

INSTRUCTIONS

2004 KENTUCKY S CORPORATION INCOME AND LICENSE TAX RETURN

NOTICE—NONRESIDENT WITHHOLDING

For taxable years ending on or after December 31, 2003, under the provisions of Regulation 103 KAR 18:070, every pass-through entity required to file Form 765, Kentucky Partnership Income Tax Return, or 720S, Kentucky S Corporation Income and License Tax Return, must withhold income tax at the rate of 6 percent on the net distributive share income of each Kentucky nonresident **individual** partner, shareholder, or member. See **instructions**.

NOTICE—CORPORATION LICENSE TAX CHANGE

Important Change to Corporation License Tax—Effective for tax returns due without regard to extension on or after April 15, 2005, only bank holding companies can take a corporation license tax deduction for investments in majority owned subsidiaries. Please refer to the instructions for bank holding companies on page 2 of these instructions to learn more about the benefit that applies exclusively to that type of corporate entity. All other holding companies will not be able to take a deduction or file a consolidated return under the provisions of KRS 136.071. Holding companies had been allowed to follow the provisions of House Bill 390, which was enacted by the 2003 General Assembly. The provisions of House Bill 390 do not apply to license tax returns due, without regard to extension on or after April 15, 2005.

HOW TO OBTAIN ADDITIONAL FORMS

Forms and instructions are available at some libraries, post offices, courthouses, banks and all Kentucky Taxpayer Service Centers (see page 12). They may also be obtained by writing FORMS, Department of Revenue, Frankfort, KY 40620, or by calling (502) 564-3658. Forms can be downloaded from www.revenue.ky.gov. Forms are also available by fax through the Department of Revenue's fax-on-demand system, *TaxFax*, at (502) 564-4459. Refer to the instructions on scannable forms for information on the use of faxed copies.

KENTUCKY TAX LAW CHANGES

Income Tax Changes

Tobacco Quota Buydown Exemption—Exempts moneys that might be received from a tobacco quota buydown from the state income taxes imposed on individuals and S corporations. **(KRS 141.010)**

Important Changes to Corporate License Tax

Tax Credit Program for Reinvesting in Existing Industry—Creates a tax credit program for existing companies classified under NAICS codes 336211 (motor vehicle body manufacturing), 336111 (automobile manufacturing), 336112 (light truck and utility vehicle manufacturing), and 336120 (heavy duty truck manufacturing) for reinvesting in those industries. Kentucky Economic Development Finance Authority (KEDFA) may give final approval after July 1, 2004. A project must have eligible costs of not less than \$100 million to qualify for the inducements. Approved companies may recover up to 10 percent of the eligible costs against individual income, corporate income and corporate license taxes equal to the tax due from the reinvestment project. The approved company shall not be required to pay estimated income tax payments on income derived from the project. KEDFA may require the approved company to repay all or part of its inducements if the company terminates the agreement. The credits may be taken for a period of up to 10 years. **(HB 510)**

Bank Holding Companies—(Effective for tax periods beginning on or after January 1, 2003.) The 2004 Kentucky General Assembly enacted House Bill 292 on April 13, 2004. On April 22, 2004, Governor Fletcher signed the bill into law. This bill reinstates for bank holding companies, the corporation license tax benefits under KRS 136.071 that were eliminated by the *Illinois Tool Works (ITW)* decision. The reinstated benefits apply to license tax periods beginning on or after January 1, 2003. A bank holding company as defined in KRS 287.900 is allowed to deduct from its taxable capital, the book value of its investment in the stock or securities of subsidiaries that are subject to the bank franchise tax. The investment in subsidiaries subject to the bank franchise tax must be equal to or greater than 50 percent of the bank holding company's total

assets. A bank holding company must own more than 50 percent of the outstanding stock of a bank subsidiary in order to claim the deduction for that subsidiary. A bank holding company that elects to file per KRS 136.071 must deduct the book value of its investment in subsidiaries that are subject to the bank franchise tax from the value of capital stock and reflect the result on Part III, Line 8 of the 2004 Corporation Income and License Tax Return, Form 720. (See instructions for Part III, Line 8.)

This legislation does not permit the filing of a consolidated corporation license tax return. More detail on this issue can be found at the Department of Revenue's Web site at www.revenue.ky.gov. **(HB 292)**

Economic Development Incentives—Increases the amount of tax credit available under the Kentucky Industrial Revitalization Act (KIRA) to 75 percent of approved costs. The KIRA corporation license tax credit language of KRS 136.0704 was changed to allow the credit to be for the license tax attributable to the entire location of the project. This bill also strengthens the state's authority to terminate economic development projects that do not meet the targeted employment amounts. **(HB 593)**

Economic Revitalization Projects—Increases the amount of tax credit available under KIRA to 75 percent of approved costs. KIRA corporation license tax credit language of KRS 136.0704 was changed to allow the credit to be for the license tax attributable to the entire location of the project. These provisions were also enacted by HB 593. **(SB 248)**

Kentucky Investment Fund Act—(Effective after July 1, 2004.) An investment fund approved by the Kentucky Economic Development Finance Authority (KEDFA) that qualifies for tax credits pursuant to the Kentucky Investment Fund Act may invest up to 100 percent of its committed cash contributions in a single knowledge-based entity. A city, county, other local government entity or any entity approved by KEDFA may invest in an investment fund created for the purpose of investing in a single knowledge-based entity and may transfer the approved tax credits to a private entity. **(HB 292)**

IMPORTANT

Corporations must create a Kentucky Form 4562 and Schedule D by converting federal forms.

2003 Federal Changes to Section 179 Election to Expense Deduction and Depreciation Not Adopted by Kentucky—The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) which was signed by President Bush on May 28, 2003, has not been adopted for Kentucky income tax purposes. Thus, the provisions of the JGTRRA which allow a 50 percent special depreciation allowance and an increase in the Section 179 election to expense deduction from \$25,000 to \$102,000 do not apply for Kentucky.

2002 Federal Changes to Section 179 Election to Expense Deduction and Depreciation Still Not Adopted by Kentucky—The Job Creation and Worker Assistance Act of 2002 (JCWAA) which was signed by President Bush on March 9, 2002, still has not been adopted for Kentucky income tax purposes. Thus, the provisions of the JCWAA which allow a 30 percent special depreciation allowance and an additional Section 179 election to expense deduction for New York Liberty Zone property which are retroactive to September 10, 2001, still do not apply for Kentucky.

Depreciation, Section 179 Deduction and Gains/Losses From Disposition of Assets—For taxable years beginning before January 1, 2002, Kentucky depreciation and Section 179 deduction are determined in accordance with the Internal Revenue Code (IRC) in effect on December 31, 1999, and for taxable years beginning after December 31, 2001, Kentucky depreciation and Section 179 deduction are determined in accordance with the IRC in effect on December 31, 2001. For calendar year 2004 returns and fiscal year returns that begin in 2004, any corporation income taxpayer that elects any of the following will have a different depreciation or Section 179 expense deduction for Kentucky purposes than for federal purposes:

- 30 percent bonus depreciation allowance;
- 50 percent bonus depreciation allowance;
- additional Section 179 deduction for New York Liberty Zone Property; or
- increased Section 179 deduction from \$25,000 to \$102,000.

If any of the above federal/Kentucky differences exist, the differences will continue through the life of the assets. There will be recapture and basis differences between Kentucky and federal income tax purposes until the assets are sold or fully depreciated.

Important: If the corporation has not taken the 30 percent special depreciation allowance, the 50 percent special depreciation allowance, the additional Section 179 deduction for New York Liberty Zone Property, or the increased Section 179 deduction for federal income tax purposes on any assets for which a depreciation deduction is being claimed for the taxable year, then no adjustment will be needed for Kentucky income tax purposes. **If federal Form 4562 is required to be filed for federal income tax purposes, a copy must be submitted with Form 720S to verify that no adjustments are required.**

Determining and Reporting Depreciation and Section 179 Deduction Differences—Federal/Kentucky depreciation or Section 179 deduction differences shall be reported as follows:

1. The amount from Line 14a of the federal Form 1120S must be included on Line 3, Part I of Form 720S. **If federal Form 4562 is required to be filed for federal income tax purposes, a copy must be attached to Form 720S.**

2. Convert federal Form 4562 to a Kentucky form 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 special depreciation allowance and the additional Section 179 deduction. **NOTE:** For Kentucky purposes, the maximum Section 179 deduction amount on Line 1 is \$25,000 and the threshold cost of Section 179 property on Line 3 is \$200,000. The \$25,000 maximum allowable Section 179 deduction for Kentucky purposes is reduced dollar-for-dollar by the amount by which the cost of qualifying Section 179 property placed in service during the year exceeds \$200,000. In determining the Section 179 deduction for Kentucky, the income limitation on Line 11 should be determined by using Kentucky net income before the Section 179 deduction instead of federal taxable income.
3. The corporation **must attach the Kentucky Form 4562** to Form 720S, and the amount from Line 22 of the Kentucky Form 4562 must be included on Line 6, Part I of Form 720S and the amount from Line 12 of the Kentucky Form 4562 must be included on Line 8, Section I of Schedule K, Form 720S. A Kentucky Form 4562 must be filed for each year even though a federal Form 4562 may not be required.

Determining and Reporting Differences in Gain or Loss From Disposition of Assets—If during the year the corporation disposes of assets on which it has taken the special depreciation allowance or the additional Section 179 deduction for federal income tax purposes, the corporation will need to determine and report the difference in the amount of gain or loss on such assets as follows:

1. Convert **federal Schedule D (Form 1120S)** and other applicable federal forms to Kentucky forms by entering **Kentucky** at the top center of the form, and compute the Kentucky capital gain net income from the disposed assets using Kentucky basis. Include the amount from Line 6 of the Kentucky Schedule D (Form 1120S) on Line 4(d) or 6, Section I of Schedule K, Form 720S. Include the amount from Line 13 of the Kentucky Schedule D (Form 1120S) on Line 4(e) or 6, Section I of Schedule K, Form 720S. **Federal Schedule D (Form 1120S) filed with the federal return and the Kentucky Schedule D must be attached to Form 720S.**
2. If the amount reported on Line 4 of federal Form 1120S, Net Gain or (Loss) Form 4797, is a gain, include this amount on Line 6, Part I of Form 720S. If the amount reported on Line 4 of federal Form 1120S, Net Gain or (Loss) Form 4797, is a loss, include this amount on Line 3, Part I of Form 720S. Convert **federal Form 4797** and other applicable federal forms to Kentucky forms by entering **Kentucky** at the top center of the form, and compute the Kentucky gain or (loss) from the sale of business property using Kentucky basis. If the amount on Line 17 of Kentucky Form 4797 is a gain, include this amount on Line 3, Part I of Form 720S. If the amount on Line 17 of Kentucky Form 4797 is a loss, include this amount on Line 6, Part I of Form 720S. **Federal Form 4797 filed with the federal return and the Kentucky Form 4797 must be attached to Form 720S.**

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 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 their return, on a pro rata basis, each item of income, loss, deduction or credit of the S corporation that can affect the computation of their 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.

For taxable years beginning on or after January 1, 2004, the Kentucky Department of Revenue will not recognize the filing of a "composite return." The filing of the 740NP-WH report is required and separate filings by the individuals are necessary to take advantage of the graduated tax rates.

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 21 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

Skills Training Investment Tax Credit—To be eligible for this credit, the S corporation must have received a final authorizing resolution from the Bluegrass State Skills Corporation approving 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 final authorizing resolution is issued by the Bluegrass State Skills Corporation, and a copy of the final authorizing resolution should be attached. Each shareholder's distributive share should be reflected on the Schedule K-1 provided to them for the taxable year that the credit is approved.

Information regarding the approval process of this credit may be obtained from the Cabinet for Economic Development, Bluegrass State Skills Corporation at (502) 564-2021.

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 Education Cabinet, Department of Workforce Investment, Office of Employment and Training, 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 \$100 per qualified employee and is computed on Schedule UTC which contains detailed instructions and may be obtained from the Department of Revenue. 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 Department of Revenue. **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 Department of Revenue 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 makes a cash contribution to an investment fund approved by the Kentucky Economic Development Finance Authority (KEDFA) in accordance with KRS 154.20-250 to 154.20-284 is entitled to a nonrefundable credit equal to 40 percent of the investor's proportional ownership share of all qualified investments made by its investment fund and verified by the authority. To be entitled to the credit the S corporation must have received notification from KEDFA reflecting the amount of credit granted and the year in which the credit may first be claimed.

The 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 granted. 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 granted. **A copy of the notification from KEDFA reflecting the amount of credit granted and the year in which the credit may first be claimed must be attached to the return and provided to each shareholder.**

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.

Coal Incentive Tax Credit—Effective for tax returns filed after July 15, 2001, an electric power company or a company that owns and operates a coal-fired electric generating plant may be entitled to a coal incentive tax credit. Application for this credit is made on Schedule CI, Application for Coal Incentive Tax Credit, and a credit certificate is issued by the Kentucky Department of Revenue reflecting the amount of the approved credit.

The approved credit is passed through pro rata to each shareholder. The total amount of the credit from the certificate issued for coal purchases made during the calendar year that ended during the taxable year should be entered on Schedule K, and a copy of the certificate should be attached. Each shareholder's distributive share should be reflected on the Schedule K-1 provided to them for the taxable year. **KRS 141.0405**

Qualified Research Facility Tax Credit—An S corporation is entitled to a credit of 5 percent of the qualified costs of construction, remodeling, expanding or equipping facilities in Kentucky for "qualified research." The credit is passed through pro rata to each shareholder. Schedule QR, Qualified Research Facility Tax Credit, must be attached to the S corporation's return and the total amount of the credit should be entered on Schedule K prepared for the year during which the credit is earned. 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 earned. See instructions for Schedule QR for more information regarding this credit. **KRS 141.395**

GED Incentive Tax Credit—An S corporation is entitled to a state income tax credit for each employee that completed a learning contract in accordance with KRS 151B.127(1)(a) and Regulation 785 KAR 1:120, during the tax year. The credit is for 50 percent of the hours the employee is released from work to study for the general educational development diploma (GED) multiplied by the student's hourly salary. The credit shall not exceed \$1,250 per employee.

The credit is passed through pro rata to each shareholder. The sum of the credits reflected on the GED-Incentive Program Final Report (Form DAEL-31), for each employee that completed a learning contract during the tax year should be entered on Schedule K. Each shareholder's distributive share should be reflected on the Schedule K-1 provided to them for the taxable year. For information regarding the program, contact the Education Cabinet, Kentucky Adult Education, Council on Postsecondary Education.

GENERAL INFORMATION

Internal Revenue Code Reference Date—Effective for taxable years beginning after December 31, 2001, Kentucky Revised Statute (KRS) 141.010(3) was amended to define "Internal Revenue Code" (IRC) for Kentucky income tax purposes to mean the IRC in effect on December 31, 2001, exclusive of any amendments which (1) provide for changes in accounting methods or (2) extend provisions in effect on December 31, 2001, that would otherwise terminate. The following federal law changes have not been adopted for Kentucky income tax purposes:

1. "Victims of Terrorism Tax Relief Act of 2001" signed by President Bush on January 23, 2002.
2. "Job Creation and Worker Assistance Act of 2002" signed by President Bush on March 9, 2002.
3. "Jobs and Growth Tax Relief Reconciliation Act of 2003" signed by President Bush on May 28, 2003.

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 12) or from the Taxpayer Registration Section, Department of Revenue, Frankfort, KY 40620. 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. **KRS 141.206 and KRS 136.090**

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. A single member LLC which is ignored for federal income tax purposes and treated as a division of its member S corporation for federal income tax purposes must be treated in the same manner for Kentucky income tax purposes. **KRS 141.208**

A Qualified Subchapter S Subsidiary (QSSS) which is disregarded as an entity separate from its parent for federal income tax purposes, is treated in the same manner for Kentucky income tax purposes. However, for corporation license tax purposes the QSSS is treated as a separate corporation. Thus, a QSSS which meets any of the criteria in items (a) through (d) of the first paragraph of this section is subject to the Kentucky corporation license tax.

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, except for S corporations exempt from income tax in accordance with Public Law 86-272, 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.
4. Form 740NP-WH—Kentucky Nonresident Income Tax Withholding on Net Distributive Share Income Transmittal Report

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."
7. Form 4562—Depreciation and Amortization
8. Form 8825—Rental Real Estate Income and Expenses of a Partnership or an S Corporation

SCANNABLE FORMS

Application for Six-month Extension of Time to File, Form 41A720SL, and Kentucky Estimated Tax Voucher, Form 720ES, are scannable forms. There are boxes on these forms 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:



Reference Mark—There is a reference mark and form number near the bottom corner of each form. **Please do not write in this area.**



Important: Use only an **original printed** Form 41A720SL or Form 720ES or an **approved** computer-generated version of these forms since data must be placed in specific areas on the form to be read correctly. Use of photocopies or faxed copies may cause delays in the processing of these forms.

Substitute Forms—Any form to be used in lieu of an official Department of Revenue form must be submitted to the department 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 Department of Revenue. Attach a copy of the federal approval to the return when filed. **KRS 141.140**

Mailing/Payment—Mail the return with payment to Kentucky Department of Revenue, Frankfort, KY 40620. Make the check payable to Kentucky State Treasurer.

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 Department of Revenue, 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 Department of Revenue 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 Department of Revenue 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 C(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 2005 is published in the January 2005 **Kentucky Tax Alert** or you may contact the Department of Revenue 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)**

Jeopardy Fee—A \$100 minimum penalty on all nonfiled returns, when the taxpayer fails to file a return or provide information after being requested to do so by the Department of Revenue. **KRS 131.150(2)**

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 \$100. **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

- (a) 25 percent on all taxes which become due and owing for any reporting period, regardless of when due. These collection fees are in addition to all other penalties provided by law. **KRS 131.440(1)(a)**
- (b) 25 percent on all taxes assessed and collected by the Department of Revenue for taxable periods ending before December 1, 2001. **KRS 131.440(1)(b)**
- (c) 50 percent of any tax deficiency assessed after the amnesty period for nonfiled returns eligible for amnesty. **KRS 131.440(1)(c)**

FORM 720S—SPECIFIC INSTRUCTIONS

Period Covered

File the 2004 return for calendar year 2004 and fiscal years that begin in 2004. For a fiscal year, fill in the taxable period beginning and ending at the top of Form 720S.

All S corporations must enter Taxable Year Ending at the top right of Form 720S 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 as:

12 / 04
Mo. Yr.

- A fiscal year is 12 consecutive months ending on the last day of any month except December. A fiscal year ending January 31, 2005, would be entered as:

01 / 05
Mo. Yr.

- A 52/53-week year is a fiscal year that varies between 52 and 53 weeks. *Example:* A 52/53-week year ending the first week of January 2005, would be entered as:

12 / 04
Mo. Yr.

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

The license tax return must be a separate entity return.

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

- 20 License tax is not due. This is the S corporation's final return.
- 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 **Item E** 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.
- 28 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 owner of a single member LLC which has operations in Kentucky.

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 Corporation Income and License 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 Department of Revenue 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 720S, page 2, Schedule Q, Kentucky Corporation Questionnaire.
- (c) *Final Return*—This is the S corporation's final return. The corporation has dissolved or withdrawn. **Submit an explanation.**
- (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. 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) See instructions on page 3 regarding **depreciation and Section 179 deduction differences**, and if applicable, include the amount from Line 14a of the federal Form 1120S. **If federal Form 4562 is required to be filed for federal income tax purposes a copy must be attached.**
- (b) See instructions on page 3 regarding **differences in gain or loss from disposition of assets**. If applicable, include the amount of loss reported on Line 4 of federal Form 1120S

and the amount of gain from Line 17 of Kentucky Form 4797. **Federal Form 4797 filed with the federal return and the Kentucky Form 4797 must be attached.**

- (c) 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**
- (d) 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. **This adjustment does not apply for other federal tax credits.**

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

- (a) See instructions on page 3 regarding **depreciation and Section 179 deduction differences**, and if applicable, include the amount from Line 22 of the Kentucky Form 4562. **Kentucky Form 4562 must be attached.**
- (b) See instructions on page 3 regarding **differences in gain or loss from disposition of assets**. If applicable, include the amount of gain reported on Line 4 of federal Form 1120S and the amount of loss from Line 17 of Kentucky Form 4797. **Federal Form 4797 filed with the federal return and the Kentucky Form 4797 must be attached.**
- (c) 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**
- (d) 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 10 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 Part III 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, complete only Lines 11 through 19, 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 excess of net long-term capital gain, Line 13, Part II of federal Schedule D (Form 1120S), over any net short-term capital loss, Line 6, Part I of federal Schedule D (Form 1120S).

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.

Line 8—Income Tax Liability. 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.

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. **Annualization is not permitted if the return is for the initial or final period of operations. KRS 141.140**

Corporation Enterprise Zone Credit Update—Effective December 31, 2003, the Louisville and Hickman enterprise zones expired. For corporate tax purposes, qualified businesses in the Louisville and Hickman enterprise zones will no longer be able to claim a credit for tax year ended 2004. However, previous year carryforwards will be allowed. A schedule of this carryforward will be required.

Line 9—Enterprise Zone Tax Credit. Except for the companies located within the former Louisville and Hickman enterprise zones, 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 Education Cabinet, Department of Workforce Investment, Office of Employment and Training, 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. **This is a nonrefundable credit. Therefore, it cannot exceed the amount on Line 8. KRS 154.45-090**

Line 10—Subtract Line 9 from Line 8.

Line 11—Enter the total of estimated tax payments made for the taxable year.

Line 12—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 13—Enter the amount credited to 2004 from Part II, Line 18 of the 2003 S corporation income tax return.

Line 14—Enter the license tax overpayment credited to the 2004 income tax liability from Part III, Line 21.

Line 15—If Line 10 is greater than the total of Lines 11 through 14, enter the difference on this line and submit payment.

Line 16—If Line 10 is less than the total of Lines 11 through 14, enter the difference.

Line 17—Enter the portion of Line 16 credited to the 2004 license tax liability in Part III, Line 18.

Line 18—Enter the portion of Line 16 credited to 2005.

Line 19—Enter the portion of Line 16 (Line 16 less Lines 17 and 18) to be refunded.

PART III—LICENSE TAX COMPUTATION

NOTE: If a Final Return box in Item E has been checked, no license tax is due. Complete only Lines 19 through 23, where applicable.

Single Member of LLC—An S corporation which is the owner of a single member LLC must use a balance sheet which does not include the assets, liabilities and surplus items of the LLC to determine its capital employed. However, the corporation's balance sheet would include its investment in the LLC as though the LLC is a separate entity. Likewise, the sales, property and payroll of the LLC must be disregarded in computing the S corporation's Kentucky apportionment factor, if 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 capital stock, surplus, advances by affiliated companies, intercompany accounts and borrowed moneys. **KRS 136.070(2) and Regulation 103 KAR 20:020**

Balance Sheet—KRS 136.070(2)(a) provides that the accounts comprising capital shall be reported at the value shown on the financial statement prepared for book purposes. Regulation 103 KAR 20:020 defines "financial statement prepared for book purpose" to mean:

- (a) the balance sheet prepared on a consistent basis from the S corporation's books and records as of the last day of the taxable year; and
- (b) if the balance sheet presentation of an account is questioned, a financial statement prepared as required by generally accepted accounting principles.

The balance sheet presented for federal income tax purposes (Form 1120, Schedule L) is the balance sheet that generally meets this definition. **KRS 136.070(2)(a) and Regulation 103 KAR 20:020**

Line 1—Enter the value of capital stock computed as follows:

- (a) The sum of:
 1. the par value of all issued and outstanding shares of stock having a par value; and
 2. the amount of consideration received by the S corporation for shares of stock issued and outstanding without a par value.

- (b) Less treasury stock. **Regulation 103 KAR 20:020, Section 1 (6)**

Line 2(a)—Enter the value of total assets of the corporation computed as follows:

- (a) The sum of:
1. the original cost of the entire property of the S corporation excluding deferred tax benefits; and
 2. equity in affiliated S corporations if the S corporation records the equity on its financial statements prepared for book purposes.
- (b) Less applicable contra-asset accounts.

A schedule reflecting a computation of total assets **must be attached**. **Regulation 103 KAR 20:020, Section 1(17) and Section 3**

Line 2(b)—Enter the total debt of the S corporation including trade payables or accrued operating expense accounts. Debt does not include contingent or estimated liabilities. A schedule reflecting a computation of total debt **must be attached**. **Regulation 103 KAR 20:020, Section 1(8)**

Line 2(c)—Subtract Line 2(b) from Line 2(a) and enter the result here. **Regulation 103 KAR 20:020, Section 1(14)**

Line 2(d)—Enter the amount of capital stock from Line 1. **Regulation 103 KAR 20:020, Section 1(6)**

Line 3—Subtract Line 2(d) from Line 2(c) and enter the result here. **Regulation 103 KAR 20:020, Section 1(16)**

Line 4—Enter the excess if any of the advances by or from affiliated companies over the total advances to affiliated companies. Advances by affiliated companies include liability accounts representing a transfer of cash resulting from a cash management plan. Advances to affiliated companies include asset accounts representing a transfer of cash resulting from a cash management plan. *If advances to affiliated companies exceed advances by affiliated companies, enter zero on this line.* **Regulation 103 KAR 20:020, Section 4**

Line 5—Enter the net of intercompany payable and receivable accounts. Intercompany accounts do not include loans of money, asset or liability accounts between affiliated companies representing transfers of cash resulting from a cash management plan or advances by or to an affiliated company. *If intercompany receivables exceed intercompany payables, enter the amount on this line as a negative.* **Regulation 103 KAR 20:020, Section 5**

Line 6—Enter the year-end balance of all loans including loans from stockholders and bank overdrafts. Borrowed moneys do not include trade accounts or notes payable arising through trade transactions including salaries payable, taxes payable, or accounts representing various types of liabilities incurred for supplies, repairs, or other accounts if the seller allows the purchaser to pay within 30 to 90 days. **Regulation 103 KAR 20:020, Section 5**

Line 7—Enter moneys borrowed to purchase inventory if the S corporation can show by evidence submitted with the return that the moneys were used to purchase inventory. A schedule reflecting a computation of this amount **must be attached**. The exclusion cannot exceed the purchased material cost of ending inventory. If a loan, including a line of credit, is used, the Department of Revenue 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 loan is established, stating that the sole purpose of the loan is for purchasing inventory. If such a document is submitted to the Department of Revenue, the lesser of the loan balance at the end of the year, the total cost of the inventory purchased for the year or the purchased material cost of ending inventory will be excluded from the calculation of capital under KRS 136.070.

2. If the corporation cannot produce documentation that the loan is to be used solely for the purchase of inventory, the Department of Revenue will allow a pro rata portion of the loan balance to be excluded from capital by using a formula to determine the amount of the loan reasonably attributed to the purchase of inventory. A copy of the loan agreement or other document executed at the time the loan is established must be submitted.

- (a) The amount of moneys borrowed to finance inventory will be determined by multiplying the loan 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 moneys are attributable to the purchase of inventory will be considered by the Department of Revenue upon submission.

Line 8—If you are a bank holding company, this deduction is available **only** if you own stocks or securities in banks subject to the bank franchise tax equal to or greater than 50 percent of the bank holding company's total assets (investment ratio). The deduction amount shall include only the investment in subsidiary banks in which the bank holding company owns more than 50 percent of the subsidiary bank's outstanding stock. Attach a schedule showing the following:

1. the actual value of the bank holding company's capital stock;
2. a schedule showing the computation of the investment ratio;
3. the name of each subsidiary bank that was included in the deduction amount;
4. the percentage of stock owned in each subsidiary bank that was included in the deduction amount; and
5. the amount of the investment in each subsidiary that was included in computing the deduction.

Line 9—Combine Line 1 and Lines 3 through 8.

Line 10—Enter "100" or the apportionment fraction from Schedule A, Section I, Line 12, if applicable.

Line 11—Multiply the amount on Line 9 by the percentage on Line 10.

Line 12—Multiply the amount on Line 11 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 13—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. Do not include prior year credit on this line. **KRS 136.070(a) and Regulation 103 KAR 20:010**

Line 14—Subtract Line 13 from Line 12 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 13 from Line 12, 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 15—KIRA Tax Credit. Enter the appropriate amount from Schedule KIRA-L. *This credit is applicable only for those corporations which have been approved by the Kentucky Economic Development Finance Authority (KEDFA) for a Kentucky Industrial Revitalization (KIRA) Project and have executed a Revitalization Agreement with KEDFA. This is a nonrefundable credit. Therefore, it cannot exceed the amount on Line 14. KRS154.26-090 and KRS 136.0704*

Line 16—Net License Tax Liability. Subtract Line 15 from Line 14.

Line 17—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 18—Enter the income tax overpayment credited to the 2004 license tax liability from Part II, Line 17 and any amount credited to 2004 from Part III, Line 22 of the 2003 return.

Line 19—If Line 16 is greater than the total of Lines 17 and 18, enter the difference and submit payment.

Line 20—If Line 16 is less than the total of Lines 17 and 18, enter the difference.

Line 21—Enter the portion of Line 20 credited to the 2004 income tax liability in Part II, Line 14.

Line 22—Enter the portion of Line 20 to be credited to 2005.

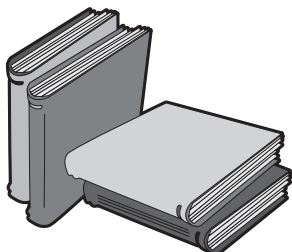
Line 23—Enter the portion of Line 20 (Line 20 less Lines 21 and 22) to be refunded.

Tax Payment Summary—The payment submitted with Form 720S must be itemized. Enter the amount of income tax payment on the Income line (Part II, Line 15), the amount of license tax payment on the License line (Part III, Line 19), the amount of interest payment on the Interest line, the amount of penalty payment on the Penalty line, and the total payment on the TOTAL line.

No Packet Required—The S corporation does not require a forms packet in future years since the forms will be obtained from an alternative source, e.g., software.



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 and C. 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 Department of Revenue. A copy of each shareholder's K-1 (Form 720S) must be attached to Form 720S filed with the Department of Revenue, 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 Department of Revenue, 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) must equal the amounts reported on the same lines of Schedule K (Form 720S), Lines 1 through 23. Lines 24 through 28 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 23—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 B(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 25—Enter on attached schedules the supplemental information required to be reported separately to each shareholder for Lines 1 through 23 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 17.

Lines 26 through 28—The amounts in Column (b) are to be entered by the shareholder, not the S corporation.

TAXPAYER ASSISTANCE

Forms:

Operations and Support Services Branch
200 Fair Oaks Lane
Frankfort, KY 40620
(502) 564-3658
(502) 564-4459 (Forms by Fax)
www.revenue.ky.gov (Internet)



Information:

Corporation Income and License Tax Branch
Department of Revenue
P.O. Box 1302
Frankfort, KY 40602-1302

Department of Revenue
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, 201 West Professional Park Court, 42104-3278
(270) 746-7470

Central Kentucky, 200 Fair Oaks Lane, Frankfort, 40620
(502) 564-4581 (*Taxpayer Assistance*)

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, Corporate Center, Suite 201C
401 Frederica Street, 42301-6295
(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

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 can be obtained from your local county property valuation administrator’s office or the Office of Property Valuation.

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 your local county property valuation administrator’s office or the Office of Property Valuation. You may also go to www.revenue.ky.gov to download these forms. A separate form must be filed for each location in Kentucky where you have tangible personal property.

**Kentucky Department of Revenue
Mission Statement**

The mission of the Kentucky Department of Revenue is to . . .

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

* * * * *

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

YOUR RIGHTS AS A KENTUCKY TAXPAYER

The mission of the Kentucky Department of Revenue (DOR) is to provide courteous, accurate and efficient services for the benefit of the Commonwealth and administer Kentucky tax laws in a fair and impartial manner.

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.

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 on page 12 of the instructions 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.