.

PART I—MANDATORY NEXUS CONSOLIDATION

Section A—Current Net Operating Loss Adjustment

DRAFT 9-22-05

Name	Kentucky Corporation Account Number	Includible Corporations A Kentucky Net Income	Includible Corporations B Kentucky Net Losses (Enter as Positive Amount)
1. Common Parent			
2. **Includible Corporations**			
3. Totals (add Columns A and B)			
4. Limitation (line 3, Column A, multiplied by 50%)			
5. If line 3, Column B, is greater than line 4, enter the difference here; on Section B, line 1; and as a positive amount on Form 725, Part I, line 11; or Form 765, Part I, line 24. If line 3, Column B, is less than line 4, enter -0- on Section B, line 1, and on Form 725, Part I, line 11; or Form 765, Part I, line 24			

Section B—NOL Carryforward

1. Current year disallowed carryforward from Part I, Section A, line 5	
2. If no entry on line 3, Column A, enter amount from line 3, Column B	
3. Enter the amount from line 1 or line 2	
4. Less Kentucky net loss distributed to individuals	
5. Total NOL carryforward (line 3 less line 4)	

PART II—SINGLE ENTITY FILERS

Section A—Kentucky NOL Carryforward

1. Carryforward from prior year(s)	
2. Net operating loss (current year) from Form 725, Part I, line 13; or Form 765 Part I, line 26	
3. Total of lines 1 and 2	
4. Less Kentucky net loss distributed to individuals	
5. Total Kentucky NOL carryforward (line 3 less line 4)	

DRAFT 9-22-05

INSTRUCTIONS FOR SCHEDULE NOL (FORM 725 OR 765)

Purpose of this Form—This form must be completed and submitted with the income tax return (Form 725 and 765) when a corporation has a current year net operating loss or a net operating loss carryforward.

Part I of this form must be completed and submitted with a nexus consolidated tax return if the parent or any includible subsidiary has a current year net operating loss or a nexus net operating loss carryforward. A nexus net operating loss carryforward will not apply for the year 2005 as this is the first year for the new corporate entities. KRS 141.200(11)(b) provides that includible corporations that have incurred a net operating loss shall not deduct an amount that exceeds, in aggregate, 50 percent of the income realized by the remaining includible corporations that did not realize a net operating loss. The portion of any net operating loss limited by the application of this subsection shall be available for carryforward in accordance with the provisions of KRS 141.011.

Part II of this form must be completed by a corporation filing a separate return and having a current year net operating loss or a net operating loss carryforward. A net operating loss carryforward will not apply to 2005 as this is the first year for the new corporate entities.

LINE-BY-LINE INSTRUCTIONS

PART I-MANDATORY NEXUS CONSOLIDATION

Section A—Current Net Operating Loss Adjustment

Line 1—Enter the name and Kentucky Corporation Account Number of the parent corporation filing the return. In Column A, enter the Kentucky net income of the parent corporation or enter in Column B the Kentucky net loss of the parent corporation. The net loss must be entered as a positive number.

Line 2—Enter the name and Kentucky Corporation Account Number of each includible corporation included in the consolidated tax return. In Column A, enter the net income or enter in Column B the net loss of each subsidiary included in the consolidated return. A net loss must be entered as a positive number.

Line 3—Enter the total of Column A and Column B.

Line 4—Enter the amount of Line 3, Column A multiplied by 50 percent.

Line 5—If Line 3, Column B is greater than Line 4, Column A, enter the difference here; on Section B, Line 1; and on Form 725, Part I, Line 11; or Form 765, Part I, Line 24. If Line 3, Column B is less than Line 4, Column A, enter -0- on Section B, Line 1; and on Form 725, Part I, Line 11; or Form 765, Part I, Line 24.

Section B—NOL Carryforward

Line 1—Enter the amount from Part I, Section A, Line 5.

Line 2—If no entry on Part I, Section A, Line 5, enter the amount, if any, from Part I, Section A, Line 3, Column B.

Line 3—Enter the greater of Line 1 or Line 2.

Line 4—Enter the amount from Line 3 multiplied by the total of the individuals' stock or ownership percentages. KRS 141.011(4) provides that for taxable years beginning on or after January 1, 2005, the net operating loss carryforward deduction of a corporation shall be reduced by the amount of distributive share income, loss, and deduction distributed to an individual.

Line 5—Enter the amount of Line 3 less Line 4.

PART II—SEPARATE ENTITY FILERS

Section A—Kentucky NOL Carryforward

Line 1—Enter the Kentucky net operating loss carryforward from prior years, only if you did not file a nexus consolidated tax return. This will not apply for the 2005 year as this is first year of filing for new corporate entities.

Line 2-Enter net operating loss from Form 725, Part I, Line 13; or Form 765, Part I, Line 26, only if you did not file a consolidated nexus tax return.

Line 3—Enter the amount of Line 1 plus Line 2.

Line 4—Enter the amount of Line 3 multiplied by the total of individuals' stock or ownership percentages. KRS 141.011(4) provides that for taxable years beginning on or after January 1, 2005, the net operating loss carryforward deduction of a corporation shall be reduced by the amount of distributive share income, loss, and deduction distributed to an individual.

Line 5—Enter the amount of Line 3 less Line 4.

SCHEDULE KCR (Form 725)
41A725KCR (10-05)
Department of Revenue

KENTUCKY NEXUS CONSOLIDATED RETURN SCHEDULE

(Attach All Applicable Schedules)

Taxable Year Ending
__ __ / __ __
Mo. Yr.

Common Parent Corporation | Kentucky Corporation Account Number

	Parent	Name ____ FEIN ____ KY Corp. Acct. #	Name ____ FEIN ____ KY Corp. Acct. #	Combined Total	Intercompany Eliminations	Consolidated Total
1. Kentucky ordinary income (loss) (see instructions)						
2. Net income (loss) from rental real estate activities						
3. Net income (loss) from other rental activities						
4. Interest income						
5. Royalty income						
6. Net short-term and long-term capital gain						
7. Other portfolio income (loss)						
8. Section 1231 net gain (loss) (other than due to casualty or theft)						
9. Other income (loss) (attach schedule)						
10. Federal depreciation (attach federal Form 4562)						
11. Total additions (add lines 1 through 10)						
12. Other income (loss) (KRS 141.010(12)): (a) Related party expenses (KRS 141.205)						
(b) Expenses related to nontaxable income						
(c) Add net distributable loss from corporations						
(d) Subtract net distributable income from corporations						
(e) Other						
13. Total income after adjustments (add lines 11 and 12)						
14. Charitable contributions (see instructions)						
15. Section 179 expense deduction (Kentucky Form 4562)						
16. Kentucky depreciation (attach Kentucky Form 4562)						
17. Deductions related to portfolio income (loss) (attach schedule)						
18. Other deductions (attach schedule)						
19. Kentucky depletion adjustment (see instructions)						
20. Total deductions (add lines 14 through 19)						
21. Other adjustments (KRS 141.010(13))						
22. Total deductions (add lines 20 and 21)						
23. Net income (loss) (line 13 less line 22)						

DRAFT 9-30-03

Schedule KCR

Kentucky Nexus Consolidated Return Schedule

GENERAL INSTRUCTIONS

Purpose of Form—This schedule must be completed and submitted with the consolidated income tax return (Form 725) to show the statutory adjustments for each member of the affiliated group.

Specific Instructions—For each subsidiary, enter the name, FEIN and Kentucky corporation account number. If there are more than two subsidiaries in the affiliated group, use Schedule KCR-C, Kentucky Nexus Consolidated Return Schedule Continuation Sheet. This form can be duplicated as needed.

SCHEDULE KCR-C (Form 725)
41A725KCR-C (10-05)
Department of Revenue

KENTUCKY NEXUS CONSOLIDATED RETURN SCHEDULE
Continuation Sheet
(Attach All Applicable Schedules)

Taxable Year Ending
__ __ / __ __
Mo. Yr.

Common Parent Corporation

Kentucky Corporation Account Number

	Name ____ FEIN ____ KY Corp. Acct. #	Name ____ FEIN ____ KY Corp. Acct. #	Name ____ FEIN ____ KY Corp. Acct. #	Name ____ FEIN ____ KY Corp. Acct. #	Name ____ FEIN ____ KY Corp. Acct. #
1. Kentucky ordinary income (loss) (see instructions)					
2. Net income (loss) from rental real estate activities					
3. Net income (loss) from other rental activities					
4. Interest income					
5. Royalty income					
6. Net short-term and long-term capital gain					
7. Other portfolio income (loss)					
8. Section 1231 net gain (loss) (other than due to casualty or theft)					
9. Other income (loss) (attach schedule)					
10. Federal depreciation (attach federal Form 4562)					
11. Total additions (add lines 1 through 10)					
12. Other income (loss) (KRS 141.010(12)): (a) Related party expenses (KRS 141.205)					
(b) Expenses related to nontaxable income					
(c) Add net distributable loss from corporations					
(d) Subtract net distributable income from corporations					
(e) Other					
13. Total income after adjustments (add lines 11 and 12)					
14. Charitable contributions (see instructions)					
15. Section 179 expense deduction (Kentucky Form 4562)					
16. Kentucky depreciation (attach Kentucky Form 4562)					
17. Deductions related to portfolio income (loss) (attach schedule)					
18. Other deductions (attach schedule)					
19. Kentucky depletion adjustment (see instructions)					
20. Total deductions (add lines 14 through 19)					
21. Other adjustments (KRS 141.010(13))					
22. Total deductions (add lines 20 and 21)					
23. Net income (loss) (line 13 less line 22)					

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Form **765-GP**
42A765-GP
Department of Revenue
Kentucky

KENTUCKY GENERAL PARTNERSHIP INCOME RETURN

➤ **Attach a complete copy of the federal return.**

DRAFT 10-4-05

2005

A. Date business commenced or qualified	For calendar year 2005 or fiscal year beginning ____________, 2005, and ending ____________, 2006.	
B. Number of partners (attach K-1s)	Name	E. Federal Employer Identification Number
C. NAICS business code number (Relating to Kentucky activity) (See www.census.gov)	Number and street or P.O. box	F. Kentucky Withholding Account Number
D. Partnership telephone number	City, town or post office / County / State / ZIP code	G. Sales and Use Tax Permit Number

H. Check applicable boxes: ☐ Initial return ☐ Final return ☐ Amended return ☐ Short-period return ☐ Change of name and address

I. ☐ Qualified investment partnership (Check box only if you are a general partnership or a limited partnership that has been formed as a qualified investment partnership.)

J. Is a composite return being filed for any electing nonresident partners? ☐ Yes ☐ No

1. Federal ordinary income (loss) (Form 1065, line 22)	1		
2. Federal depreciation from Form 4562	2		
3. Other (attach schedule) (see instructions)	3		
4. **Total** (add lines 1, 2 and 3)	4		
SUBTRACTIONS:			
5. Federal work opportunity credit	5		
6. Kentucky depreciation from revised Form 4562	6		
7. Other (attach schedule) (see instructions)	7		
8. **Total** (add lines 5, 6 and 7)	8		
9. **Ordinary income (loss)** (line 4 less line 8)	9		

I declare under the penalties of perjury that this return (including any accompanying schedules and statements) has been examined by me and, to the best of my knowledge and belief, is a true, correct and complete return.

Signature of partner or member | Identification number of partner or member | Date

Typed or printed name of preparer other than taxpayer | Identification number of preparer | Date

Mail to Kentucky Department of Revenue, Frankfort, Kentucky 40620.

Schedule K—PARTNERS' SHARES OF INCOME, CREDIT, DEDUCTIONS, ETC.

SECTION I

Income or (Loss)

(a) Distributive Share Items		(b) Total Amount
1. Ordinary income or (loss) from trade or business activities (page 1, line 9)	1	
2. Net income or (loss) from rental real estate activities (from attached federal schedule)	2	
3. a Gross income from other rental activities	3a	
b Minus expenses (attach schedule)	3b	
c Net income or (loss) from other rental activities	3c	
4. Portfolio income or (loss):		
a Interest income	4a	
b Dividend income	4b	
c Royalty income	4c	
d Net short-term capital gain or (loss) (from attached federal schedule)	4d	
e Net long-term capital gain or (loss) (from attached federal schedule)	4e	
f Other portfolio income or (loss) (attach schedule)	4f	
5. Guaranteed payments to partners	5	
6. Net gain or (loss) under IRC Section 1231 (other than due to casualty or theft) (attach federal Form 4797)	6	
7. Other income or (loss) (attach schedule)	7	

Deductions

8. Charitable contributions (attach list) and housing for homeless deduction (attach Schedule HH)	8	
9. IRC Section 179 expense deduction (attach federal Form 4562 and Kentucky revised Form 4562)	9	
10. Deductions related to portfolio income (do not include investment interest expense)	10	
11. Other deductions (attach schedule)	11	

Investment Interest

12. a Interest expense on investment debts	12a	
b (1) Investment income included on lines 4a, 4b, 4c and 4f above	12b(1)	
(2) Investment expenses included on line 10 above	12b(2)	

Credits

13. Kentucky Unemployment Tax Credit (attach Schedule UTC)	13	
14. Recycling and Composting Equipment Tax Credit (attach *approved* Schedule RC)	14	
15. Other (see instructions) ➤	15	

Other

16. a Type of expenditures	16a	
b Total expenditures to which IRC Section 59(e)(2) election may apply	16b	
17. Other items and amounts not reported above (attach schedule)	17	

SECTION II—Kentucky Distributable Corporation Income and Tax Credits

1. Individual partners' net distributable share of taxable income previously taxed under KRS 141.040	1	
2. Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3))	2	
3. Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c))	3	

SECTION III—Kentucky Nonresident Partners' Distributable Income Computation

1. Individual nonresident partners' net distributive share of taxable income reported on this return	1	
2. Net distributable income to nonresident individual partners from entities previously taxed under KRS 141.040	2	
3. Nonresident individual partners' net distributive share of taxable income not previously taxed	3	

KENTUCKY SCHEDULE K-1
FORM 765-GP
Commonwealth of Kentucky
DEPARTMENT OF REVENUE

PARTNER'S SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.

For calendar year 2005 or fiscal year
beginning ________ 2005, and ending ________ , 2006.

2005

Partner's identifying number ➤
Partner's name, address and ZIP code

DRAFT 10-4-05

Partnership's FEIN ➤
Partnership's name, address and ZIP code

A Partner's share of liabilities:
Nonrecourse .... $ ________
Qualified nonrecourse financing .... $ ________
Other .... $ ________

B What type of entity is this partner? .... ➤ ________

D Enter partner's percentage of:

	(i) Before change or termination	(ii) End of year
Profit sharing	%	%
Loss sharing	%	%
Ownership of capital	%	%

C Partner's taxable percentage of partnership's distributive share items below (see instructions)
(1) Resident partner 100%
(2) Nonresident partner (see Schedule A, Section I, line 12) .... ➤ %

☐ Final K-1
☐ Amended K-1

	(a) Distributive Share Items		(b) Amount
Income or (Loss)	1. Ordinary income or (loss) from trade or business activities	1	
	2. Net income or (loss) from rental real estate activities	2	
	3. Net income or (loss) from other rental activities	3	
	4. Portfolio income or (loss):		
	a Interest	4a	
	b Dividends	4b	
	c Royalties	4c	
	d Net short-term capital gain or (loss)	4d	
	e Net long-term capital gain or (loss)	4e	
	f Other portfolio income or (loss) (attach schedule)	4f	
	5. Guaranteed payments to partners	5	
	6. Net gain or (loss) under IRC Section 1231 (other than due to casualty or theft)	6	
	7. Other income or (loss) (attach schedule)	7	
Deductions	8. Charitable contributions (attach schedule) and housing for homeless deduction (attach Schedule HH)	8	
	9. IRC Section 179 expense deduction (attach federal Form 4562 and Kentucky revised Form 4562)	9	
	10. Deductions related to portfolio income (attach schedule)	10	
	11. Other deductions (attach schedule)	11	
Invest-ment Interest	12. a Interest expense on investment debts	12a	
	b (1) Investment income included in lines 4a, 4b, 4c and 4f above	12b(1)	
	(2) Investment expenses included in line 10 above	12b(2)	
Credits	13. Kentucky Unemployment Tax Credit	13	
	14. Recycling and Composting Equipment Tax Credit (attach Schedule RC (K-1))	14	
	15. Other ➤	15	
Other	16. a Type of expenditures	16a	
	b Total expenditures to which IRC Section 59(e)(2) election may apply	16b	
	17. Other items and amounts not reported above (attach schedule)	17	
Pass-Through Credits	18. Individual partner's share of net distributable income previously taxed under KRS 141.040	18	
	19. Nonrefundable Kentucky corporation income tax credit (KRS 141.420(3))	19	
	20. Refundable Kentucky corporation income tax credit (KRS 141.420(3)(c))	20	
Resident Adjustment	21. Combination of Kentucky Schedule K-1, lines 1 through 6, 9 and portions of 7 and 11. Add income amounts and subtract (loss) and deduction amounts (see instructions)	21	
	22. Combination of federal Schedule K-1, lines 1 through 10, 12 and portions of 11 and 13. Add income amounts and subtract (loss) and deduction amounts (see instructions)	22	
	23. Enter the difference of lines 21 and 22 here and on Form 740, Schedule M, line 3, if difference is positive, or line 13, if difference is negative	23	

PARTNER'S INSTRUCTIONS FOR SCHEDULE K-1 (FORM 765-GP)

Who Must File—Although the partnership is not subject to income tax, the partners are liable for tax on their share of the partnership income, whether or not distributed, and must include their share on the individual income tax return.

If you were a Kentucky resident for the entire year, your filing requirement depends upon the amount of adjusted gross income, age and whether you or your spouse are considered to be blind.

Any person with gross receipts exceeding the threshold amount determined under KRS 141.066 from self-employment must file a Form 740 regardless of the amount of adjusted gross income or the number of tax credits claimed. Generally, all income of Kentucky residents, regardless of where it was earned, is subject to Kentucky income tax. See Form 740 Instructions.

Nonresidents with income from Kentucky sources and part-year residents receiving income while a Kentucky resident or from Kentucky sources while a nonresident must file a Kentucky return. **Partnership income is not exempted by reciprocal agreements between Kentucky and any other state.** Form 740-NP must be filed by an individual with income from Kentucky sources and a combined gross income from all sources exceeding the threshold amount determined under KRS 141.066. Full-year nonresidents must report all income from Kentucky sources and from property located in Kentucky. Persons moving into Kentucky must report income received from Kentucky sources prior to becoming residents and income received from all sources after becoming Kentucky residents. Residents moving out of Kentucky during the year must report income from all sources while a resident and from Kentucky sources while a nonresident.

When to Report—Include your share of the partnership's income or (loss), credits, deductions, etc., as shown by your Schedule K-1 (Form 765-GP) on your Kentucky income tax return for the year in which the tax year of the partnership ends. For example, if you, the partner, are on a calendar year, and the partnership's tax year ends January 31, 2005, you must take the items listed on Schedule K-1 (Form 765-GP) into account on your tax return for calendar year 2005.

At-Risk Limitations—Generally, if you have a loss from any activity carried on as a trade or business or for the production of income by the partnership and you, the partner, have amounts invested in that activity for which you are not at risk, you will be required to complete federal Form 6198, At-Risk Limitations, to figure the allowable loss to report on your Kentucky income tax return. Your deductible loss from each activity for the tax year generally is limited to the amount you are at risk for the activity at the end of the partnership's tax year or the amount of the loss, whichever is less. To help you complete Form 6198, if required, the partnership has provided a schedule showing your share of income, expenses, etc., for each at-risk activity.

NOTE: Form 740 filers see Form 740 instructions for Schedule M, Line 5 and/or Line 15.

Passive Activity Limitations—The passive activity limitations in IRC Section 469 are figured at the partner level and may apply to any loss reported on Lines 1, 2 or 3 and any other related items of income, loss and deductions reported on Schedule K-1 (Form 765-GP). Refer to the federal Partner's Instructions for Schedule K-1 (Form 1065) to determine if the passive activity limitations apply to your share of loss(es) reported on Schedule K-1 (Form 765-GP), and if you must file Form 8582-K, Kentucky Passive Activity Loss Limitations.

SPECIFIC INSTRUCTIONS

Kentucky Resident Partners (Form 740 Filers)—To determine the net difference between the federal Schedule K-1 amounts and the Kentucky Schedule K-1 amounts, complete Lines 21, 22 and 23. This will adjust the items of income, loss and deductions used to compute your federal adjusted gross income to the Kentucky amounts shown in Column (b), Schedule K-1.

Line 21—Include on this line, the Kentucky Schedule K-1 amounts from Lines 1 through 6 and 9. Also include the amounts from Lines 7 and 11 that do not pass through to Schedule A as itemized deductions.

Line 22—Include on this line, the federal Schedule K-1 amounts from Lines 1 through 10 and 12. Also include the amounts from Lines 11 and 13 that do not pass through to Schedule A as itemized deductions.

NOTE: If Form 8582-K is required, adjust the amounts entered on Lines 21 and 22 to exclude any income, loss, deduction or expense related to a passive activity. Complete the passive activities adjustment worksheet (Form 8582-K, page 2) to determine additions to or subtractions from federal adjusted gross income. **See Form 740 instructions for Schedule M, Line 3 and/or Line 13.**

If amounts on Lines 4(d) and 4(e) are subject to the capital loss limitations, do not include on Lines 21 and 22. Complete federal Schedule D using Kentucky amounts to determine additions to or subtractions from federal adjusted gross income.

Line 23—Enter difference of Lines 21 and 22. If Line 21 is greater than Line 22, enter the difference as an addition to federal adjusted gross income on Schedule M, Line 3. If Line 22 is greater than Line 21, enter the difference as a subtraction on Schedule M, Line 13.

Caution: If the amounts on both Lines 21 and 22 are loss amounts, the smaller dollar amount of loss is the greater amount and to determine the difference subtract the smaller dollar amount from the larger dollar amount. If the amount on either Line 21 or 22 is an income amount and the amount on the other line is a loss amount, the income amount is the greater amount and to determine the difference add the two amounts.

Nonresident Individual Partners (Form 740-NP Filers)—If you are a nonresident individual needing to file Form 740-NP, in order to take advantage of the graduated withholding rates on income withheld by the partnership, follow the directions below. The nonresident individual may also need to file Form 740-NP to take advantage of capital loss, net operating loss and credit carryforwards.

Nonresident partners must report their distributive share of income by multiplying the percentage reported on Item C(2) by all items of income (loss) reported on the Kentucky Schedule K-1, Column (b). If the percentage shown in Item C(2) is 100%, you must enter on the appropriate lines of Form 740-NP and related schedules the amounts shown on Lines 1 through 6 and 9, portions of Lines 7, 11 and 12(a) and the portion of Line 16(a) actually deducted for the current year. If the percentage shown in Item C(2) is less than 100 percent, the amounts on Lines 1 through 6 and 9, the portions of Lines 7, 11 and 12(a) which do not pass through to Schedule A and the portion of Line 16(a) actually deducted for the current year must be multiplied by this percentage and entered on the appropriate lines of the Nonresident or Part-Year Resident Income Tax Return, Form 740-NP, and related schedules. Lines 8 and 10, and the portions of Lines 7, 11 and 12(a) which pass through to Schedule A should not be multiplied by the percentage in Item C(2). The Kentucky tax credits on Lines 13 and 14 should not be multiplied by the percentage in Item C(2). Refer to specific instructions below and federal Partner's Instructions for Schedule K-1 (Form 1065).

Lines 1 through 3—Enter on federal Schedule E using Kentucky amounts or Form 8582-K, if applicable.

Line 4(a)—Enter on Form 740-NP, Section D, Line 3.

Line 4(b)—Enter on Form 740-NP, Section D, Line 4.

Line 4(c)—Enter on federal Schedule E using Kentucky amounts.

Lines 4(d) and (e)—Enter on federal Schedule D using Kentucky amounts or Form 8582-K, if applicable.

Line 4(f)—Enter on applicable lines of your return (see federal Partner's Instructions for Schedule K-1 (Form 1065)).

Line 5—Enter on applicable line of your tax return (see federal Partner's Instructions for Schedule K-1 (Form 1065)).

Line 6—Enter on federal Form 4797.

Line 7—Enter on applicable lines of your return (see federal Partner's Instructions for Schedule K-1 (Form 1065)).

Line 8—Enter on Schedule A, Form 740-NP.

Line 9—Enter on federal Schedule E using Kentucky amounts.

Line 10—Enter on Schedule A, Form 740-NP.

Line 11—Enter on applicable form or schedule (see federal Partner's Instructions for Schedule K-1 (Form 1065)).

For All Partners

Line 12—See federal Partner's Instructions for Schedule K-1 (Form 1065).

Line 13—Enter credit on Schedule UTC.

Lines 14 and 15—Enter credit on appropriate line of Form 720, 740, 740-NP or 741.

Lines 16(a), 16(b) and 17—See federal Partner's Instructions for Schedule K-1 (Form 1065).

For Individual Partners

Line 18—Enter on Line 2 of the Kentucky Corporation Tax Credit Worksheet located in the instructions under Business Incentive Credits.

Line 19—Enter on Line 7 of the Kentucky Corporation Tax Credit Worksheet located in the instructions under Business Incentive Credits.

Line 20—Enter on Form 740, Form 740-NP or Form 741, Line 30(c).

Estates and Trusts (Form 741 Filers)—Estates or trusts report the amounts shown in Column (b) on Form 741, Kentucky Fiduciary Income Tax Return, and related schedules. See federal Partner's Instructions for Schedule K-1 (Form 1065).

DRAFT
10-4-05

Chapter Six – Related Party Expense Deduction

This chapter explains what conditions must exist for the allowance of the related party expense deduction and for the disallowance of the deduction.

House Bill 272 significantly increased the Department of Revenue's authority to disallow deductions made to related entities. KRS 141.205 was amended to provide the Department the authority to disallow deductions claimed for payments of intangible expenses, intangible interest expenses and management fees made to a related member in an affiliated group or to a foreign corporation.

Under certain conditions, a deduction for payments of intangible expenses, intangible interest expenses and management fees will be allowed.

Effective Date of Related Party Expense Deduction Provisions of House Bill 272

The House Bill 272 provisions that address related party expense deductions are effective for tax years beginning on or after January 1, 2005.

Deductions for Intangible Expenses and Intangible Interest Expenses

KRS 141.205(2) states:

> "A corporation subject to the tax imposed by KRS 141.040 shall not be allowed to deduct an intangible interest expense 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 of an affiliated group or with a foreign corporation as defined in subsection (1) of this section."

TIP: *A drafting error resulted in the inadvertent omission of the term "intangible expense" from KRS 141.205(2). It is the Department of Revenue's position that it will administer the law as if that term was correctly included. You will note below that the law does define the term. The Department will pursue corrective legislation on this issue during the 2006 General Assembly. Any corrective legislation will have a retroactive effective date that will apply to tax periods beginning on or after January 1, 2005.*

KRS 141.205(1)(b) states:

"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."

KRS 141.205(1)(c) states:

"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."

"Affiliated group" has the same meaning as provided in KRS 141.200.

KRS 141.205(1)(g) states:

"Related member" means a person that, with respect to the corporation 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;

A deduction taken on the federal income tax return for intangible expenses and intangible interest expenses should be added to federal taxable income in computing Kentucky net income. On form 720, the add-back amount should be reflected on Part I, line 6.

The adjustment on the return and the disallowance of intangible expenses and intangible interest expenses under the provisions of KRS 141.205(2) will not apply if following conditions provided by KRS 141.205(3) are met:

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

(b) The corporation 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 or the intangible expense between the corporation and the recipient was made at a commercially reasonable rate and at terms comparable to an arm's length transaction; or,

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

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

The Department of Revenue's position on the disclosure requirement referred to in KRS 141.205(3)(b) and (c) is as follows:

1. **"Measured by, in whole or in part, net income"** as referenced in KRS 141.205(3)(b) means that the receipt of the payment by the recipient is reported and included in income for purposes of a tax on net income or in the franchise for purposes of the franchise tax, and not offset or eliminated in a combined or consolidated return which includes the corporation.

2. **"Comprehensive Income Tax Treaty"** as referenced in KRS 141.205(3)(b) means a convention, or agreement, entered into by the United States and approved by Congress, with a foreign government for the allocation of all categories of income subject to taxation and/or the withholding of tax on interest, dividends, and royalties, for the prevention of double taxation of the respective nations' residents, and the sharing of information.

3. As part of the required disclosure, the corporation shall provide a description of the nature of the intangible expense or intangible interest expense payment made to the recipient. This description shall contain a narrative regarding the underlying transaction that gives rise to the payment by the corporation to the recipient, the extent of the rights being transferred (for example, if a patent is being licensed, whether that license is exclusive or nonexclusive, and whether the transferee has any rights to sublicense), how the amount of the payment is calculated and if there is any document that sets forth the terms of the transaction, a copy of that document.

4. Whenever there are actual comparable transactions between the recipient and unrelated parties involving the same intangible property ("actual comparables") to the subject transaction, actual comparables shall be used.

5. When there are no actual comparables, the two primary factors to take into account when determining whether the subject transaction was made at a commercially reasonable rate and at terms comparable to an arm's length transaction are (i) the degree of comparability between the subject transaction and the proposed comparable transactions, and (ii) the quality of the data and assumptions used in the analysis.

6. The required disclosure information must be included with form 720 and must clearly establish that the transaction meets the provisions of KRS 141.205(3).

Practitioner's Question: Will the Department of Revenue accept an Internal Revenue Code Section 482 transfer pricing study or a federal advance pricing agreement that is prepared for the IRS as satisfying the disclosure requirement of KRS 141.205?

Answer: The Department considers the disclosure rules listed above to describe the necessary information that will legitimize an intangibles deduction. The Department will consider the facts and circumstances of each case. In some cases, a study performed under the provisions of Code Section 482 and related regulations will provide substantial documentation towards meeting the disclosure requirement. The Department is still considering to what extent we might adopt some of the information provided under an advance pricing agreement.

Practitioner's Question: Will the Department disallow all related party interest payments?

Answer: No. The intangible interest add-back would only add back those expenses defined in KRS 141.205(1), and would not extend to all related party interest payments. It is important to note that intangible property is defined by KRS 141.205(1)(a) to mean: "franchises, patents, patent applications, trade names, trademarks, service marks, copyrights, trade secrets, and similar types of intangible assets."

Deductions for Management Fees

KRS 141.205(4) states:

> "A corporation subject to the tax imposed by KRS 141.040 shall not be allowed to deduct management fees 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 of an affiliated group or with a foreign corporation as defined in subsection (1) of this section."

A deduction taken on the federal income tax return for management fees should be added to federal taxable income in computing Kentucky net income. On form 720, the add-back amount should be reflected on Part I, line 6.

The adjustment on the return and the disallowance of management fees under the provisions of KRS 141.205(4) will not apply if following conditions provided by KRS 141.205(5) are met:

> "The disallowance of the deduction provided in subsection (4) of this section shall not apply if:
>
> (a) The corporation and recipient are both included in the same consolidated Kentucky corporation income tax return for the relevant taxable year;
>
> (b) The corporation makes a disclosure and establishes by a preponderance of the evidence that the transaction giving rise to the management fees between the corporation and the recipient was made at a commercially reasonable rate and at terms comparable to an arm's-length transaction; or,
>
> (c) The corporation and the Department of Revenue agree in writing to the application or use of an alternative method of apportionment under subsection KRS 141.120(9)."

A corporation must provide a narrative of the services being performed by the recipient of the management fees in order to meet the disclosure requirement of KRS 141.205(5)(b). The narrative must describe in detail how the amount of the payment is calculated and include a copy of any document that sets forth the terms of the transaction.