

# Kentucky Tax Alert

A REVENUE PUBLICATION FOR THE TAX PROFESSIONAL

February 2007; Vol. 26, No. 1



## 2006 Kentucky Individual Income Tax Updates and Filing Tips



**Standard Deduction**—The standard deduction has increased to \$1,970 for 2006.

**Correction to Schedule A Itemized Deductions Limitation Schedule**—The Itemized Deductions Limitation Schedule located on the back of the Schedule A has been updated since the Kentucky forms went to press. This update is due to a provision in the Economic Growth & Tax Relief Reconciliation Act of 2001 that became effective with the 2006 tax year.

This limitation schedule is used by taxpayers with adjusted gross income in excess of \$150,500 (\$75,250 if married filing separately on a combined return or married filing separate returns). Please visit the Department of Revenue's (DOR) Web site at [www.revenue.ky.gov](http://www.revenue.ky.gov) or contact the Taxpayer Assistance Section at (502) 564-4581 to receive the updated Schedule A Itemized Deductions Limitation Schedule.

**Family Size Tax Credit**—The Family Size Tax Credit threshold amounts for 2006 are \$9,800 for a family of one, \$13,200 for a family of two, \$16,600 for a family of three and \$20,000 for a family of four or more.

**Income Exclusion for Military Personnel Killed in the Line of Duty**—All income earned by soldiers killed in the line of duty is exempted from Kentucky tax for the year during which the death occurred and the year prior to the year during which the death occurred.

The changes are applicable for tax years beginning after December 31, 2001. The income exclusion applies to all income from all sources of the decedent, not just military income. The exclusion includes all federal and state death benefits payable to the estate or any beneficiaries.

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### Gasoline Excise Tax Rate

Under KRS 138.210 and KRS 138.220, the DOR is responsible for establishing the average wholesale price (AWP) of gasoline for the purposes of calculating the gasoline excise tax rate. The current price calculation is based on sales data accumulated for the month of October 2006 and a grade and formulation weighted average reflecting gasoline consumption patterns.



For the quarter commencing Jan. 1, 2007, the DOR has determined the AWP of gasoline remains at \$1.476. Therefore, the rate remains 19.7 cents per gallon for gasoline and 16.7 cents per gallon for special fuels and is inclusive of the 1.4 cents Petroleum Storage Tank Environmental Assurance Fee. Additionally, the rate for liquefied petroleum remains at 18.3 cents per gallon.

## 2006 Kentucky Individual Income Tax Updates

(continued from page 1)

Amended returns may be filed for the year the soldier was killed in the line of duty and the year prior to the year of death. The amended returns must be filed within the statute of limitations period.

If a combined return was filed, the exclusion would apply to the income reported in Column A or Column B of the Kentucky return attributable to the military member. If a joint return was filed, the income must be separated accordingly.

**Two New Tax Credits**—There are two new nonrefundable credits that are listed in Section A of Kentucky Form 740 and 740NP. The **Environmental Stewardship Credit** is available against the corporation and individual income taxes for a corporation or individual that undertakes an environmental stewardship project with a minimum investment of at least \$5 million. The Cabinet for Economic Development must approve the project. The **Clean Coal Incentive Credit** is available to an electricity generation facility certified as using clean coal equipment and technology and burning coal subject to Kentucky's severance tax. The credit applies to electricity generation facilities with an investment of more than \$150 million and meets the Natural Resources and Environmental Protection Cabinet standards.

**Deduction for Clean-Fuel Vehicles**—The clean-fuel deduction is still available for Kentucky income tax purposes in 2006. The deduction must be taken as a subtraction from federal adjusted gross income on Schedule M, line 15.

**IRS Extender Bill**—The Tax Relief and Health Care Act of 2006 was signed into law in December of 2006. This act extended the deductions for state and local sales tax, higher education tuition and fees and educator expenses for federal purposes. The deductions for higher education tuition and fees and educator expenses are an adjustment to income and become part of federal adjusted gross income so there is no further adjustment needed for Kentucky purposes. Kentucky does not allow the state and local sales tax as an itemized deduction on Kentucky Schedule A.

### FILING TIPS:

**File Electronically**—Filing electronically is the fastest way to receive your refund. Electronically filed returns

generally process within 7–21 days. And it's the only way to have your refund check direct deposited into your bank account.

**Payments**—When submitting payments for electronically filed returns, **do not** send a copy of your return. Use form 740-V to remit your payment. Include your Social Security number and tax year on the check.

**Wage and Tax Statements**—Be sure that all necessary statements are attached to support the *Kentucky withholding* claimed on the return.

**Social Security Numbers**—The numbers **are not** on the pre-printed labels. Please enter them legibly and in the appropriate boxes on the return.

**Addresses**—If your address is correct use the pre-printed labels furnished with your booklet. Otherwise, make sure the address entered on the return is the correct address. If you move after you have submitted your return, please contact the DOR to update your address.

**Form 2210-K**—When applicable use Form 2210-K to calculate any underpayment of estimated tax penalties or to claim an exception to the penalty. Check the appropriate box on Form 740 when Form 2210-K is attached.

**2D Barcode Returns**—Even though some W-2 information is included the wage statements need to be attached for verification of withholding claimed.

**Credit for Tax Paid to Another State**—Paper returns *must* include copies of other state(s) returns if claiming a credit. Electronically filed returns must have the Credit for Tax Paid to Another State worksheet completed and submitted with the electronic submission for proper processing.

**Amended Returns**—Use the proper form for the year you are amending and include a complete explanation of the changes.

**Attach Supporting Schedules**—Make sure all appropriate schedules and worksheets are attached to the return (i.e., K-1s, 8863-K, etc.)

**Kentucky Schedule K-1**—Attach K-1s when claiming a refundable or nonrefundable corporate tax credit.

**Use Tax Reminder**



We would like to remind tax professionals and their clients of the use tax responsibilities. KRS 139.310 and 139.330

impose use tax on those out-of-state purchases for storage, use or other consumption in Kentucky. Purchases of items such as aircraft, boats, artwork, jewelry, furniture, clothing, software, sporting goods, electronics, computers, books and magazines are examples of personal items bought out of state that may be subject to Kentucky use tax.

Use tax purchases may be reported by individuals on line 27 of the Kentucky individual income tax return (740 and 740-NP) or line 9 (740EZ). Use tax may also be reported and paid on Form 51A113(O), available on the Web site at [www.revenue.ky.gov](http://www.revenue.ky.gov). Businesses and entities registered for sales tax must report their use tax on line 23(a) of the Kentucky sales and use tax return. If you have any questions about use tax, please call the Division of Sales and Use Tax at (502) 564-5170.

*Kentucky Tax Alert* comments and suggestions should be addressed to the Office of Public Information, Finance Secretary's Office, Frankfort, Kentucky, (502) 564-9165, ext. 4500.

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The Department of Revenue can be found at [www.revenue.ky.gov](http://www.revenue.ky.gov).

**CORPORATION TAX ISSUES—2007**

The 2006 Extraordinary Special Session of the General Assembly passed HB 1, which defines a *corporation* to mean a *corporation* as provided by Section 7701(a)(3) of the Internal Revenue Code effective for tax years beginning before Jan. 1, 2005 and after Dec. 31, 2006. Corporations will be subject to the tax imposed by KRS 141.040 and KRS 141.0401 (2). Limited liability pass-through entities will be subject to the Limited Liability Entity Tax (LLET) imposed by KRS 141.0401 (2). The LLET shall not apply to entities listed in KRS 141.0401 (6). Pass-through entities and limited liability pass through entities shall withhold Kentucky income tax on the distributive share income, whether distributed or undistributed, of each nonresident individual partner, member, or shareholder, or each corporate partner or member that is doing business in Kentucky only through its ownership interest in a pass-through entity. A nonresident individual partner, member or shareholder whose only source of income within this state is distributive share income from one or more pass-

through entities may elect to be included in a composite income tax return filed pursuant to KRS 141.206 (13).

Every corporation and every pass through entity subject to the tax imposed by KRS 141.040 or KRS 141.0401 shall make a declaration of estimated tax and pay installments if the taxes imposed may reasonably be expected to exceed \$5,000. Failure to pay estimated tax installments equal to the amount determined by first subtracting \$5,000 from 70 percent of the total LLET shown on the return and then the remaining against the corporation income tax shown on the return for the taxable year will result in the assessment of an underpayment penalty. Entities whose prior year tax liability is less than or equal to \$25,000 may make estimated tax installments equal to its prior year tax less \$5,000 and avoid the underpayment penalty. The Form 720ES has been modified to accept installment payments of both corporation income and limited liability entity tax and is now available on our Web site.

NOTE: If a return due date falls on a scheduled holiday or weekend, returns will be due the next working day.

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<b>January</b>	15	Estimated Corporation Income Tax/One Half Est. (FY ending 7/31)
	15	Estimated Corporation Income Tax/One Fourth Est. (FY ending 1/31)
	15	Estimated Corporation Income Tax/One Fourth Est. (FY ending 4/30)
	15	Estimated Tax/Individuals/One Fourth Est.
	22	Coal Severance Tax Returns (December Payment)
	22	Oil Production Tax Returns (December Payment)
	22	Monthly Sales Tax Returns (December Payment)
	22	Quarterly Sales Tax Returns
	22	Annual Sales Tax Returns
	22	Health Care Provider Tax Returns (December Payment)
	25	Monthly Motor Fuels Tax Returns (December Payment)
	25	Monthly Sales Tax Returns (Accelerated Payment)
	31	Income Tax Withholding Returns/Electronic Funds Transfer (EFT) Filers/Annual Reconciliation
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	31	Annual Income Tax Withholding Returns (Annual Payment and K-2s)
<b>February</b>	1	Minerals and Gas Severance Tax Returns (December Payment)
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	15	Estimated Corporation Income Tax/One Fourth Est. (FY ending 2/28)
	15	Estimated Corporation Income Tax/One Fourth Est. (FY ending 5/31)
	15	Monthly Income Tax Withholding Returns (January Payment)
	20	Coal Severance Tax Returns (January Payment)
	20	Oil Production Tax Returns (January Payment)
	20	Monthly Sales Tax Returns (January Payment)
	20	Health Care Provider Tax Returns (January Payment)
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	26	Monthly Motor Fuels Tax Returns (January Payment)
	26	Monthly Sales Tax Returns (Accelerated Payment)
<b>March</b>	1	Minerals and Gas Severance Tax Returns (January Payment)
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	20	Health Care Provider Tax Returns (March Payment)
	25	Twice-Monthly Income Tax Withholding Returns (April 1 - April 15 Payment/EFT Payment)
	25	Monthly Motor Fuels Tax Returns (March Payment)
	25	Monthly Sales Tax Returns (Accelerated Payment)

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<b>May</b>	1	Income Tax Withholding Returns/Electronic Funds Transfer (EFT) Filers/First Quarter Reconciliation	
	1	Quarterly Income Tax Withholding Returns	
	1	Minerals and Gas Severance Tax Returns (March Payment)	
	1	Public Service Company Property Tax Returns (as of 12/31/06)	
	1	Railroad Car Line Property Tax Returns (as of 12/31/06)	
	10	Twice-Monthly Income Tax Withholding Returns (April 16 - April 30 Payment/EFT Payment)	
	15	Intangible Personal Property Tax Return (Taxpayer will be billed later)	
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	15	Estimated Corporation Income Tax/One Fourth Est. (FY ending 8/31)	
	15	Estimated Corporation Income Tax/One Fourth Est. (FY ending 11/30)	
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25	Monthly Motor Fuels Tax Returns (July Payment)		
25	Monthly Sales Tax Returns (Accelerated Payment)		

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<b>September</b>	3	Minerals and Gas Severance Tax Returns (July Payment)	
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	17	Estimated Corporation Income Tax/One Fourth Est. (FY ending 9/30)	
	17	Estimated Corporation Income Tax/Limited Liability Entity Tax/One Fourth Est. (FY ending 12/31)	
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2006 FEDERAL/KENTUCKY INDIVIDUAL INCOME TAX DIFFERENCES

Kentucky income tax law is based on the federal income tax law in effect on December 31, 2004. The Department of Revenue generally follows the administrative regulations and rulings of the Internal Revenue Service in those areas where no specific Kentucky law exists.

The chart below provides a quick reference guide to the major federal/Kentucky differences. It is not intended to be all inclusive. Items not listed may be referred to the Department of Revenue to determine Kentucky tax treatment.

PROVISION	FEDERAL TAX TREATMENT	KENTUCKY TAX TREATMENT
1. Interest from Federal Obligations	Taxable	Exempt
2. Retirement Income from:		-----
Commonwealth of Kentucky Retirement Systems	Taxable	Partially exempt if retired after December 31, 1997; exempt if retired before January 1, 1998; Schedule P may be required
Kentucky Local Government Retirement Systems	Taxable	
Federal and Military Retirement Systems	Taxable	-----
3. Pensions and Annuities Starting After 7/1/86 and Before 1/1/90	3-year recovery rule eliminated	3-year recovery rule retained
4. Other Pension and Annuity Income	Taxable	100% excludable up to \$41,110; Schedule P may be required
5. Benefits from U.S. Railroad Retirement Board	May be taxable	Exempt; Schedule P may be required
6. Social Security Benefits	May be taxable	Exempt
7. Capital Gains on Sale of Kentucky Turnpike Bonds	Taxable	Exempt
8. Other States' Municipal Bond Interest Income	Exempt	Taxable
9. Kentucky Local Government Lease Interest Payments	Taxable	Exempt
10. Long-Term Care Insurance Premiums Paid With After-Tax Dollars	Limited deduction as self-employed health insurance	100% adjustment to gross income
11. Medical and Dental Insurance Premiums Paid With After-Tax Dollars	Limited deduction as self-employed health insurance	100% adjustment to gross income
12. Capital Gains on Property Taken by Eminent Domain	Taxable	Exempt
13. Election Workers—Income for Training or Working at Election Booths	Taxable	Exempt
14. Artistic Contributions itemized deduction adjustment to income	Noncash contribution allowed as itemized deduction or	Appraised value allowed as
15. State Income Taxes	Deductible	Nondeductible
16. Leasehold Interest—Charitable Contribution	May be deductible required	Deductible; Schedule HH
17. Kentucky Unemployment Tax Credit	No credit allowed	\$100 per certified employee; Schedule UTC required
18. Work Opportunity Credit (federal Form 5884)	Tax credit allowed; wage expense reduced by amount of credit	No credit allowed; entire wage expense is deductible
19. Welfare to Work Credit (federal Form 8861)	Tax credit allowed; wage expense reduced by amount of credit	No credit allowed; wage expense reduced by amount of federal credit
20. Child and Dependent Care Credit	Tax credit based on expenses	20% of federal credit
21. Family Size Tax Credit	No credit allowed	Decreasing tax credit allowed
22. Education Tuition Tax Credit	Tax credit based on expenses	25% of federal credit for Kentucky undergraduate studies
23. Taxpayer Who May be Claimed as Dependent on Another's Return (i.e., full-time student)	May not claim self	May claim self
24. Child's Income Reported by Parent	Permitted; taxed at parent's rate	Not permitted
25. National Tobacco Settlement TLAP Income	Taxable	Exempt
Quota Buyout (including imputed interest)		
26. Bonus Depreciation/Additional Section 179 Expense	Deductible	Nondeductible