



# INSTRUCTIONS FOR 1999 KENTUCKY S CORPORATION INCOME AND LICENSE TAX RETURN

# 720S

## IMPORTANT FORM CHANGES FOR 1999

The S corporation income tax forms have been changed so that they can be processed using new scanning and imaging equipment. The new equipment scans the forms, extracts data, and stores images of the document. The changes are part of an *EMPOWER Kentucky* initiative to improve government services and overall operations. The redesign of the S corporation forms and use of the new equipment will greatly increase the speed and accuracy of processing returns and payments. The information requested on the redesigned forms is the same as that requested in prior years.

Several changes are noted throughout the instructions and forms. The most noticeable change is the use of boxes where scannable data is to be entered. Use black ink to enter data. Either handwritten data or machine print is acceptable. Numbers should be written like this:



When entering data in these boxes, the numbers should be right justified (blank spaces should be on the left). **No dollar signs, commas, decimals or other symbols should be used.** If there is no information to be entered in a box, leave it blank. All amounts should be rounded to the nearest dollar and no cents entered. For example, \$11,949.50 or \$11,950.49 would be entered:



There is also a reference mark and form number near the bottom left corner of each form. Please do not write in this area.



**Important:** Use only an **original printed** form or an **approved** computer-generated version of this year's income tax forms since data must be placed in specific areas on the return to be read correctly. Use of photocopies or faxed copies may cause delays in the processing of the return.

Forms and instructions are available at some libraries, post offices, courthouses, banks and all Kentucky Taxpayer Service Centers (see page 8). They may also be obtained by writing FORMS, Revenue Cabinet, Frankfort, KY 40620, or by calling (502) 564-3658. Forms can be downloaded from <http://www.state.ky.us/agencies/revenue>. Forms are also available by fax through the Revenue Cabinet's fax-on-demand system, *TaxFax*, at (502) 564-4459. However, the use of scannable forms received from *TaxFax* may cause delays in processing.

## Tax Treatment of S Corporation and Shareholder(s)

A corporation which elects S corporation treatment for federal income tax purposes in accordance with Sections 1361(a) and 1362(b) of the Internal Revenue Code (IRC) must file as an S corporation for Kentucky income tax purposes. Generally, income earned by an S corporation is taxed at the shareholder level rather than at the corporate level although S corporations are taxed on certain capital gains. Each shareholder includes on

his return, on a pro rata basis, each item of income, loss, deduction or credit of the S corporation that can affect the computation of his tax liability. Pursuant to Section 1366 of the IRC, each such item is treated as if it were realized directly from the source from which it was realized by the S corporation or incurred in the same manner as incurred by the S corporation.

The shareholders, rather than the S corporation, are taxed on the income of the S corporation and some income and expense items are subject to special rules. Therefore, it is necessary to report the S corporation's items of income, loss, expense and credit in two categories: (1) separately stated items and (2) items used to figure nonseparately computed income or loss. Nonseparately computed income or loss is the net income or loss (gross income less allowable deductions) of the S corporation computed after excluding all the items that must be separately stated. The separately stated items and the nonseparately computed income or loss are collectively known as pass through items because they are passed through to the shareholders on a pro rata basis.

S corporations having 15 or more full-year nonresident individual shareholders with no other Kentucky income may receive permission from the Revenue Cabinet to file a combined return in lieu of separate returns for the qualifying shareholders (see Revenue Circular 40C010). For further information, contact the Division of Compliance and Taxpayer Assistance, Revenue Cabinet, Frankfort, KY 40620.

**Banks and Savings and Loan Associations**—KRS 141.010(10)(j) excludes from the Kentucky adjusted gross income of the shareholders the distributive share of net income from an S corporation subject to tax under KRS 136.505, the bank franchise tax, or KRS 136.300, the savings and loan association capital stock tax. KRS 141.010(10)(j) also excludes from the Kentucky adjusted gross income of the shareholders the portion of the distributive share of net income from an S corporation related to a qualified S subsidiary subject to tax under KRS 136.505 or KRS 136.300.

An S corporation subject to tax under KRS 136.505 or KRS 136.300 should enter zero on lines 1 through 6 and 8 and 9 of Form 720S, Schedule K. An S corporation related to a qualified S subsidiary subject to tax under KRS 136.505 or KRS 136.300 should exclude from the amounts entered on lines 1 through 6 and 8 and 9 of Form 720S, Schedule K the portion of these items related to the subsidiary. The net amount of the items of income and deductions excluded from lines 1 through 6 and 8 and 9 of Form 720S, Schedule K should be entered on line 17 of Form 720S, Schedule K. A statement should be attached to each shareholder's Form 720S, Schedule K-1 advising the shareholder that this income is excluded for Kentucky income tax purposes because the S corporation is subject to tax under either KRS 136.505 or KRS 136.300.

## PASS THROUGH TAX CREDITS

**Unemployment Tax Credit**—If an S corporation has hired a Kentucky resident classified as unemployed for at least 60 days and the resident remains in the employ of the S corporation for 180 consecutive days during the tax year (a qualified person), the S corporation may be entitled to the unemployment tax credit. The period of unemployment must be certified by the Cabinet for Workforce Development, Frankfort, KY, and a copy of the certification must be maintained by the S corporation. **KRS 141.065**

The unemployment tax credit is determined by the S corporation and then passed through pro rata to its shareholders. The credit is computed on Schedule UTC which contains detailed instructions and may be obtained from the Revenue Cabinet. To claim the credit, Schedule UTC must be attached.

**Recycling/Composting Tax Credit**—An S corporation, which purchases recycling and/or composting equipment to be used exclusively in Kentucky for recycling or composting post-consumer waste materials, may be entitled to a credit against the income tax imposed on the S corporation by KRS Chapter 141 in an amount equal to 50 percent of the installed cost of the equipment. Application for this credit must be made by the S corporation on Schedule RC, which may be obtained from the Revenue Cabinet. **KRS 141.390**

The approved credit is passed through pro rata to the shareholders of the S corporation. A copy of Schedule RC reflecting the amount of credit approved by the Revenue Cabinet must be attached to the S corporation's return for the year during which the equipment was purchased. The total amount of the approved credit should be entered on Schedule K. The S corporation must compute each shareholder's pro rata share by completing Parts I and II of Schedule RC (K-1), Pro Rata/Distributive Share of Approved Recycling and/or Composting Equipment Tax Credit. A copy of the completed Schedule RC (K-1) should be provided to each shareholder with their Schedule K-1 (Form 720S).

**Kentucky Investment Fund Tax Credit**—An S corporation which is an investor in an investment fund which has been approved by the Kentucky Economic Development Finance Authority (KEDFA) in accordance with KRS 141.20-257 is entitled to a nonrefundable credit against Kentucky income tax. To be entitled to the credit the S corporation must have received approval from KEDFA of the amount of the qualified investment and the amount of the credit.

The approved credit is passed through pro rata to each shareholder. The total amount of the credit should be entered on Schedule K prepared for the taxable year during which the credit is approved by KEDFA, and a copy of the form received from KEDFA that shows the amount of the approved credit should be attached. Each shareholder's distributive share of the credit should be reflected on the Schedule K-1 provided to them for the taxable year during which the credit is approved by KEDFA. Information regarding the approval process for this credit may be obtained from the Cabinet for Economic Development, Department of Financial Incentives at (502) 564-7670.

## GENERAL INFORMATION

**Internal Revenue Code Reference Date**—Effective for taxable years beginning after December 31, 1996, the "Internal Revenue Code" (IRC) for Kentucky income tax purposes means the IRC in effect on December 31, 1997, exclusive of any amendments made subsequent to that date, other than amendments which (1) provide for changes in accounting methods or (2) extend provisions in effect on December 31, 1997, that would otherwise terminate.

**Kentucky Tax Registration Application**—Prior to doing business in Kentucky, each S corporation should complete a Kentucky Tax Registration Application, Revenue Form 10A100. The application is available at Kentucky Taxpayer Service Centers (see page 8) or from the Revenue Cabinet, Taxpayer Registration Section, Frankfort, KY 40620 (see Revenue Circular 10C030). The application may be faxed to (502) 227-0772.

**Who Must File**—A Kentucky S Corporation Income and License Tax Return, Form 720S, must be filed by every S corporation (a) organized under the laws of Kentucky, (b) having its commercial domicile in Kentucky, (c) owning or leasing property in Kentucky, (d) having one or more individuals employed or subject to unemployment insurance tax in Kentucky or (e) which is a partner in a partnership doing business in Kentucky. A limited liability

company (LLC) is treated for Kentucky income tax purposes in the same manner as it is treated for federal income tax purposes. Therefore an LLC filing a U.S. Income Tax Return for an S Corporation, Form 1120S, for federal income tax purposes must file Form 720S. **KRS 141.200, 141.208 and KRS 136.090**

## S Corporations Not Required to File

**Income Tax**—S Corporations which are exempt by law from Kentucky income tax include financial institutions as defined in KRS 136.500, insurance companies, savings and loan associations, corporations exempted by IRC Section 501 and religious, educational, charitable and like corporations not conducted for profit. **KRS 141.040**

**License Tax**—S Corporations which are exempt by law from Kentucky income tax are also exempt from Kentucky license tax. In addition, public service companies subject to ad valorem tax under KRS 136.120, certified alcohol production facilities and certified fluidized bed energy production facilities are exempt from Kentucky license tax. An S corporation doing business in Kentucky solely as a partner in a partnership is not subject to the Kentucky license tax. **KRS 136.070**

Certain unincorporated entities may elect to be treated as S corporations for federal income tax purposes and thus, would be treated as S corporations for Kentucky income tax purposes. However, such entities are not subject to the corporation license tax. Examples of such entities are associations, joint stock companies, LLCs, partnerships and trusts.

**Required Forms and Information**—Each S corporation must enter all applicable information on Form 720S, attach a schedule for each line item or line item instruction which states "attach schedule," and the following forms or schedules, if applicable:

## Kentucky Forms and Schedules

1. Schedule A—Apportionment and Allocation
2. Form 41A720SL—Application for Six-Month Extension of Time to File
3. Schedule K-1 (Form 720S)—Kentucky Shareholder's Share of Income, Credits, Deductions, Etc.

## Required Federal Forms and Schedules

All S corporations **must** provide a copy of the following federal forms submitted to the Internal Revenue Service:

1. Form 1120S, Pages 1 and 3
2. Form 1120S, Page 4, Schedule L, Balance Sheet—**If the S corporation is not required to submit a balance sheet for federal income tax purposes, attach the balance sheet prepared from the books and records of the corporation used to complete Form 720S, Part III—License Tax Computation.**
3. Form 4797—Sales of Business Property
4. Schedule D—Capital Gains and Losses
5. Form 5884—Work Opportunity Credit
6. Schedules for items on Form 1120S, Schedule L, which state "attach schedule."

**Substitute Forms**—Any form to be used in lieu of an official Revenue Cabinet form must be submitted to the Cabinet for prior approval.

**Accounting Procedures**—Kentucky income tax law requires an S corporation to report income on the same calendar or fiscal year and to use the same methods of accounting required for federal income tax purposes. Any federally approved change in accounting periods or methods must be reported to the Revenue Cabinet. Attach a copy of the federal approval to the return when filed. **KRS 141.140**

**Filing/Payment Date**—An S corporation return must be filed and payment must be made on or before the 15th day of the fourth

month following the close of the taxable year. Mail the return with payment to Kentucky Revenue Cabinet, Frankfort, KY 40620. Make the check payable to **Kentucky State Treasurer. KRS 141.160 and KRS 141.220**

If the filing/payment date falls on a Saturday, Sunday or a legal holiday, the filing/payment date is deemed to be on the next business day. **KRS 446.030(1)(a)**

**Extensions**—An extension of time to file an S corporation income and license tax return may be obtained by either making a specific request to the Revenue Cabinet or attaching a copy of the federal extension to the return when filed. **A copy of the federal extension submitted after the return is filed does not constitute a valid extension, and late filing penalties will be assessed.** For further information, see the instructions for Form 41A720SL. **Regulation 103 KAR 15:050**

**NOTE:** An extension of time to file a return does not extend the date for payment of tax.

**Estimated Tax Payments**—Estimated tax payments must be made by each S corporation whose income tax liability for the taxable year can reasonably be expected to exceed \$5,000. In general, the first estimated tax payment must be made by the 15th day of the sixth month of the taxable year. To determine the amount of the first payment, subtract \$5,000 from the estimated full-year tax liability, and divide the result by two. The remaining one-half is due in equal installments on the 15th day of the ninth and 12th month, respectively. The prior year's income tax liability is not a factor in determining whether a declaration of estimated tax is required. **KRS 141.044**

Failure to pay estimated tax installments equal to the amount determined by subtracting \$5,000 from 70 percent of the total income tax liability shown on the return for the taxable year will result in the assessment of an underpayment penalty. The amount of the penalty is 10 percent of the amount of the underpayment, but not less than \$25. **KRS 131.180(3) and KRS 141.990(3)**

The **Corporation Estimated Income Tax Voucher, Form 720ES**, is used to submit estimated tax payments. If the S corporation is required to make estimated tax payments but did not receive Form 720ES, contact the Revenue Cabinet at (502) 564-3658.

**Amended Return**—To correct Form 720S as originally filed, file an amended Form 720S and check the appropriate box on page 1. If the amended return results in a change in income or a change in the distribution of any income or other information provided to shareholders, an amended Schedule K-1 (Form 720S) must also be filed with the amended Form 720S and given to each shareholder. Check Item E(2) on each Schedule K-1 to indicate that it is an amended Schedule K-1.

**Internal Revenue Service Audit Adjustments**—An S corporation which has received final adjustments resulting from Internal Revenue Service audits must submit a copy of the "final determination of the federal audit" within 30 days of the conclusion of the federal audit. Use Form 720S for reporting federal audit adjustments and check the Amended Return box.

**Interest**—Interest at the tax interest rate is applied to corporation income and license tax liabilities not paid by the date prescribed by law for filing the return (determined without regard to extensions thereof). The tax interest rate for 2000 is published in the January 2000 **Kentucky Tax Alert** or you may contact the Revenue Cabinet at (502) 564-8139 to obtain the tax interest rate.

### Penalties

**Failure to file an income and license tax return by the filing date including extensions**—2 percent of the tax due for each 30 days or fraction thereof that the return is late (maximum 20 percent). The minimum penalty is \$10. **KRS 131.180(1)**

**Failure to pay income or license tax by the payment date**—2 percent of the tax due for each 30 days or fraction thereof that the payment is overdue (maximum 20 percent). The minimum penalty is \$10. **KRS 131.180(2)**

**Late payment or underpayment of estimated tax**—10 percent of the late payment or underpayment. The minimum penalty is \$25. **KRS 131.180(3)**

**Failure or refusal to file an income and license tax return or furnish information requested in writing**—5 percent of the tax assessed for each 30 days or fraction thereof that the return is not filed or the information is not submitted (maximum 50 percent). The minimum penalty is \$25. **KRS 131.180(4)**

**Negligence**—10 percent of the tax assessed. **KRS 131.180(7)**

**Fraud**—50 percent of the tax assessed. **KRS 131.180(8)**

**Cost of Collection Fees**—20 percent on all taxes which become final, due and owing. These collection fees are in addition to all other penalties provided by law. **KRS 131.440**

### FORM 720S—SPECIFIC INSTRUCTIONS

#### Period Covered

File the 1999 return for calendar year 1999 and fiscal years that begin in 1999. For a fiscal year, fill in the taxable period beginning and ending at the top of Form 720S.

**All S corporations must fill in the boxes for Taxable Year Ending** at the top right of Form 720 and supporting forms and schedules to indicate the ending month and year for which the return is filed.

- A calendar year is a period from January 1 through December 31 each year. This would be entered in the boxes as:

1 2 9 9

- A fiscal year is 12 consecutive months ending on the last day of any month except December. A fiscal year ending January 31, 2000, would be entered in the boxes as:

0 1 0 0

- A 52/53-week year is a fiscal year that varies between 52 and 53 weeks. A 52/53-week year ending December 27, 1999, or January 4, 2000, would be entered in the boxes as:

1 2 9 9

Failure to properly reflect the **Taxable Year Ending** may result in delinquency notices or billings for failure to file.

**Item A**—The applicable boxes must be checked to identify the S corporation's filing status.

#### Income Tax Filing Status

An S corporation must file on the same basis for Kentucky income tax purposes as for federal income tax purposes.

**Return not required**—Check this box and enter one of the following reason codes if the S corporation is not required to file the income tax return.

Reason  
Code

Reason

- 11 This return contains only the license tax computation. This corporation is a qualified Subchapter S subsidiary which was treated as a division of the parent corporation for income tax purposes. **Item D must be completed by entering the name and the Kentucky Account Number of the parent corporation.**

- 12 This return contains only the license tax computation. The S corporation is exempt from income tax in accordance with Public Law 86-272.

**License Tax Filing Status**

**Separate entity**—Check this box if the license tax return is filed on a separate entity basis.

An S corporation is required to file a separate entity license tax return except as provided in KRS 136.071. **KRS 136.090**

In any case where two or more corporations merge, consolidate or otherwise combine into a single corporation after the close of the taxable year, but before the beginning of the succeeding taxable year, all factors used to determine the corporation license tax liability of the surviving corporation shall be computed on the basis of the consolidated accounting records of such corporations. Attach a schedule listing the corporations included in the return. **KRS 136.100(3)**

**Consolidated**—Check this box if the S corporation qualifies and computes capital employed on a consolidated basis in accordance with KRS 136.071.

An S corporation domiciled in Kentucky which holds stock or securities in other corporations equal to or greater than 50 percent of its total assets (investment ratio) may file a consolidated license tax return with all corporations (except those corporations exempt from tax under KRS 136.070) in which it owns directly or indirectly more than 50 percent of the corporation's outstanding stock. Attach a schedule listing the corporations included in the license tax return and the computation of the investment ratio. Attach a consolidated balance sheet (prepared in columnar form) for the corporations included in the consolidated license tax return. **KRS 136.071**

**Return not required**—Check this box and enter one of the following reason codes if the corporation is not required to file the license tax return.

| Reason Code | Reason  |
|-------------|---|
| 21          | License tax is not due. This S corporation is a public service company subject to taxation under KRS 136.120.   |
| 22          | License tax is not due. The net income tax liability is computed on a short-period basis due to a change in ownership or a change to C corporation status without a change in accounting period (see <b>Item E</b> if a short-period return is filed).  |
| 23          | This return contains only the income tax computation. This S corporation is not organized in Kentucky, does not have its commercial domicile in Kentucky, and does not own or lease property or have individuals receiving compensation in Kentucky, but is the parent of a qualified Subchapter S subsidiary which has operations in Kentucky. |
| 25          | This return contains only the income tax computation. This S corporation carries on business in Kentucky only as a partner in a partnership.  |
| 26          | This return contains only the income tax computation. This entity is an LLC and is therefore not subject to license tax.  |
| 27          | This return contains only the income tax computation. This is an unincorporated entity such as an association, a joint stock company, a partnership or a trust and is therefore not subject to license tax (see Revenue Policy 41P600).   |

**Name and Address**—Print or type the S corporation's name as set forth in the charter. For the address, include the suite, room or other unit number after the street address. If the U.S. Postal

Service does not deliver mail to the street address and the S corporation has a P.O. box, show the box number instead of the street address (see **Item E** if a change in name or address has occurred).

**Telephone Number**—Enter the business telephone number of the principal officer or chief accounting officer signing this return.

**Kentucky Business Code Number**—Enter the principal business activity code number listed in the federal Form 1120S instructions that best describes the principal business activity in Kentucky. Enter a brief description of the Kentucky activity in the appropriate box.

**Federal Business Code Number**—Enter the S corporation's federal principal business activity number from the instructions to Form 1120S.

**NOTE:** The Kentucky and federal business code numbers entered on Form 720S may be different if the principal business in Kentucky varies from the principal business outside Kentucky.

**Item B**—Enter the S corporation's Federal Identification Number. See federal Publication 583 if the corporation has not obtained this number.

**Item C**—Enter the six-digit Kentucky Account Number in the appropriate box at the top of each form and schedule and on all checks and correspondence. This number is located in correspondence received from the Revenue Cabinet as a result of registration.

If the account number is not known, telephone (502) 564-8139.

**Item D**—See Reason Code 11 under Item A.

**Item E**—Check the applicable boxes:

- (a) *LLC*—This return is for a limited liability company.
- (b) *Initial Return*—This return is the S corporation's initial return. Complete questions 1, 2 and 3 on Form 720, page 2, Schedule Q, Kentucky Corporation Questionnaire.
- (c) *Final Return*—This return is the S corporation's final return, i.e., the corporation dissolved, withdrew its qualification, or otherwise ceased to do business in Kentucky during the taxable period.
- (d) *Amended Return*—Submit an explanation for the amended return.
- (e) *Short-period Return*—This return is a short-period return. **Submit an explanation for the short-period return.**
- (f) *Change of Name/Address*—A change in name or address has occurred. **Submit a copy of the amendment of the articles of incorporation for a name change.**

**PART I—ORDINARY INCOME (LOSS) COMPUTATION**

**Line 1**—Enter the amount from Form 1120S, Line 21, ordinary income (loss) from trade or business activities. **Attach Form 1120S, pages 1, 3 and 4.**

**Additions to Federal Ordinary Income**—Lines 2 and 3 itemize items of additional income or unallowed deductions which are differences between federal ordinary income and Kentucky ordinary income.

**Line 2**—Enter state taxes measured in whole or in part by gross or net income. "State" means any state of the United States, the District of Columbia, the commonwealth of Puerto Rico, any territory or possession of the United States or any foreign country or political subdivision thereof (see Revenue Policies 41P100, 41P110, 41P120 and 41P121). Attach a schedule reflecting the total taxes deducted on Form 1120S. **KRS 141.010(11)(a)**

**Line 3**—Enter other differences which result in additions to federal ordinary income in computing Kentucky ordinary income:

- (a) To determine the allowable depletion deduction for Kentucky purposes, the percentage limitations provided by the IRC must be applied to Kentucky gross/net income rather than federal gross/net income. **KRS 141.206**
- (b) Any difference in the gain (loss) upon disposition of intangible assets resulting from a difference between the accumulated federal amortization deduction and the accumulated Kentucky amortization deduction. **Regulation 103 KAR 15:090**

**Line 4**—Enter the total of Lines 1, 2 and 3.

**Subtractions from Federal Ordinary Income**—Lines 5 and 6 itemize items of additional deductions allowed which are differences between federal ordinary income and Kentucky ordinary income.

**Line 5**—Enter the amount of the work opportunity credit reflected on federal Form 5884. For Kentucky purposes, the S corporation may deduct the total amount of salaries and wages paid or incurred for the taxable year (see Revenue Policy 41P090).

**Line 6**—Enter other differences which result in subtractions to federal ordinary income in computing Kentucky ordinary income:

- (a) To determine the allowable depletion deduction for Kentucky purposes, the percentage limitations provided by the IRC must be applied to Kentucky gross/net income rather than federal gross/net income. **KRS 141.206**
- (b) Any difference in the gain (loss) upon disposition of intangible assets resulting from a difference between the accumulated federal amortization deduction and the accumulated Kentucky amortization deduction. **Regulation 103 KAR 15:090**

**Line 7**—Subtract Lines 5 and 6 from Line 4.

## PART II—INCOME TAX COMPUTATION

**KRS 141.040(5) imposes an income tax on certain capital gains of an S corporation. Lines 1 through 7 must be completed if: (1) the S corporation's Kentucky taxable income is more than \$25,000; (2) Kentucky net capital gain is more than \$25,000 and more than 50 percent of taxable income; and (3) the capital gains are not exempt from federal income tax under IRC Section 1374.**

**If the capital gain results in the S corporation being subject to the tax determined in either Part III or Part IV of the federal Schedule D (Form 1120S), the gain is deemed not to be exempt from tax under IRC Section 1374, and therefore, the S corporation is subject to the tax imposed by KRS 141.040(5) if the tests in the above paragraphs are met.**

**If the tests in the above paragraphs are not met, skip Lines 1 through 8, enter zero on Line 9 and complete Lines 10 through 20, where applicable.**

**Line 1**—Enter the taxable income of the S corporation. Taxable income is computed in the same manner as in the case of an individual under KRS 141.010(9) through (11) and the adjustments required under IRC Sections 703(a) and 1363(b) which include all items of income, loss and expense separately stated and all items used to figure nonseparately computed income or loss reported on Form 720S. Attach a schedule used in computing taxable income. **KRS 141.206**

**Line 2**—Subtract the statutory exemption of \$25,000 from Line 1 and enter the amount. **KRS 141.040(5)**

**Line 3**—Enter the net capital gain.

**Line 4**—Subtract the statutory exemption of \$25,000 from Line 3 and enter the amount. **KRS 141.040(5)**

**Line 5**—Enter the lesser of Line 2 or Line 4.

**Line 6**—Enter "100" or the apportionment fraction from Schedule A, Section I, Line 12, if applicable. Schedule A, Section II does not apply to S corporations.

**Line 7**—Multiply the amount on Line 5 by the percentage on Line 6.

**Lines 8(a) through (e)**—To compute the liability, apply the following rates:

- (a) 4 percent of the first \$25,000 of taxable income;
- (b) 5 percent of the amount of taxable income in excess of \$25,000, but not in excess of \$50,000;
- (c) 6 percent of the amount of taxable income in excess of \$50,000, but not in excess of \$100,000;
- (d) 7 percent of the amount of taxable income in excess of \$100,000, but not in excess of \$250,000; and
- (e) 8.25 percent of the amount of taxable income in excess of \$250,000.

**Line 9**—Add Lines 8(a) through (e).

**Short-period Computation of Income Tax**—An S corporation filing an income tax return for a period of less than 12 months is required to annualize taxable net income. To annualize, multiply taxable net income computed for the short period by 365 and divide by the number of days in the short period. The income tax liability shall be the tax computed on the annualized income multiplied by the number of days in the short period and divided by 365 (see Revenue Policy 41P020). Annualization is not permitted if the return is for the initial or final period of operations. **KRS 141.140**

**Line 10—Enterprise Zone Tax Credit.** For employees hired on or after July 14, 1992, an S corporation certified by the Kentucky Enterprise Zone Authority as a qualified business may be entitled to a credit against Kentucky S corporation income tax equal to 10 percent of wages paid to each employee who has been certified by the Cabinet for Workforce Development as having been unemployed for at least 90 days or having received public assistance benefits, based on need and intended to alleviate poverty, for at least 90 days prior to employment with the qualified business. The credit is limited to \$1,500 per employee, and any unused credit may be carried forward for up to five years. To claim the credit, Schedule EZC must be filed (see Revenue Circular 10C001). **KRS 154.45-090**

**Line 11**—Subtract Line 10 from Line 9.

**Line 12**—Enter the total of estimated tax payments made for the taxable year.

**Line 13**—Enter the amount of income tax paid with Form 41A720SL, Application for Six-month Extension of Time to File Kentucky Corporation Income and License Tax Return.

**Line 14**—Enter the amount credited to 1999 from Part II, Line 19 of the 1998 S corporation income tax return.

**Line 15**—Enter the license tax overpayment credited to the 1999 income tax liability from Part III, Line 23.

**Line 16**—If Line 11 is greater than the total of Lines 12 through 15, enter the difference on this line and submit payment.

**Line 17**—If Line 11 is less than the total of Lines 12 through 15, enter the difference.

**Line 18**—Enter the portion of Line 17 credited to the 1999 license tax liability in Part III, Line 20.

**Line 19**—Enter the portion of Line 17 credited to 2000.

**Line 20**—Enter the portion of Line 17 (Line 17 less Lines 18 and 19) to be refunded.

### PART III—LICENSE TAX COMPUTATION

**NOTE:** If the Final Return box in Item E has been checked, no license tax is due. Enter -0- on Line 18 and complete Lines 20 through 25, where applicable.

**Capital Defined**—Capital is defined by KRS 136.070(2) and is not dependent upon the various technical definitions of capital prescribed for accounting, economics or other governmental purposes. Capital includes, but is not limited to, the capital stock accounts, surplus (retained earnings) accounts, intercompany accounts, advances by affiliated companies, borrowed monies (see exceptions in the following paragraph) and all other accounts which represent capital used and employed in the business, such as deferred income or taxes, customer advances and customer deposits. Equity capital required under A.P.B. Opinion 18 shall be included in capital if the S corporation records such equity on its books or general ledger. **KRS 136.070(2)**

Do not include those liabilities representing customer trade accounts and trade notes payable, taxes payable, salaries payable and accounts payable. In the case of borrowed monies, the S corporation may exclude amounts directly borrowed to purchase inventory, provided the S corporation can show that the amounts excluded were specifically used to purchase inventory.

KRS 136.070 provides that the accounts comprising capital shall be reported at the value shown on the financial statement prepared for book purposes, i.e., the value shown on the year-end general ledger after all closing entries have been made. Amounts from various special purpose balance sheets such as equity, businessman's, tax, etc., are not acceptable.

**Line 1**—Enter the year-end balance of capital stock from the balance sheet (Form 1120S, Schedule L). Capital stock consists of the issued and outstanding capital stock, less treasury stock (see Revenue Policy 41P520). **KRS 136.070(2)(a)**

**Line 2**—Enter the year-end balance of additional paid-in capital from the balance sheet (Form 1120S, Schedule L) (see Revenue Policy 41P520). **KRS 136.070(2)(a)**

**Line 3**—Enter the year-end balance of retained earnings from the balance sheet (Form 1120S, Schedule L) (see Revenue Policy 41P520). **KRS 136.070(2)(a)**

**Line 4**—Enter the year-end balance of adjustments to shareholders' equity from the balance sheet (Form 1120S, Schedule L) (see Revenue Policy 41P520). **KRS 136.070(2)(a)**

**Line 5**—Enter the year-end balance of mortgages, notes and bonds payable in less than one year from the balance sheet (Form 1120S, Schedule L). Borrowed monies include short-term borrowing of funds and loans from shareholders (see Revenue Policy 41P520). **KRS 136.070(2)(a)**

**Line 6**—Enter the year-end balance of advances by affiliated companies from the balance sheet (Form 1120S, Schedule L). **KRS 136.070(2)(a)**

**Line 7**—Enter the year-end balance of mortgages, notes and bonds payable in one year or more from the balance sheet (Form 1120S, Schedule L). Borrowed monies include long-term borrowing of funds and loans from shareholders (see Revenue Policy 41P520). **KRS 136.070(2)(a)**

**Line 8**—Enter the year-end balance, or portion thereof, of all other liability accounts, current and long term, that represent additional capital employed in the business from the balance sheet (Form 1120S, Schedule L) (see Revenue Policy 41P520). **KRS 136.070(2)(a)**

**Line 9**—Enter the year-end balance of intercompany accounts. **KRS 136.070(2)(a)**

**Line 10**—Enter the year-end balance of all other accounts representing additional capital used and employed in the business from the balance sheet (Form 1120S, Schedule L). Include all other unspecified accounts which are reported in the Liabilities and Stockholders Equity section of the balance sheet which are not generally categorized or which may be unique to certain businesses (see Revenue Policy 41P520). **KRS 136.070(2)(a)**

**Line 11**—Enter monies borrowed to purchase inventory if the S corporation can show by evidence submitted with the return that the monies were used to purchase inventory. If a line of credit is used, the Revenue Cabinet will accept the following types of evidence to establish that all or a portion of the borrowed money has been used directly to purchase inventory:

1. A copy of the loan agreement, or other document executed at the time the line of credit is established, stating that the sole purpose of the loan is for purchasing inventory. If such a document is submitted to the Revenue Cabinet, the lesser of the balance of the line of credit at the end of the year or the total cost of the inventory purchased for the year will be excluded from the calculation of capital under KRS 136.070.
2. If the S corporation cannot produce documentation that the line of credit is to be used solely for the purchase of inventory, the Revenue Cabinet will allow a pro rata portion of the line of credit balance to be excluded from capital by using a formula to determine the amount of the line of credit reasonably attributable to the purchase of inventory. A copy of the loan agreement or other document executed at the time the line of credit is established must be submitted.
  - (a) The amount of monies borrowed to finance inventory will be determined by multiplying the line of credit balance at the end of the taxable year by a fraction, the numerator of which is cash outlays for inventory during the taxable year and the denominator of which is total cash outlays during the taxable year.
  - (b) Any other formula sufficient to document that all or a portion of the borrowed monies are attributable to the purchase of inventory will be considered by the Revenue Cabinet upon submission.

(See Revenue Policies 41P520, 41P530 and 41P550.)

**Line 12**—This deduction is available only to an S corporation filing a separate entity license tax return which is domiciled in Kentucky and holds stock or securities in other corporations equal to or greater than 50 percent of its total assets (investment ratio). Enter the book value of the S corporation's investment in the stock and securities of any corporation in which it owns more than 50 percent of the corporation's outstanding stock. Attach a schedule showing the computation of the investment ratio and a schedule showing the computation of the deduction listing the name of each corporation, percentage of stock owned and the amount of deduction taken. **KRS 136.071**

**Line 13**—Enter the total of Lines 1 through 12.

**Line 14**—Enter "100" or the apportionment fraction from Schedule A, Section I, Line 12, if applicable.

**Line 15**—Multiply the amount on Line 13 by the percentage on Line 14.

**Line 16**—Multiply the amount on Line 15 by .0021. Enter the result or \$30, whichever is greater. The license tax rate is \$2.10 on each \$1,000 of capital employed in the business in Kentucky or a minimum of \$30. **KRS 136.070(1) and (5)**

**Line 17**—An S corporation with gross income of \$500,000 or less is allowed a credit of \$1.40 per \$1,000 of the first \$350,000 of capital employed (maximum credit \$490) against the license tax. For the purpose of this credit, gross income means total taxable and nontaxable receipts before reduction for cost of goods sold, cost of assets sold or other deductions. **KRS 136.070(a) and Regulation 103 KAR 20:010**

**Line 18**—Subtract Line 17 from Line 16 and enter the result or \$30, whichever is greater.

**Short-period Computation of License Tax**—An S corporation filing a short-period license tax return resulting from a **change in accounting period** is required to annualize its license tax liability. To annualize, subtract Line 17 from Line 16, multiply by the number of months in the short period, divide by 12, and enter the result or \$30, whichever is greater. The license tax liability is not annualized on an initial return. **KRS 136.100**

**NOTE:** No license tax return is required for short periods due to a change in ownership or the termination of the election of S corporation treatment **unless** there is a change in accounting period.

**Line 19**—Enter the amount of license tax paid with the Application for Six-month Extension of Time to File Kentucky Corporation Income and License Tax Return, Form 41A720SL.

**Line 20**—Enter the income tax overpayment credited to the 1999 license tax liability from Part II, Line 18.

**Line 21**—If line 18 is greater than the total of Lines 19 and 20, enter the difference and submit payment.


**Line 22**—If Line 18 is less than the total of Lines 19 and 20, enter the difference.

**Line 23**—Enter the portion of Line 22 credited to the 1999 income tax liability in Part II, Line 15.

**Line 24**—Enter the portion of Line 22 credited to 2000.

**Line 25**—Enter the portion of Line 22 (Line 22 less Lines 23 and 24) to be refunded.

**Tax Payment Summary**—The payment submitted with Form 720S must be itemized. Enter the amount of income tax payment in the Income boxes (Part II, Line 16), the amount of license tax payment in the License boxes (Part III, Line 21), the amount of interest payment in the Interest boxes, the amount of penalty payment in the Penalty boxes, and the total payment in the TOTAL boxes.

 **Signature**—Form 720S must be signed by an authorized corporate officer. **Failure by corporate officers to sign the return, to complete all applicable lines on any required Kentucky form, to attach all applicable schedules including copies of federal forms, or to complete all information on the questionnaire will delay the processing of tax returns and may result in the assessment of penalties.**



## SCHEDULE K-1 (FORM 720S)—KENTUCKY SHAREHOLDER'S SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.

### General Instructions

Schedule K-1 (Form 720S) shows each shareholder's pro rata share of the S corporation's income, deductions, credits, etc. On each Schedule K-1 (Form 720S) enter the names, addresses and identifying numbers of the shareholder and S corporation, complete items A, B, C, D and E. All shareholders' names, Social Security or identifying numbers and other shareholder information must be complete and legible. Schedule K-1 (Form 720S) must be completed and given to each shareholder with instructions on or before the day on which Form 720S is filed with the Revenue Cabinet.

A copy of each shareholder's K-1 (Form 720S) must be attached to Form 720S filed with the Revenue Cabinet, and a copy kept as part of the S corporation's records.

**Photocopies of Schedule K-1 (Form 720S)** may be used in lieu of the official schedule printed by the Revenue Cabinet, provided the photocopies are on bond paper of at least 16 pounds and are of good quality.

### Specific Instructions

Federal instructions for Schedule K-1 (Form 1120S) explain the rules for allocating items of income (loss), deductions, credits, etc., to each shareholder. The total pro rata share items (Column (b)) of all Schedules K-1 (Form 720S) should equal the amounts reported on the same lines of Schedule K (Form 720S), Lines 1 through 19. Lines 21 through 23 do not correspond with Schedule K (Form 720S).

**Multiple Activities**—If items of income, loss or deduction from more than one activity are reported on Lines 1, 2 or 3 of Schedule K-1 (Form 720S), the S corporation must provide information for each activity to its shareholders. See **Passive Activity Reporting Requirements** in the instructions for Schedule K-1 (Form 1120S) for details on the information to be provided on an attachment to Schedule K-1 (Form 720S) for each activity.

**At-Risk Activities**—If the S corporation is involved in one or more at-risk activities for which a loss is reported on Schedule K-1 (Form 720S), the S corporation must report information separately for each at-risk activity. See **Special Reporting Requirements for At-Risk Activities** in the federal instructions for Schedule K-1 (Form 1120S) for details on the information to be provided on an attachment to Schedule K-1 (Form 720S) for each at-risk activity.

**Lines 1 through 20**—Enter the shareholder's total pro rata share of each item listed on Schedule K, Form 720S. **Do not multiply these amounts by the percentage entered on Item D(2).** Attach schedules showing separately the required information for each IRC Section 469 passive activity and each Section 465 at-risk activity. Other schedules are to be attached for line items where requested on Schedule K-1 (Form 720S).

**Line 21**—Enter on attached schedules the supplemental information required to be reported separately to each shareholder for Lines 1 through 20 and any other information or items and amounts not included on Schedule K-1 (Form 720S) that the shareholder needs to prepare a Kentucky income tax return including, but not limited to, any recapture of Section 179 deduction, gross income and other information relating to oil and gas well properties enabling the shareholder to figure the allowable depletion deduction, etc. See instructions for federal Schedule K-1 (Form 1120S), Line 23.

**Lines 22 through 24**—The amounts in Column (b) are to be entered by the shareholder, not the S corporation.

**TAXPAYER ASSISTANCE**

*Forms:*



Support Services Branch  
Revenue Cabinet  
200 Fair Oaks Lane  
Frankfort, KY 40620  
(502) 564-3658  
(502) 564-4459 (Forms by Fax)  
<http://www.state.ky.us/agencies/revenue>  
(Internet)

*Information:*

Corporation Tax Section  
Revenue Cabinet  
P.O. Box 1302  
Frankfort, KY 40602-1302

Revenue Cabinet  
200 Fair Oaks Lane  
Frankfort, KY 40620  
(502) 564-4581  
(502) 564-3058 (Telecommunication Device for the Deaf)



**KENTUCKY TAXPAYER SERVICE CENTERS**

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**, 1502 Westen Street, 42104-3356  
(270) 746-7470

**Corbin**, Falls Road Plaza  
1707 18th Street, Suite 5, 40701-8676  
(606) 528-3322

**Hazard**, 233 Birch Street, 41701-2179  
(606) 435-6017

**Hopkinsville**, 105 Hammond Plaza  
4011 Ft. Campbell Blvd., 42240-4929  
(270) 889-6521

**Lexington**, 301 East Main Street,  
Suite 500, 40507-1556  
(606) 246-2165\*

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

**Northern Kentucky**, Turfway Ridge Office Park  
7310 Turfway Road, Suite 190, Florence, 41042-1385  
(606) 371-9049\*

**Owensboro**, Building C, Suite 201  
401 Frederica Street, 42302  
(270) 687-7301

**Paducah**, Paducah Bank Building, Suites 302/306  
555 Jefferson Street, 42001-1001  
(270) 575-7148

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

*\*Effective April 1, 2000, area code changes from 606 to 859.*

**INTANGIBLE PROPERTY TAXES**—The listing period for intangible property is January 1 through May 15 of each year. Each taxpayer is responsible for reporting intangible property subject to ad valorem taxation. The Intangible Property Tax Return, Revenue Form 62A376, and instructions are included in this packet.

**TANGIBLE PERSONAL PROPERTY TAXES**—The listing period for tangible personal property is January 1 through May 15 of each year. Each taxpayer is responsible for reporting his tangible personalty subject to ad valorem taxation. The Tangible Personal Property Tax Return, Revenue Form 62A500, and instructions can be obtained from the Department of Property Valuation or your local county property valuation administrator's office. A separate form must be filed for each location in Kentucky where you have tangible personal property.

**Kentucky Revenue Cabinet Mission Statement**

To provide courteous, accurate and efficient services for the benefit of Kentucky and its citizens, and administer the tax laws of the Commonwealth in a fair and impartial manner.

\* \* \* \* \*

*The Kentucky Revenue Cabinet does not discriminate on the basis of race, color, national origin, sex, religion, age or disability in employment or the provision of services.*