



COMMONWEALTH OF KENTUCKY
DEPARTMENT OF REVENUE
FRANKFORT, KENTUCKY 40620

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2005 KENTUCKY S CORPORATION INCOME TAX FORMS AND INSTRUCTIONS

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Your Rights as a Kentucky Taxpayer
S Corporation Income Tax Return (Form 720S)
Kentucky Shareholder's Share of Income, Credits, Deductions, Etc.—Schedule K-1 (Form 720S)
Apportionment and Allocation (Schedule A)
Application for Filing Extension (Form 41A720SL)

On March 18, 2005, Governor Ernie Fletcher signed into law House Bill 272, the most sweeping tax change in the history of the Commonwealth. Corporation income and license tax changes in the bill include a repeal of the license tax, a reduction in the top corporation income tax rate, and the taxation of S corporations at the entity level. A credit of the corporation income tax paid by the S corporation is passed through to individual shareholders based on the shareholder's ownership percentage. The instructions on the following pages provide details of the corporation income and license tax law changes. **Please note that this forms packet does not include an intangible property tax form. House Bill 272 repealed the intangible property tax for most intangible property, effective January 1, 2006.** The Department of Revenue looks forward to explaining the law changes to you. You can find additional information about House Bill 272 at our Web site at www.revenue.ky.gov. Please call us at (502) 564-8139 if you have any questions.

IMPORTANT

TAX PRACTITIONERS AND S CORPORATIONS FILING THEIR OWN RETURN

If you wish to no longer receive this forms packet, check the box below and return this page by mail to Kentucky Department of Revenue, Station 52, Frankfort, Kentucky 40620. You may also fax your response to (502) 564-3392 or contact us by e-mail at krc.webresponsecorporationtax@ky.gov.

The Department of Revenue Web site at www.revenue.ky.gov has a printable version of all the forms in this packet.

We do not need to receive the corporation income tax forms packet via mail since we obtain these forms from an alternative source.

Enter Kentucky Corporation Account Number _____

NOTICE—CORPORATION LICENSE TAX CHANGE

Important Change to Corporation License Tax—Effective for tax returns due on or after December 31, 2005, the license tax imposed by KRS 136.070 shall not apply. **KRS 136.0701**

PURPOSE OF THE FORMS PACKET

This packet has been designed for S corporations, both domestic and foreign, which are required by law to file a Kentucky S corporation income tax return. It contains the forms and schedules needed by most S corporations. Refer to the chart on page 3 to determine what corporation income tax form your business needs to file. Other schedules are available from the Department of Revenue or Kentucky Taxpayer Service Centers (see page 14).

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 14). 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. Refer to the instructions on scannable forms for information on the use of faxed copies.

KENTUCKY TAX LAW CHANGES

CORPORATION LICENSE TAX

Repealed—(Effective for tax periods ending on or after December 31, 2005.) The corporation license tax is repealed. Returns and tax for prior periods remain due. **KRS 136.070**

A corporation license tax return due without regard to extension on or after April 15, 2004 for a corporation, other than a bank holding company, that holds directly or indirectly stock in other corporations equal to or greater than 50 percent of its total assets may compute its capital employed based upon: (1) a consolidated license tax return that includes the parent and all subsidiary corporations in which the parent owns more than 50 percent of the outstanding stock; or (2) a separate license tax return and deducting the book value of its investment in the stock and securities of any corporation in which it owns more than 50 percent of the outstanding stock. **KRS 136.071**

CORPORATION INCOME TAX

Rate Reduction—(Effective for tax periods beginning on or after January 1, 2005.) The top corporate rate is reduced and lower brackets expanded. The 4 percent bracket applies to the first \$50,000 of taxable net income and the 5 percent bracket applies to taxable net income between \$50,001 and \$100,000. For taxable years beginning on or after January 1, 2005, and prior to January 1, 2007, the top corporate rate will be 7 percent on all taxable net income over \$100,000. For tax years beginning on or after January 1, 2007, the top rate will be 6 percent on all taxable net income over \$100,000. **KRS 141.040**

Corporation Income Tax Base Expansion—(Effective for tax periods beginning on or after January 1, 2005.) The corporation income tax base is expanded to include corporations, LLPs, LLCs, including single member LLCs, limited partnerships, and S corporations. General partnerships and sole proprietorships will not be subject to the expanded corporation income tax. Publicly traded partnerships and their limited partnership and limited liability company affiliates will be taxed as general partnerships. A pass-through entity subject to corporation income tax does not pass through income, loss or credit to other entities subject to corporation income tax. Individual partners, members or shareholders of pass-through entities subject to corporation income tax will receive credit for tax paid at the entity level. **KRS 141.010 and KRS 141.040**

Reference to Internal Revenue Code (IRC)—(Effective for tax periods beginning on or after January 1, 2005, except where otherwise indicated.) The IRC reference date is updated to December 31, 2004, except that depreciation and Section 179 expenses are calculated based on the IRC in effect on December 31, 2001, and the federal NOL carryback provisions do not apply. By updating the reference date, Kentucky's tax laws conform more closely with federal laws, providing ease of filing for taxpayers and ease of administration for the Department of Revenue. **KRS 141.010**

Alternative Minimum (AMC)—(Effective for tax periods beginning on or after January 1, 2005.) Taxpayers must pay the greater of the income tax, the alternative minimum tax or \$175. Taxpayers must select between the lesser of the two methods to calculate the alternative minimum: 9.5 cents per \$100 of the corporation's gross receipts or 75 cents per \$100 of the corporation's Kentucky gross profits. Kentucky gross profits mean Kentucky gross receipts reduced by returns and allowances attributable to Kentucky gross receipts, less Kentucky cost of goods sold. Cost of goods sold includes direct labor and the cost of specialized transportation for gasoline and special fuels. **KRS 141.040**

Mandatory Nexus Consolidated Returns—(Effective for tax periods beginning on or after January 1, 2005, except as otherwise noted.) All corporations with nexus in Kentucky that are connected through an ownership interest of 80 percent or more must file a consolidated Kentucky return. This includes the expanded definition of corporation, with limited liability entities included in the affiliated group. **KRS 141.200**

Intangible Property, Management Fees and Other Related Party Expenses—Certain deductions relating to transactions with one or more related members of an affiliated group may be disallowed unless:

1. the corporation and the related member are included in the same consolidated Kentucky corporation income tax return for the relevant taxable year;
2. a disclosure is made and evidence provided to establish that the transaction was at arm's length, that the payment made to a related member was subject to income tax in another jurisdiction, and the related member has substantial business activities other than the management or ownership of intangible property;
3. a disclosure is made and evidence provided that the recipient regularly engages in transactions with one or more unrelated parties on terms identical to that of the subject transactions; or
4. the Department of Revenue and taxpayer agree in writing to an alternative method of apportionment. **KRS 141.205**

Doing Business Nexus Standard—(Effective for tax periods beginning on or after January 1, 2005.) The standard in Kentucky changes from a "physical presence" standard to a "doing business" standard. "Doing business" includes deriving income from or attributable to sources within this state. **KRS 141.010(25)**

Net Operating Losses (NOL)—(Effective for tax periods beginning on or after January 1, 2005.) Corporations may no longer carry NOLs back to previous years. **KRS 141.011**

Multiple Taxing Jurisdictions (Apportionment)—(Effective for tax periods beginning on or after January 1, 2005.) All limited liability entities, S corporations and limited partnerships subject to corporation income tax that do business within and without Kentucky and general partnerships that do business within and without Kentucky will be required to utilize a three-factor apportionment formula to apportion income to Kentucky. **KRS 141.120 and KRS 141.206**

Phase II Tobacco Payments—(Effective for tax periods beginning on or after January 1, 2005.) State funds that may be paid out as an addition to or a replacement of Phase II tobacco payments are exempt from corporation income tax. **KRS 141.010**

Pass-Through Entity Income—Exclude the distributive share income or loss received from a corporation subject to the tax imposed by KRS 141.040. **KRS 141.010**

Conversion—An ordinary corporation may convert to a nonprofit, nonstock corporation under KRS Chapter 273. **KRS 273.382**

Economic Development Incentives and Credits

New Limits on Kentucky Investment Fund Act (KIFA) Credits—(Effective July 1, 2005.) KIFA tax credits available to any single investment fund are limited to \$1.3 million for all investors and all taxable years. Total KIFA tax credits available for all investors in all investment funds shall not exceed \$5 million per fiscal year. **(2005 Acts of the General Assembly, Chapter 173)**

Voluntary Environmental Remediation (Brownfields) Credit—(Effective for tax periods beginning after December 31, 2004.) Taxpayers who agree to clean up or develop an existing abandoned brownfield area may qualify for a credit against corporation or individual income taxes in a maximum amount of \$150,000. **KRS 141.418**

Biodiesel Credit—(Effective for tax periods beginning on or after January 1, 2005.) Credits may be taken against corporation or individual income taxes for producing or blending biodiesel

fuels of up to \$1 per gallon produced or blended, limited to a maximum statewide credit of \$1.5 million. The credit may not be carried forward. **KRS 141.422 to 141.425**

Recycling Tax Credits—(Effective for tax periods beginning after December 31, 2004.) Corporation and individual income tax recycling credits available are expanded for major recyclers who make a significant investment in plant and equipment and who meet certain employment standards. Credits are allowed for up to 50 percent of the cost of new and expanded recycling equipment, limited each taxable year to 50 percent of the total tax liability for the year the credit is claimed over the tax liability for the most recent taxable year ending prior to January 1, 2005 or \$2.5 million, whichever is less. This bill also provides for the recapture of the credit if the equipment is no longer used in a qualifying manner or is sold or disposed of within five years from the date it is purchased, based upon the useful life of the equipment and year of disposition. An exception to the recapture exists in the case of transfers due to death or change in business ownership or organization as long as the equipment remains qualifying equipment. **KRS 141.390**

Historic Preservation Restoration Credit—(Effective for tax periods ending on or after December 31, 2005.) This bill allows a credit against corporation or individual income taxes for a portion of the cost of restoring a qualified residential and commercial structure listed on the National Registry of Historic Places. The credit is equal to 30 percent of the rehabilitation expenses, in the case of owner-occupied residential property, and 20 percent of the rehabilitation expenses, in the case of all other property. The total credit available is capped at \$3 million annually, with each individual owner-occupied property receiving no more than \$60,000. **KRS 171.397**

| Filing Form Guide | |
|--|---|
| Ownership Scenario | Form Required |
| 1. C corporation | 720 |
| 2. Disregarded single member LLC whose single member is a C corporation | 720 |
| 3. Disregarded single member LLC whose single member is an S corporation | 720S |
| 4. Disregarded single member LLC whose single member is a partnership | 765 |
| 5. Nexus consolidated group of affiliated corporations with a C corporation common parent and LLC affiliates | 720 |
| 6. Nexus consolidated group of affiliated corporations with a multi-member LLC common parent and LLC affiliates | 765 if common parent is taxed as a partnership for federal tax purposes 720 if LLC common parent elects to be taxed as a corporation for federal income tax purposes |
| 7. Nexus consolidated group of affiliated corporations with a single member LLC common parent and LLC affiliates | 725 if single member LLC common parent is owned by an individual 720 if single member LLC common parent is owned by a C corporation |
| 8. S corporation | 720S |
| 9. Disregarded single member LLC whose single member is an individual | 725 |
| 10. Limited liability partnership with 50/50 partners that are corporations | 765 |
| 11. Limited partnership | 765 |
| 12. Nexus consolidated group of affiliated corporations with an LLP common parent and LLC affiliates. | 765 |
| 13. General partnership | 765-GP |
| 14. Public traded partnership | 765-GP |
| 15. Real estate investment trusts | 720 |
| 16. Financial asset securitization investment trusts | 720 |
| 17. Regulated investment companies | 720 |
| 18. Real estate mortgage investment conduits | 765 |

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 been adopted for Kentucky income tax purposes except for 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 \$105,000.

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, has been adopted for Kentucky income tax purposes except for 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.

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 2005 returns and fiscal year returns that begin in 2005, 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 \$105,000.

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 page 4, Schedule OI, Line 3, 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 less Line 12 and portions of Line 14 relating to 30 percent and 50 percent special depreciation allowance, must be included on page 4, Schedule OI, Line 7, Form 720S and the amount from Line 12 of the Kentucky Form 4562 must be included on Schedule K, Section I, Line 8. 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 page 4, Schedule OI, Line 8, 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 page 4, Schedule OI, Line 4, 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 page 4, Schedule OI, Line 4, Form 720S. If the amount on Line 17 of Kentucky Form 4797 is a loss, include this amount on page 4, Schedule OI, Line 8, 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 1361(b) of the IRC must file as an S corporation for Kentucky income tax purposes. For taxable years beginning on or after January 1, 2005, S corporations are taxed at the corporate level and shall pay for each taxable year a tax to be computed by the taxpayer (S corporation) on taxable net income as defined in KRS 141.010(14) or the alternative minimum calculation computed under KRS 141.040. In addition, the shareholder's distributive share of net income, gain, loss, or deduction shall be computed as nearly as practicable in a manner identical to that required for federal income tax purposes except for the differences required by KRS 141.010. **KRS 141.420**

Resident shareholders of an S corporation shall report and pay tax on the distributive share of net income, gain, loss, or deduction. Nonresident shareholders of an S corporation shall report and pay tax on the distributive share of net income, gain, loss, or deduction multiplied by the apportionment fraction in KRS 141.120(8). **KRS 141.420(2)**

Resident and nonresident individual shareholders shall be entitled to a nonrefundable credit against tax imposed under KRS 141.020 (Kentucky individual income tax). The credit shall be the shareholders' proportionate share of the tax due from the corporation as determined under KRS 141.040, before the application of any credit identified in KRS 141.0205(4) and reduced by the required minimum imposed by KRS 141.040(6). **KRS 141.420(3)**

For taxable years beginning after December 31, 2004, and before January 1, 2007, the portion of the credit computed as provided above that exceeds the credit that would have been utilized if the corporation's income were taxed at the rates in KRS 141.020 shall be refundable. The refundable portion of the credit shall be the shareholders' proportionate share of the amount computed by multiplying the amount the corporation's income exceeds \$216,600 by 1 percent. **KRS 141.420(3)**

The nonrefundable credit determined above shall not operate to reduce the shareholders' tax due to an amount that is less than what would have been payable were the income attributable to doing business in this state by the corporation ignored.

Banks and Savings and Loan Associations—KRS 141.040(1) excludes financial institutions (banks and savings and loan associations) as defined in KRS 136.500 from tax on taxable net income or alternative minimum calculation as provided in KRS 141.040.

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 10 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 10 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 10 of Form 720S, Schedule K should be entered on Line 13 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.

GENERAL INFORMATION

Internal Revenue Code Reference Date—Effective for taxable years beginning after December 31, 2004, 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, 2004, exclusive of any amendments made subsequent to that date, other than amendments that extend provisions in effect on December 31, 2004, that would otherwise terminate and as modified by KRS 141.0101, except that for property placed in service after September 10, 2001, only the depreciation and expense deductions allowed under Sections 168 and 179 of the Internal Revenue Code in effect on December 31, 2001, exclusive of any amendments made subsequent to that date. **KRS 141.010(3)**

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 14) 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 Tax Return, Form 720S, must be filed by every S corporation: (a) being organized under the laws of this state; (b) having a commercial domicile in this state; (c) owning or leasing property in this state; (d) having one or more individuals performing services in this state; (e) maintaining an interest in a general partnership doing business in this state; (f) deriving income from or attributable to sources within this state, including deriving income directly or indirectly from a trust doing business in this state; or (g) directing activities at Kentucky customers for the purpose of selling them goods or services. **KRS 141.010(25)**

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.

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.

General Partnerships—An S corporation doing business in Kentucky solely as a partner in a general partnership will file Form 720S pursuant to the provisions of KRS 141.010, 141.120 and 141.206. (See Schedule A—Apportionment and Allocation Instructions, Sales Factor.)

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**

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

- 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:

- Form 1120S, Pages 1 through 4
- Form 4797—Sales of Business Property
- Schedule D—Capital Gains and Losses
- Form 5884—Work Opportunity Credit
- Schedules for items on Form 1120S, Schedule L, which state, "attach schedule."
- Form 4562—Depreciation and Amortization
- 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 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 D(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 tax liability not paid by the date prescribed by law for filing the return (determined without regard to extensions

thereof). The tax interest rate for 2006 is published in the January 2006 *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 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 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 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 2005 return for calendar year 2005 and fiscal years that begin in 2005. 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:

$\frac{1}{\text{Mo.}} / \frac{05}{\text{Yr.}}$

- A fiscal year is 12 consecutive months ending on the last day of any month except December. A fiscal year ending January 31, 2006, would be entered as:

$\frac{01}{\text{Mo.}} / \frac{06}{\text{Yr.}}$

- 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 2006, would be entered as:

$\frac{1}{\text{Mo.}} / \frac{05}{\text{Yr.}}$

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

Item A—Number of shareholders (Attach K-1s).

Name and Address—Use the label on the packet mailed to the S corporation. Using the label will accelerate the processing of the return, ensure the proper processing of payments, and eliminate a request for a delinquent return. Cross out any errors and print the correct information on the label. **If the S corporation does not have a label or the name or address is incorrect, 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.

NAICS 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.

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 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 the upper right portion of the address label on the packet or 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—Enter number of QSSS included in return.

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 3, 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.

INSTRUCTIONS FOR PREPARING THE NEW FORM 720S

NOTE: The starting point for computation of Kentucky ordinary income (loss) is on page 4 of this return. This computation is necessary in order to comply with the new corporate statute KRS 141.420(1)(b) which states:

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

SCHEDULE OI (FORM 720S)

PAGE 4—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, 2, 3 and 4.**

Additions to Federal Ordinary Income—Lines 2, 3 and 4 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(13)(a)**

Line 3—Enter federal depreciation (do not include Section 179 deduction). See instructions on page 4 regarding depreciation and Section 179 deduction. If a federal Form 4562 is required to be filed for federal income tax purposes, a copy must be attached.

Line 4—Enter other differences which result in additions to federal ordinary income in computing Kentucky ordinary income:

- (a) See instructions on page 4 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.**
- (b) 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 141.050**
- (c) 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 5—Enter the total of Lines 1, 2, 3 and 4.

Subtractions from Federal Ordinary Income—Lines 6 through 8 itemize items of additional deductions allowed which are differences between federal ordinary income and Kentucky ordinary income.

Line 6—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 7—Enter Kentucky depreciation (do not include Section 179 deduction). See instructions on page 4 regarding depreciation and Section 179 deduction differences, and if applicable, Kentucky Form 4562 must be attached.

Line 8—Enter other differences which result in subtractions to federal ordinary income in computing Kentucky ordinary income:

- (a) See instructions on page 4 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.**
- (b) 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 141.050**
- (c) 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 9—Subtract Lines 6, 7 and 8 from Line 5.

SCHEDULE K (FORM 720S)

General Instructions—Complete all applicable lines entering the total pro rata share amount for each item listed. Federal instructions for Form 1120S and federal Schedule K provide additional information which will assist the S corporation in completing Schedule K, Form 720S.

Special Note for Multiple-Tier Pass-Through Entities

If your organizational structure is composed of multiple tiers of pass-through entities with an individual or individuals as the ultimate owners, you may qualify to pass through income, loss and credit through the multiple tiers to the individual owners. To learn more about this filing situation, please look for specific guidance at the Department of Revenue’s Web site at www.revenue.ky.gov. Guidance on this issue will be posted on our Web site no later than January 1, 2006.

Special Note for Election to Pay Corporation Tax by Individual Shareholder, Partner or Member in Accordance with KRS 141.040(9)(a)

Should a shareholder, partner or member of a pass-through entity taxed as a corporation for Kentucky purposes elect to pay the tax on behalf of the corporation, a form will be designed by the Kentucky Department of Revenue and posted to the Department of Revenue's Web site at www.revenue.ky.gov no later than January 1, 2006.

NOTE: Banks and savings and loan associations see special instructions under Tax Treatment of S Corporation and Shareholder(s) on page 5 of the 720S packet.

Section I—Income (Loss) and Deductions

Line 1—Enter Kentucky ordinary income (loss) from trade or business activities reported on Form 720S, page 4, Schedule OI, Line 9.

Line 2—Enter net income (loss) from rental real estate activities reported on federal Schedule K, Form 1120S, adjusted to reflect any differences in Kentucky and federal income tax laws.

Line 3(a)—Enter the gross income from other rental activities reported on federal Schedule K, Form 1120S.

Line 3(b)—Enter the expenses from other rental activities reported on federal Schedule K, Form 1120S, adjusted to reflect any differences in Kentucky and federal income tax laws.

Line 3(c)—Enter the difference of Line 3(a) and Line 3(b).

Line 4(a)—Enter interest income from federal Schedule K, Form 1120S, adjusted to exclude tax-exempt U.S. government interest, if any, and to include interest income from obligations of states other than Kentucky and their political subdivisions.

Lines 4(b) and 4(c)—Enter the amount of dividend and royalty income reported on federal Schedule K, Form 1120S.

Line 4(d)—See instructions on page 4 of the 2005 Form 720S packet regarding **differences in gain or loss from disposition of assets**, and if applicable, enter the amount from Line 6 of the Kentucky Schedule D that is portfolio income. Report any gain or loss that is not portfolio income on Line 6, Schedule K, Form 720S. **Kentucky Schedule D must be attached to Form 720S.** Otherwise, enter the amount from Line 6 of the federal Schedule D (Form 1120S) that is portfolio income.

Line 4(e)—See instructions on page 4 of the 2005 Form 720S packet regarding **differences in gain or loss from disposition of assets**, and if applicable, enter the amount from Line 13 of the Kentucky Schedule D that is portfolio income. Report any gain or loss that is not portfolio income on Line 6, Schedule K, Form 720S. **Kentucky Schedule D must be attached to Form 720S.** Otherwise, enter the amount from Line 13 of the federal Schedule D (Form 1120S) that is portfolio income.

Line 4(f)—Enter any other portfolio income not reported on Lines 4(a) through 4(e), Schedule K, Form 720S.

Line 5—See instructions on page 4 of the 2005 Form 720S packet regarding **differences in gain or loss from disposition of assets**. If applicable, enter the amount from Line 7 of the Kentucky Form 4797, and **Kentucky Form 4797 must be attached to Form 720S.** Otherwise, enter net gain (loss) under Section 1231 from federal Form 4797. Do not include net gains (losses) from involuntary conversions due to casualties or thefts on this line. Instead, report them on Line 6.

Line 6—Enter all other items of income (loss) of the S corporation not included on Lines 1 through 5. See federal instructions for Schedule K, Form 1120S.

Line 7—Enter total contributions paid by the S corporation during its taxable year and attach a schedule showing separately the contributions subject to the 50 percent, 30 percent and 20 percent limitations. These percentage limitations must be applied to the Kentucky amounts rather than the federal amounts.

Also, enter amount of deduction allowable from Schedule HH for the value of leasehold interest of property donated for living quarters for a homeless family. The ordinary charitable contribution deduction must be reduced by any amount attributable to property on which this deduction is taken.

Line 8—See instructions on page 4 of the 2005 Form 720S packet regarding **depreciation and Section 179 deduction differences**, and if applicable, include the amount from Line 12 of the Kentucky Form 4562. **Kentucky Form 4562 must be attached.** Otherwise, enter Section 179 deduction from federal Form 4562.

Line 9—Enter the expenses related to portfolio income reported on federal Schedule K, Form 1120S, adjusted to exclude expenses related to tax-exempt interest income and other exempt income.

Line 10—Enter any other deductions of the S corporation not included on Lines 7, 8 and 9. See federal instructions for Schedule K, Form 1120S.

Line 11(a)—Enter the S corporation's deductible interest expense allocable to debt on property held for investment purposes. Property held for investment purposes includes property that produces investment income (interest, dividends, annuities, royalties, etc.). The total amount entered should equal the amount of interest expense reported on federal Schedule K, Form 1120S, adjusted to exclude any interest expense on debts incurred to purchase or carry investment property producing, or held for the production of, U.S. government interest income.

Lines 11(b)(1) and (b)(2)—Enter only the investment income included on Lines 4(a), 4(b), 4(c) and 4(f), Schedule K, Form 720S, and only the investment expenses related thereto included on Line 9, Schedule K, Form 720S. See federal instructions for Schedule K, Form 1120S.

Line 12(a)—Enter the information provided on federal Schedule K, Form 1120S, Line 12c(1).

Line 12(b)—Enter the amount reported on federal Schedule K, Form 1120S, Line 12c(2).

Line 13—Enter the total amount of interest income of the S corporation from U.S. government bonds and securities and obligations of Kentucky and its political subdivisions.

Line 14—Enter the total amount of any other type of income of the S corporation on which the shareholder is exempt from Kentucky income tax.

Line 15—Enter the total amount of nondeductible expenses paid or incurred by the S corporation including, but not limited to, state taxes measured by gross/net income, expenses related to tax-exempt income, etc. Do not include a deduction reported elsewhere on Schedule K, Form 720S, capital expenditures or items the deductions for which are deferred to a later year.

Line 16—Enter the amount reported on federal Schedule K, Form 1120S, Line 16d.

Line 17—Attach schedules to report the S corporation's total income, expenses and other information applicable to items not included on Lines 1 through 16 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 shareholders to figure the allowable depletion deduction, and any other information the shareholders need to prepare their Kentucky income tax returns. See federal instructions for Schedule K, Form 1120S, Line 17d.

Line 18—Enter the amount reported on federal Schedule K, Form 1120S, Line 17c.

Section II—Kentucky Distributable Corporation Income and Tax Credits

Line 1—Enter the total of shareholders' net distributive share of taxable income (loss) from page 1, Part I, Line 24.

Line 2—Multiply Line 1 by the individual shareholders' total percentage ownership.

Line 3—Enter amount from page 2, Part VI, Line 4.

Line 4—Enter amount from page 2, Part VI, Line 5.

Nonresident Withholding (Form 740NP-WH)

For taxable years ending on or after December 31, 2003, under the provisions of Regulations 103 KAR 18:070, every general partnership required to file Form 765-GP, Kentucky General Partnership Income Return, must withhold income tax at the rate of 6 percent on the net distributive share income not taxed at the corporate level of each nonresident **individual** partner. However, for those Kentucky nonresident general partners whose net distributive income not taxed at the corporate level is less than \$1,000, no withholding is required. All general partnerships are liable for the payment of the tax required to be withheld less any credits passed through to the individual partner that are reasonably expected to be claimed in the current year.

The reporting of net distributive share income and payment of tax due by the general partnership shall satisfy the filing requirement for a Kentucky nonresident individual general partner (Form 740-NP) whose only Kentucky source income is net distributive share income from the general partnership. The Kentucky nonresident individual partner may file a Kentucky individual return (Form 740-NP) to take advantage of the graduated tax rates and apply the tax withheld against tax imposed on the individual return for the taxable year in which the income is reported.

For taxable years beginning January 1, 2005, there is no withholding at the entity level on net distributive share of income not taxed at the corporate level of a nonresident individual partner/member of a partnership (LLC, LLP and LP taxed as a corporation) or nonresident shareholder of an S corporation. However, distributive share dividend income to a nonresident individual partner/member or shareholder and guaranteed payments paid to a nonresident individual partner are subject to Kentucky individual income tax and Form 740-NP must be filed if the nonresident individual shareholder/partner has gross income from Kentucky sources and a total gross income exceeding the threshold amount determined under KRS 141.066. KRS 141.180(2)(c)

General partnerships having Kentucky individual nonresident partners with net distributive share income of \$1,000 or more shall complete Form 740NP-WH and Form PTE-WH for each individual nonresident partner and mail Form 740NP-WH and Copy A of PTE-WH to the Kentucky Department of Revenue with payment. The general partnership must furnish Copies B and C of Form PTE-WH to the general partners by the 15th day of the fourth month following the close of the taxable year. Form PTE-WH is available on the Kentucky Department of Revenue's Web site at www.revenue.ky.gov.

PAGE 1 INSTRUCTIONS

PART I – TAXABLE INCOME COMPUTATION

The following line items are necessary in order to compute corporation taxable income:

Line 1—Enter the amount from Schedule K, Section I, Line 1—Kentucky Ordinary income (loss) from trade or business activities.

Line 2—Enter the amount from Schedule K, Section I, Line 2—Net income (loss) from rental real estate activities.

Line 3—Enter the amount from Schedule K, Section I, Line 3(c)—Net income (loss) from other rental activities.

Line 4—Enter the amount from Schedule K, Section I, Line 4(a)—Interest income.

Line 5—Enter the amount from Schedule K, Section I, Line 4(c)—Royalty income.

Line 6—Enter the gain (if loss, enter zero) from Schedule K, Section I, Line 4(d)—Net short-term capital gain (loss). A corporation may only use its capital losses to offset its capital gains (Code Sec. 1211(a)). A corporation may carry back a capital loss to each of the three tax years preceding the loss year. Any excess may be carried forward for five years following the loss year. However, the amount carried back is limited to an amount that does not cause or increase a net operating loss in the carryback year (Code Sec. 1212(a)(1)). **For a corporation, whose first tax year begins in 2005, capital losses shall be carried forward.**

Line 7—Enter the gain (if loss, enter zero) from Schedule K, Section I, Line 4(e)—Net long-term capital gain (loss). A corporation may only use its capital losses to offset its capital gains (Code Sec. 1211(a)). A corporation may carry back a capital loss to each of the three tax years preceding the loss year. Any excess may be carried forward for five years following the loss year. However, the amount carried back is limited to an amount that does not cause or increase a net operating loss in the carryback year (Code Sec. 1212(a)(1)). **For a corporation, whose first tax year begins during 2005, capital losses shall be carried forward.**

Line 8—Enter the amount from Schedule K, Section I, Line 4(f)—Other portfolio income (loss).

Line 9—Enter the amount from Schedule K, Section I, Line 5—Section 1231 net gain (loss).

Line 10—Enter the amount from Schedule K, Section I, Line 6—Other income (loss).

Line 11—Enter the total of Lines 1 through 10.

Line 12—KRS 141.010(12) adjustments which were not made in the Ordinary Income (Loss) Computation or Schedule K, Section I, Lines 1 through 10 and Line 12(b):

- Enter related party and intangible expenses prohibited by the provisions of KRS 141.205.
- Enter expenses related to nontaxable income.
- Add net distributive loss received from a corporation subject to the tax imposed by KRS 141.040.
- Subtract net distributive income received from a corporation subject to the tax imposed by KRS 141.040.
- Enter any other adjustments provided by KRS 141.010(12).

Line 13—Enter the total of Lines 11 through 12(e).

Line 14—Enter the amount from Schedule K, Section I, Line 7—Charitable contributions adjusted, if applicable, as follows:

Limitation on Deduction—The total amount of charitable contributions claimed cannot be more than 10 percent of net income on Line 23 computed without regard to the deduction for contributions. **KRS 141.050**

Carryover—Charitable contributions over the 10 percent limitation cannot be deducted for the tax year but can be carried over to the next five years.

Special rules apply if the corporation has a net operating loss deduction (NOLD) for the tax year (does not apply to 2005 tax year). In figuring the charitable contribution deduction for the tax year, the 10 percent limit is applied using the taxable income after taking into account any deduction for the NOLD.

Line 15—Enter the amount from Schedule K, Section I, Line 8—Section 179 expense deduction.

Line 16—Enter the amount from Schedule K, Section I, Line 9—Deductions related to portfolio income (loss).

Line 17—Enter the amount from Schedule K, Section I, Line 10—Other deductions.

Line 18—Enter the amount from Schedule K, Section I, Line 12(b)—Amount of Section 59(e)(2) expenditures. The election of Code Section 59(e)(1) shall be made by the corporate entity. If the corporate entity elects the optional 10-year write-off provided by Code Section 59(e)(1) the amount entered on Line 16 would be the qualified expenditures taken ratably over 10-year period (3-year period is the case of circulation expenses). Intangible drilling and development costs may be deducted over a 60-month period, beginning with the month paid or incurred.

Line 19—Enter the total of Lines 14 through 18.

Line 20—Enter depletion for oil and gas properties. To determine the allowable depletion deduction for Kentucky purposes, the percentage limitation provided by the Internal Revenue Code must be applied to Kentucky gross/net income rather than the federal gross/net income. **KRS 141.050**

Line 21—Enter other adjustments provided by KRS 141.010(13) which were not made in the Ordinary Income (Loss) Computation or Schedule K, Section I, Lines 1 through 10 or 12(b).

Line 22—Enter the total of Lines 19 through 21.

Line 23—Enter Line 13 less Line 22.

Line 24—Enter the amount from Line 23 or the amount from Line 8 of Schedule A, Section II, if applicable. A corporation “doing business in this state” must allocate and apportion its income to Kentucky by using a three factor (payroll, property, and sales) apportionment formula with a double weighted sales factor. “Doing business in this state” includes, but is not limited to: (a) being organized under the laws of this state; (b) having a commercial domicile in this state; (c) owning or leasing property in this state; (d) having one or more individuals performing services in this state; (e) maintaining an interest in a general partnership doing business in this state; (f) deriving income from or attributable to sources within this state, including deriving income directly or indirectly from a trust doing business in this state; or (g) directing activities at Kentucky customers for the purpose of selling them goods or services. **KRS 141.120 and KRS 141.010(25)**

PART II—ALTERNATIVE MINIMUM (AMC)

Line 1—Enter Kentucky gross receipts less Kentucky returns and allowances. For purposes of this paragraph, “gross receipts” means the numerator of the sales factor under the provisions of KRS 141.120(8)(c).

Line 2—Enter the amount of Line 1 multiplied by .00095. For alternative minimum (AMC) purposes Kentucky gross receipts are taxed at 9.5 cents (\$0.095) per \$100.

Line 3—Enter the amount of Kentucky gross receipts before Kentucky returns and allowances.

Line 3(a)—Enter the Kentucky returns and allowances applicable to Kentucky gross receipts on Line 3.

Line 3(b)—Enter the Kentucky cost of goods sold applicable to Kentucky gross receipts on Line 3.

Line 4—Subtract Lines 3(a) and 3(b) from Line 3. For purposes of this paragraph, “Kentucky gross profit” means Kentucky gross receipts reduced by returns and allowance attributable to Kentucky gross receipts, less the cost of goods sold attributable to Kentucky gross receipts (KRS 141.010(27)). Gross profit attributable to Kentucky is determined either by separate accounting by the taxpayer or, if separate accounting is not maintained, by the ratio of Kentucky gross receipts to total gross receipts as provided by KRS 141.120(8)(c).

Line 5—Enter the amount of Line 4 multiplied by .0075. For alternative minimum (AMC) purposes Kentucky gross profit is taxed at 75 cents (\$0.75) per \$100.

PART III—TAX COMPARISON

Line 1—Enter the regular income tax. The following rates are applied to the taxable net income on Part I, Line 24:

- (a) 4 percent of the first \$50,000 of taxable net income;
- (b) 5 percent of taxable net income in excess of \$50,000, but not in excess of \$100,000; and
- (c) 7 percent of taxable net income in excess of \$100,000.

Short-period Computation of Income Tax—A corporation filing an income tax return for a period of less than 12 months is required to annualize taxable net income. To annualize taxable net income, multiply taxable net income computed for the short period by 365 divided 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. **KRS 141.140**

Line 2—Enter the lesser of Line 2 or Line 5 from Part II.

PART IV—TAX COMPUTATION

Line 1—Enter the amount from Part III, greater of Line 1, Line 2 or \$175 minimum.

Line 2—Enter the recycling/composting equipment tax credit recapture. If the recycling/composting equipment tax credit recapture is for equipment placed in service and approved by the Department of Revenue before January 1, 2005, the corporation may elect to recapture the tax credit at the corporate level (attach Schedule RC-R). If the election is not made, attach Schedule RC-R and a Schedule RC-R (K-1) for each shareholder. **KRS 141.390**

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

Line 4—Enter the total tax credits from Part V, Line 13.

Line 5—Subtract Line 4 from Line 3 and enter result or \$175, whichever is greater. A minimum of \$175 shall be due, regardless of the application of any credits provided under any provisions of the Kentucky Revised Statutes for which the business entity may qualify. **KRS 141.040(6)**

Line 6—Enter the total of estimated tax payments made for the taxable year. Do not include the amount credited from prior year.

Line 7—Enter the amount of tax paid with Form 41A720SL, Application for Six-Month Extension of Time to File Kentucky Corporation Income Tax Return.

Line 8—Enter the amount credited to 2005 from Part II, Line 18 of the 2004 tax return.

Line 9—If Line 5 is greater than the total of Lines 6 through 8, enter the difference on this line and submit payment.

Line 10—If Line 5 is less than the total of Lines 6 through 8, enter the difference.

Line 11—Enter the portion of Line 10 to be credited to 2006.

Line 12—Enter the portion of Line 10 to be refunded (Line 10 less Line 11).

PART V—SCHEDULE OF TAX CREDITS

Line 1—Economic Development Tax Credits. This line should be completed only if the corporation has been approved for one or more of the credits authorized by the Kentucky Rural Economic Development Act (KREDA), the Kentucky Jobs Development Act (KJDA), the Kentucky Industrial Revitalization Act (KIRA), the Kentucky Industrial Development Act (KIDA), the Kentucky Economic Opportunity Zone (KEOZ), the Skills Training Investment Credit Act (STICA) or the Kentucky Reinvestment Act (KRA). **If an amount is entered on this line, the return and applicable schedules must be mailed to Economic Tax Credits, Tax Credits Section, Department of Revenue, P.O. Box 181, Frankfort, KY 40602-0181.**

To qualify for the KREDA, KJDA, KIRA, KIDA, KEOZ or KRA credits, the corporation must be approved by the Kentucky Economic Development Finance Authority (KEDFA) and have executed and activated the appropriate agreement with KEDFA. Form(s) and instructions for the computation of the credit(s) will be mailed to the approved corporation. To claim any of these credits, the applicable tax credit schedule must be attached.

To claim the STICA credit, a copy of the final authorizing resolution received from the Bluegrass State Skills Corporation reflecting the amount of credit awarded must be attached. The credit shall be claimed on the income tax return filed for the taxable year during which the final authorizing resolution is adopted by the Bluegrass State Skills Corporation. If the amount of the credit exceeds the income tax liability for the taxable year during which the final authorizing resolution is adopted by the Bluegrass State Skills Corporation, the excess may be carried forward for three successive years. If the credit claimed is being carried forward from a prior year, attach a schedule reflecting the computation of the amount of credit available to be carried forward in addition to the final authorizing resolution from the Bluegrass State Skills Corporation.

Information regarding the approval process for these credits may be obtained from the Cabinet for Economic Development, Department of Financial Incentives at (502) 564-7670.

Line 2—Historic Preservation Restoration Tax Credit. This line should be completed only if the corporation has been approved for the credit by the Kentucky Heritage Council. Credit allowed against taxes imposed by KRS 141.020 and KRS 141.040 for qualified rehabilitation expenses on certified historic structures. For more information regarding this credit visit the Council's Web site at www.heritage.ky.gov.

Line 3—Unemployment Tax Credit. If a corporation has hired a Kentucky resident classified as unemployed for at least 60 days and the resident remains in the employ of the corporation for 180 consecutive days during the tax year (a qualified person), the corporation may be entitled to the unemployment tax credit. For each qualified person, a one-time nonrefundable credit of \$100 may be claimed. 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 corporation. For certification questions, call (502) 564-7456. To claim this credit, Schedule UTC must be attached. **KRS 141.065**

Line 4—Recycling/Composting Tax Credit. A 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 nonrefundable credit against the income tax imposed on the 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 on Schedule RC, and a copy of the schedule reflecting the amount of credit approved by the Department of Revenue must be attached to the corporation's return on which the credit is claimed. The amount of this credit claimed for the tax year may not exceed 25 percent of the income tax liability and cannot exceed 10 percent of the credit approved in the first year of eligibility.

For taxable years beginning after December 31, 2004, a corporation which purchases recycling and/or composting equipment to be used exclusively in Kentucky for recycling or composting post-consumer waste material that qualifies as a Major Recycling Project is entitled to a nonrefundable credit against the income tax imposed on the corporation by KRS Chapter 141. The credit is an amount equal to 50 percent of the installed cost of the recycling or composting equipment limited to: 50 percent of the excess of the total of each tax liability over the baseline tax liability of the taxpayer or \$2,500,000. To qualify, the taxpayer must: (1) invest more than \$10,000,000 in recycling or composting equipment to be used exclusively in this state; (2) have more than 750 full-time employees with an average hourly wage of more than 300 percent of the federal minimum wage; and (3) have plant and equipment with a total cost of more than \$500,000,000. Application for this credit must be made on Schedule RC, and a copy of the schedule reflecting the amount of credit approved by the Department of Revenue must be attached to the corporation's return on which the credit is claimed. The credit is limited to a period of 10 years commencing with the approval of the recycling credit application.

A taxpayer is entitled to claim the recycling credits in KRS 141.390(a) and (b) but cannot claim both for the same recycling and/or composting equipment.

Enter the amount of additional recycling credit allowed from Schedule RC-R, Disposition of Recycling or Composting Equipment, Line 10. **Schedule RC-R must be attached. KRS 141.390**

Line 5—Coal Conversion Tax Credit. A corporation which converts boilers from other fuels to the use of Kentucky coal or which substitutes Kentucky coal for other fuels in a boiler capable of burning coal and other fuels to produce energy for specific purposes may be entitled to a credit against corporation income tax equal to 4.5 percent of expenditures for Kentucky coal (less transportation costs). Unused portions of this credit may not be carried forward or back. To claim this credit, Schedule CC must be attached. **KRS 141.041**

Corporation Enterprise Zone Update—Effective December 31, 2004, the Ashland and Covington enterprise zones expired. To date, Ashland, Covington, Hickman and Louisville enterprise zones have expired. For corporate tax purposes, qualified businesses in these enterprise zones will no longer be able to claim a credit for tax year ended 2005. However, previous year carryforwards will be allowed. A schedule of this carryforward is required.

Line 6—Enterprise Zone Tax Credit. Except for companies located within the former Ashland, Covington, Hickman and Louisville enterprise zones, for employees hired on or after July 14, 1992, a corporation certified by the Kentucky Enterprise Zone Authority as a qualified business may be entitled to a

nonrefundable credit against Kentucky 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. For certification questions, call (502) 564-3906. 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 attached. **KRS 154.45-090**

Line 7—Kentucky Investment Fund Tax Credit. A corporation which makes a cash contribution to an investment fund approved by 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. The credit may be applied against corporation income tax. **To claim the credit 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.**

The tax credit amount that may be claimed by an investor in any tax year shall not exceed 50 percent of the initial aggregate credit amount approved by the authority for the investment fund which would be proportionally available to the investor. **Example:** *An investor with a 10 percent investment in a fund which has been approved for a total credit to all investors of \$400,000 would be limited to \$20,000 maximum credit in any given year. (\$400,000 x 10% x 50%)*

If the amount of credit that may be claimed in any tax year exceeds the corporation's income tax liability the excess credit may be carried forward, but the carryforward of any excess tax credit shall not increase the limitation that may be claimed in any tax year. Any credit not used in 15 years, including the year in which the credit may first be claimed, shall be lost.

Information regarding the approval process for these credits may be obtained from the Cabinet for Economic Development, Department of Financial Incentives at (502) 564-7670.

Line 8—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 copy of the credit certificate issued by the Kentucky Department of Revenue must be attached to the corporation's return on which the credit is claimed. **KRS 141.0405**

Line 9—Qualified Research Facility Tax Credit. A corporation is entitled to a credit against corporation income tax of 5 percent of the qualified costs of construction, remodeling, expanding and equipping facilities in Kentucky for "qualified research." Any unused credit may be carried forward 10 years. Schedule QR, Qualified Research Facility Tax Credit, must be attached to the corporation's return on which this credit is claimed. Federal Form 6765, Credit for Increasing Research Activities, must also be attached if applicable. See instructions for Schedule QR for more information regarding this credit. **KRS 141.395**

Line 10—GED Incentive Tax Credit. To claim this credit attach the GED-Incentive Program Final Report (Form DAEL-31) for each employee that completed a learning contract during the tax year. The credit reflected on this line must equal the sum of the credits reflected on the attached GED-Incentive Program Final Reports. This credit may be claimed only in the year during which the learning contract was completed and unused portions of the credit may not be carried forward or back. For information regarding the program, contact the Education Cabinet, Kentucky Adult Education, Council on Postsecondary Education. **KRS 151B.127**

Line 11—Voluntary Environmental Remediation Tax Credit (Brownfields). This line is completed only if the corporation has an agreed order with the Environmental and Public Protection Cabinet under the provisions of KRS 224.01-518 and has been approved for the credit by the Department of Revenue. Maximum credit allowed to be claimed per taxable year is 25 percent of approved credit. For more information regarding credit for voluntary environmental remediation property, contact the Environmental and Public Protection Cabinet at (502) 564-3350. To claim this credit, Schedule VERB must be attached. **KRS 141.418**

Line 12—Biodiesel Tax Credit. Producers and blenders of biodiesel are entitled to tax credit against taxes imposed by KRS 141.020 and KRS 141.040. The taxpayer must file a claim for biodiesel credit with the Department of Revenue by January 15 each year for biodiesel produced or blended in the previous calendar year. The department shall issue a credit certification to taxpayer by April 15. The credit certification must be attached to the tax return on which credit is being claimed. **KRS 141.424**

Line 13—Enter total credits from Lines 1 through 12.

Tax Payment Summary

Tax—Check the applicable box that denotes the method used to calculate the tax paid: Income, AMC Gross Receipts, AMC Gross Profits or Minimum \$175.

The payment submitted with Form 720S must be itemized. Enter the amount of tax payment from Part IV, Line 9, on the Tax line, 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 18. Lines 19 through 24 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 18—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).

Enter on attached schedules the supplemental information required to be reported separately to each shareholder for Lines 1 through 18 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.

Include on Lines 19 through 21 only income subject to tax on this return. Do not include amounts from Part I—Taxable Income Computation, Lines 12(c) and (d). Provide a separate schedule for income, loss and credit the S corporation received as a partner or member. Include name, address, FEIN, for each entity and the shareholders' pro rata share of items requested for Lines 19 through 21.

Line 19—Enter individual shareholders' pro rata share of net distributable income (loss) taxed under KRS 141.040 from page 4, Schedule K, Section II, Line 2.

Line 20—Enter individual shareholders' pro rata share of non-refundable Kentucky corporation income tax credit from page 4, Schedule K, Section II, Line 3.

Line 21—Enter individual shareholders' pro rata share of refundable Kentucky corporation income tax credit from page 4, Schedule K, Section II, Line 4.

Lines 22 through 24—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
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) 564-8139
(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, 311 West Second Street, 42301-0734
(270) 687-7301

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

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

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 personal property 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 administer tax laws, collect revenue, and provide services in a fair, courteous, and efficient manner for the benefit of the Commonwealth and its citizens.

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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.