INSTRUCTIONS—FORM 765

2002 KENTUCKY PARTNERSHIP INCOME RETURN

WHO MUST FILE—Any partnership, syndicate, group, pool or joint venture which derives income from property located in Kentucky or does business in Kentucky must file a partnership return on Form 765.

NEW IN 2002—Qualified Investment Partnerships—Under KRS 141.206(9), nonresident individuals shall not be taxable on investment income distributed by a qualified investment partnership. For purposes of this subsection a "qualified investment partnership" means a partnership formed to hold only investments that produce income that would not be taxable to the nonresident individual if held or owned individually. Check the box on page 1, Line J for qualified investment partnership and inform nonresident partners that the income is not subject to Kentucky income tax.

INCOME/DEDUCTIONS TO BE REPORTED—The income and deductions of a Kentucky partnership are determined under the Internal Revenue Code in effect December 31, 2001, except for differences provided in KRS 141.010 and 141.206. The following differences apply:

(1) Exclude interest income from U.S. government obligations.

(2) Include interest income from obligations of other states and their political subdivisions.

(3) Exclude the 30 percent special depreciation allowance and the additional New York Liberty Zone Section 179 deduction allowed under the Job Creation and Workers Assistance Act of 2002.

For additional instructions for reporting income and deductions, see federal instructions, Form 1065.

INTERNAL REVENUE CODE DEFINED—Kentucky income tax law is based on the federal Internal Revenue Code in effect on December 31, 2001. The Revenue Cabinet generally follows the administrative regulations and rulings of the Internal Revenue Service in those areas where no specific Kentucky law exists.

➤ **ATTACH A COPY OF FEDERAL FORM 1065 AND ALL SCHEDULES.**

SPECIFIC INSTRUCTIONS—The Kentucky Form 765 begins with ordinary income (loss) reported on federal Form 1065, Line 22. Report adjustments to federal ordinary income (loss) on Form 765, **Lines 2, 3, 5, 6 and 7**. See instructions for Lines 2, 6 and 7 for reporting differences in depreciation and basis for assets purchased after September 10, 2001. Prepare a schedule of other differences in federal ordinary income (loss) and report on Lines 3 and 7.

Reporting Depreciation Differences—***Important:*** *Use Lines 2 and 6 only if the partnership has elected for federal income tax purposes to take the 30 percent special depreciation allowance.* For separately stated Distributive Share Items, compute Kentucky income and enter on page 2, Schedule K, Section I. All others attach a copy of the federal Form 4562 filed for federal income tax purposes to verify that no adjustments are required.

Line 2—The amount from Line 22 of the federal Form 4562 must be entered on Line 2, Form 765 and the federal Form 4562 filed for federal income tax purposes must be attached to Form 765.

Line 6—Convert federal Form 4562 to a Kentucky Form 4562 by entering **Kentucky** at the top center of the form above Depreciation and Amortization. Compute Kentucky depreciation and Section 179 deduction in accordance with the IRC in effect on December 31, 2001, by ignoring the lines and instructions regarding the 30 percent special depreciation allowance and the New York Liberty Zone Section 179 deduction. Attach Kentucky Form 4562, and enter the amount from Line 22 of the Kentucky Form 4562 on Line 6.

Reporting Differences in Gain or Loss From Disposition of Assets—If the partnership disposes of assets during the year on which the 30 percent special depreciation allowance was taken for federal income tax purposes, determine and report the difference in the amount of gain or loss on such assets as follows:

Line 7—Convert federal Schedule D, federal Form 4797 and other applicable federal forms to Kentucky forms by entering **Kentucky** at the top center of the form. Compute Kentucky gain or loss from the disposed assets using Kentucky basis. Enter the difference in ordinary income from federal gain or loss and the Kentucky gain or loss on page 1, Line 7, and enter all other Kentucky gains or losses on page 2, Schedule K, Section I. Attach the Kentucky Form 4797 and other forms or schedules to Form 765 as necessary.

Reporting Section 179 Deduction Differences, Line 9—The additional New York Liberty Zone Section 179 deduction is not allowable for Kentucky tax purposes. Enter the Section 179 deduction allowable under the IRC in effect on December 31, 2001, on Schedule K-1. **NOTE:** In determining the Section 179 deduction for Kentucky, the income limitation on Form 4562, Line 11 is Kentucky net income before the Section 179 deduction instead of federal taxable income.

SCHEDULES K and K-1—Complete Kentucky Schedule K, Section II and Schedule K-1 for all nonresident partners. Kentucky Schedules K and K-1 are to be completed for resident partners only if the amounts to be reported are different from the amounts reported on the federal Schedules K and K-1.

SCHEDULE K, SECTION II

A partnership which has all of its property and payroll within Kentucky does not make the computation in Section II and must enter 100 percent on Schedule K-1 (Form 765), Item D(2). A partnership which has property or payroll both within and without Kentucky must compute the percentage of its gross receipts from sales to purchasers or customers in Kentucky or services performed in Kentucky to its gross receipts from sales or services everywhere during the tax year. The terms "sales" or "services" mean all gross receipts derived from transactions or activities in the ordinary and regular course of the partnership's trade or business and which are includible in its gross income. Interest, dividends, royalties and gains or losses on the disposition of property acquired, held, owned or used in **the ordinary or regular course of the partnership's business** are gross receipts used to determine the business ratio. Gross receipts of this kind are included in the Kentucky receipts portion (numerator) of the business ratio if the partnership is domiciled in Kentucky or the source of such income is in Kentucky. If the partnership is domiciled outside of Kentucky but the source of such income is in Kentucky, the gross receipts are in the numerator of the business ratio. The denominator of the business ratio is the total gross receipts in the ordinary or regular course of the partnership's trade or business. Gross receipts, for determining the business ratio, do not include in either the numerator or the denominator interest, dividends, royalties and gains or losses on the disposition of property held for **other than trade or business purposes**.

RECAPTURE OF IRC SECTION 179 DEDUCTIONS—Furnish each partner a schedule showing the amount of IRC Section 179 expense subject to recapture that was originally passed through to the partners. Include the partnership's tax year in which the amount was passed through for tax purposes. Inform the partner if the recapture amount was caused by the disposition of the recovery property.

LIABILITY OF PARTNERS—Partnerships are exempt by law from Kentucky income tax. However, **partners of partnerships doing business in Kentucky must report their share of income for Kentucky income tax purposes**. This applies to individuals, trusts, estates and corporations. Individuals who are Kentucky residents are required to file Form 740 and report their share of partnership income earned within or without Kentucky. Nonresidents are required to file Form 740-NP and report their distributive share of income from partnerships doing business in Kentucky.

COMBINED RETURN—Partnerships having 15 or more full-year nonresident individual partners with no other Kentucky income may receive special permission from the Revenue Cabinet to file a combined return in lieu of separate returns for the qualifying partners. For further information, see Revenue Circular 40C010. Mail your request to: Taxpayer Assistance, P.O. Box 181, Station 56, Frankfort, KY 40602-0181.

LINE 13, KENTUCKY UNEMPLOYMENT TAX CREDIT—Partnerships must complete and attach Schedule UTC to compute the total credit. Compute each partner's distributive share to be entered on Schedules K and K-1, Line 13. The distributive share is determined by multiplying the total credit on Schedule UTC, Line 31, times the percentage of each partner's share of the partnership profits and losses. See Schedule UTC for further instructions.

LINE 14, RECYCLING AND COMPOSTING EQUIPMENT TAX CREDIT—Attach a copy of Schedule RC approved by the Revenue Cabinet to the partnership'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 partnership must compute each partner's distributive share of the total approved credit reflected on Schedule K 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 partner with their Schedule K-1 (Form 765).

LINE 15, OTHER CREDITS—The total amount of the approved credit should be entered on Schedule K. The partnership must compute each partner's distributive share of the total approved credit.

Kentucky Investment Fund—Attach a copy of the certification from Kentucky Economic Development Finance Authority (KEDFA).

Bluegrass Skills Training Corporation—Attach a copy of the final authorizing resolution from the Bluegrass Skills Corporation.

Coal Incentive Tax Credit—Attach a copy of the credit certificate issued by the Revenue Cabinet.

Qualified Research Facility Tax Credit—Attach a copy of Schedule QRFTC.

Employer GED Incentive Tax Credit—Attach completed Forms DAEL-31 for each employee that completed a learning contract during the taxable year.

SCHEDULE K-1, PARTNERS' SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.—**Complete Schedule K-1 for each nonresident partner. For resident partners, complete only if different from federal Schedule K-1.** Schedule K-1 (Form 765) shows each partner's separate share of items to be reported on their individual income tax return. If required, this form must be prepared in triplicate for each partner. One copy of each K-1 must be attached to Form 765 filed with the Kentucky Revenue Cabinet. One copy must be retained with the copy of the partnership return as a part of the partnership's records. One copy with instructions must be given to each partner.

Enter the name, address and identifying number of the partner, and the partnership. Schedule K-1 (Form 765) must be completed and given to each partner on or before the day on which Form 765 is filed with the Revenue Cabinet. Complete items A, B, C, D, E and F, and enter the distributive share of each item listed.

Photocopies of Schedule K-1 (Form 765) 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. You may find it more convenient to make photocopies of the schedule than to order the schedule from the Cabinet. **If photocopies are made, be sure to give each partner a copy of the instructions for Schedule K-1 (Form 765) included on the reverse side of the official schedule.** Prior approval from the Cabinet to use photocopies of Schedule K-1 (Form 765) is not required.

Nonresident Partners' Taxable Percentage—Item D(2) must be completed for nonresident partners. To complete Item D(2) the partnership must enter, in the space provided, its percentage of business in Kentucky. A partnership, which has all of its property and payroll within Kentucky, must enter 100 percent.

For Qualified Investment Partnerships Only—Item D(2), the percentage for nonresident partners is zero (0). Schedule K-1 does not need to be completed for nonresident partners, however, a copy of the federal K-1 must be attached for each nonresident partner.

ASSISTANCE—Additional information or assistance in completing the partnership return may be obtained by contacting the Revenue Cabinet, Frankfort, Kentucky 40620, (502) 564-4581 or 564-3058 Telecommunication Device for the Deaf). Assistance may also be obtained from any Taxpayer Service Center located in the following cities: Ashland, Bowling Green, Corbin, Florence, Frankfort, Hopkinsville, Louisville, Owensboro, Paducah and Pikeville.