



Ernie Fletcher
Governor

FINANCE AND ADMINISTRATION CABINET
DEPARTMENT OF REVENUE

John Farris
Secretary

Office of Income Taxation
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FRANKFORT, KENTUCKY 40620
502-564-5495
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Marian Davis
Commissioner

August 22, 2006

Penny Gold, Executive Director
Kentucky Society of CPAs
1735 Alliant Avenue
Louisville KY 40299

Dear Ms. Gold:

The Department of Revenue wants to inform the Kentucky Society of CPA's of an issue that has been identified from 2005 Kentucky Income Tax Forms. As you are aware, House Bill 272 of the 2005 General Assembly made pass-through entities, except general partnerships, subject to corporation income tax. This law change applied to taxable years beginning on or after January 1, 2005. Several pass-through entities that are owned by non-resident individuals have not filed a Kentucky corporation income tax return, made estimated payments or applied for an extension to file a return. In such cases, an incorrect PTE-WH form (form # 40A200) was submitted. Withholding from nonresident individuals is only allowed for nonresident individual partners in a general partnership for the calendar years ending December 31, 2005 or December 31, 2006.

KRS 141.040(1) imposes the corporation income tax on: "Every corporation doing business in this state, except those corporations listed in paragraphs (a) to (h) of this subsection."

"Corporation" is defined by KRS 141.010(24) to mean:

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

KRS 141.206 allows the withholding of individual income tax due only in the case of general partnerships. KRS 141.206(4) states in pertinent part: "General partnerships may be required to withhold Kentucky income tax on the distributive share of partners under administrative regulations promulgated by the Department." There is no other provision in Kentucky's income tax law that allows pass-through entities other than a general partnership to withhold Kentucky tax due from nonresident individuals. Please note that House Bill 1 of the 2006 Extraordinary Session of the Kentucky General Assembly eliminates entity level income taxation on pass-through entities and restores provisions that require nonresident withholding from individual partners, members and shareholders for taxable years beginning on or after January 1, 2007.

In the case of pass-through entities that have already filed a PTE WH form with payment, the Department will recognize that withholding on an individual income tax return. The pass-through entity will be billed for failure to file a corporation income tax return. Once the corporation files and pays the correct amount of corporation income tax due, the individual partner, shareholder or member may file an amended return to claim the nonrefundable and refundable corporation income tax credits.

Any future filed PTE-WH form for taxable years ending in 2005 or 2006 submitted by a pass-through entity subject to corporation income tax will result in the pass-through entity and individual partners, members and shareholders receiving a letter instructing them that pass-through entity withholding will not be recognized and any PTE-WH form and accompanying payment submitted will be returned.

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If you have any questions regarding the position outlined in this letter, please contact the Pass-through Entity Branch at 502-564-8139. We look forward to continuing to work with your organization on the substantial Kentucky income tax law changes enacted during the last two years.

Sincerely,

Marian S. Davis, Commissioner
Kentucky Department of Revenue