



Kentucky Tax Alert



A KENTUCKY REVENUE CABINET PUBLICATION FOR THE TAX PROFESSIONAL

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KRC, IRS Sponsor Electronic Filing Seminars

KRC and the IRS will sponsor five seminars on electronic filing of individual income tax returns at various sites across the state as well as one in Ohio. Each seminar runs from 8:30 a.m. to 4:30 p.m. local time. Topics covered by KRC and the IRS will benefit all e-filers. There will not be a reserved time for new e-filers as in previous seminars. At the Cincinnati, Ohio, seminar, representatives from both Kentucky and Ohio will be participating. This is designed to attract Ohio and northern Kentucky EROs who e-file returns for either states.

Registration is recommended to help KRC and the IRS plan the seminars and to allow participants to be advised of any changes. Registration forms are being mailed to Kentucky EROs by the IRS. If you do not receive this form, please contact Judy Ritchie at KRC at (502) 564-5370 for a registration form.

Seminars will be held at the following locations:

Friday, Nov. 7, 2003
East Jefferson County Government Center
200 Juneau Drive
Louisville, KY

Tuesday, Nov. 18, 2003
Lexington Public Library
140 East Main Street
Lexington, KY

Wednesday, Nov. 19, 2003
Cincinnati
UC Clermont College-Batavia
4200 Clermont College Drive
Batavia, OH

Friday, Dec. 5, 2003
Chamber of Commerce
812 State Street
Bowling Green, KY

Monday, Dec. 15, 2003
McCracken County Public Library
555 Washington Street
Paducah, KY

For questions or registration, call KRC, Judy Ritchie, Electronic Filing Coordinator, at (502) 564-5370.

Electronic Commerce Notes of Interest

Electronic Filing (ELF) of Tax Returns

In cooperation with the IRS, KRC will again offer electronic filing of individual income tax returns for the 2003 tax year. Authorization for electronic filing of Kentucky full-year resident returns is available to all interested preparers who:

- (1) are accepted in the federal electronic filing program;
- (2) transmit returns to the IRS Cincinnati Service Center;
- (3) use software approved for Kentucky electronic filing; and
- (4) pass KRC suitability checks.

Preparers who wish to participate in the coming year should submit federal Form 8633, Application to Participate in the Electronic Filing Program, to the IRS. The sooner the application is submitted, the sooner the preparer will receive authorization to participate in the program. KRC does not require a separate application.

Persons who wish to obtain a copy of KRC's handbook for electronic filers may call (502) 564-5370. Visit KRC's Web site at www.revenue.ky.gov to download this publication.

Again, during the 2004 filing season, Form 8453-K, Kentucky Individual Income Tax Declaration for Electronic Filing, will not be mailed to KRC. The following guidelines have been established and were effective March 1, 2002.

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Electronic Commerce Notes *(continued from page 1)*

Fed/State E-filed Returns With a Federal PIN—For returns filed via this method, Form 8453-K is not required. The use of the federal PIN meets signature requirements for the Kentucky return.

Fed/State E-filed Returns Without a Federal PIN—For returns filed via this method, Form 8453-K is required. This document does not need to be mailed to KRC. Electronic Return Originators (ERO) must retain Form 8453-K for three years. State copies of the wage statement, supporting schedules, documents requiring signatures, and other informational documents should be attached to Form 8453-K and be retained by the ERO for three years.

Online Filing—For returns filed via this method, Form 8453-K is required. This document does not need to be mailed to KRC. Taxpayers must retain the form for a period of three years.

Form 8453-K is the signature portion of the electronic return. It must be completed, if required, and signed by all appropriate parties before the return is transmitted electronically. Form 8453-K:

- authenticates the return;
- authorizes the ERO to file the return electronically on behalf of the taxpayer; and
- authorizes KRC to inform the ERO whether a taxpayer's return has been accepted.

Electronic Funds Transfer (EFT)

KRC accepts the electronic transfer of funds for payment of sales and use, withholding, bank franchise, and certain types of motor fuels taxes. Detailed instructions for payment by EFT will be sent to all new registrants. Taxpayers who wish to participate in this program should register with KRC's Electronic Commerce Group (ECG). To obtain an application, or for additional information, contact the ECG at (502) 564-6020 (voice) or (502) 564-9897 (fax).

Common EFT errors include:

- Incorrect period end date is transmitted. The period end date is the last date of the reporting period, not the due date of the return.
- Account number and/or tax type is incorrect. Make sure the account number entered is the correct account number for the type tax being paid.
- Information is formatted incorrectly.
- Money is submitted via wire transfer without authorization.

Taxpayers registering with KRC for tax ID numbers are not automatically registered for EFT payments. Taxpayers must register with ECG to make payments electronically.

Importance of Using Correct Corporation Account Numbers

Using the correct **Kentucky corporation income and license account number**, along with the correct federal identification number, enables KRC to operate efficiently and minimizes unnecessary contacts with the taxpayer. Without the correct account number, document processing is delayed, payments are posted incorrectly, and/or delinquency notices are generated. Also, during initial document processing, if the corporation cannot be properly identified, a new and separate **Kentucky corporation income and license account number** may be issued to the corporation, resulting in duplicate account numbers.

Upon registering with KRC, corporations receive correspondence notifying them of the specific tax account numbers (corporate, sales, withholding, etc.) issued to the corporation. The **Kentucky corporation income and license account number** should always be included on all documents related to corporation income and license tax that are submitted to KRC to ensure proper handling.

Estimated Tax Payment Deadlines

Individual income taxpayers are reminded that final 2003 quarterly estimated tax payments are due on Jan. 15, 2004. Final 2003 estimated corporation income tax payments of 25 percent are due on Dec. 16, 2003.

Taxpayers who have not yet made their April 15, June 15, or Sept. 15, 2003, estimated payments should submit those payments on or before Jan. 15, 2004, to minimize underestimation penalties.

KRC Offices Closed for Holidays

Pursuant to KRS 18A.190, all KRC offices will be closed Tuesday, Nov. 11, in observance of Veteran's Day; and Thursday and Friday, Nov. 27 and 28, in observance of Thanksgiving. The two days each for Christmas and New Year's will be announced by the new administration.

Kentucky's Pension Exclusion, Standard Deduction Increase for 2004 Tax Year

Kentucky's individual income tax pension exclusion for the 2004 tax year is increasing to \$40,200. This exclusion applies to tax returns due April 15, 2005, and takes effect on Jan. 1, 2004.

Retirees who make quarterly estimated Kentucky individual income tax payments should take this revised pension exclusion into effect when calculating their quarterly payments for 2004. The first payment is due on April 15, 2004.

For the 2003 tax year, for which returns are due on April 15, 2004, the pension exclusion is \$39,400.

The revision is made pursuant to KRS 141.0105, which requires KRC to adjust the exclusion annually for inflation.

Additionally, Kentucky's standard deduction for individual income tax increases from \$1,830 to \$1,870 for the 2004 tax year as authorized by KRS 141.081(2). Taxpayers who do not itemize deductions on their individual income tax return are entitled to claim the standard deduction.

U of L Tax School

The 51st annual Louis A. Grief Tax Institute will be held on Dec. 17-19, 2003, at the School of Accountancy, University of Louisville. Registration for the three-day seminar is \$200. For more information, visit www.cbpa.louisville.edu or call (502) 852-5847.

Employers Encouraged to Release Forms W-2/K-2 Early

In an effort to speed the issuance of individual income tax refunds, employers are encouraged to release Employee's Wage and Tax Statements, Forms W-2/K-2, at the earliest possible date. This allows taxpayers to file their income tax returns earlier, thereby avoiding backlogs and delay of refunds. Fewer returns are filed at the beginning of the tax season than near the April 15 deadline. By increasing the number of tax returns filed early, refunds can be processed more efficiently.

Court Case Update

Corporation License Tax—In **Commonwealth Business Retention Trust v. Sherman**, 03-CI-00917, a business trust brought suit challenging the Governor's partial veto of House Bill 390 enacted by the 2003 General Assembly.

The provisions vetoed repealed KRS 136.071, a corporation license tax statute that had been held unconstitutional by the Franklin Circuit Court in **Illinois Tool Works, Inc. v. Revenue Cabinet** because it could only be utilized by corporations with Kentucky commercial domiciles. The vetoed legislation sought to reinstate 90 percent of the corporation license tax benefit formerly allowed under KRS 136.071, but without the Kentucky commercial domicile limitation. This reinstated tax benefit was effective for tax periods for which a corporation license tax return was due, without regard to extension, on or after April 15, 2004. However, this provision did not apply to any tax period for which a corporation license tax return is due, without regard to extension, on or after April 15, 2005.

On Sept. 22, 2003, the Franklin Circuit Court entered an opinion and order dismissing this action. The circuit court held that the business trust lacked standing or the legal right to bring this action.

The business trust sought reconsideration of this Sept. 22, 2003, opinion and order by a motion to vacate. At the same time, a motion to intervene was filed by Citizens National Corporation, Humana, Inc., Kindred Healthcare, Inc., LG&E Energy Corp., and Yum! Brands, Inc. These corporations alleged that they had qualified for the tax

treatment authorized by KRS 136.071 and desired to utilize the provision of House Bill 390 vetoed by the Governor.

On Oct. 16, 2003, the circuit court denied the business trust's motion to vacate, reaffirming its ruling that the business trust had standing. The circuit court granted the motion to intervene, however. The court's Oct. 16, 2003, opinion and order stated that the corporations seeking to intervene "plead that they qualified for similar deductions or tax relief measures in the past, that they desire to take the deductions or other tax relief measures provided for by the vetoed statute, and that they will be harmed if they cannot take the deductions or the measures." This opinion and order further stated that the intervenors' petition "strongly suggests that they will be eligible for the deductions and the tax relief measures" and that accordingly their allegations are sufficient to survive a motion to dismiss.

In **The Babcock & Wilcox Company v. Revenue Cabinet**, K01-R-34, the taxpayer omitted from the calculation of its taxable capital liability accounts referred to as "Reserve for Product Liability" and "Reserve from Retirement Plan." The "Reserve for Product Liability" account was established to account for substantial liabilities faced by the taxpayer from asbestos litigation. The "Reserve from Retirement Plan" account was established in recognition of the taxpayer's future pension plan obligations to its employees who have retired or will be retiring.

Court Case Update (continued from page 3)

The taxpayer argued that these accounts should be reduced by or offset against asset accounts referred to as Prepaid Pension and Insurance Recovery. The Prepaid Pension account represented pension fund overfundings. The Insurance Recovery account represented obligations to be paid by various insurance companies to satisfy successful product liability claims for asbestos against the taxpayer.

In a decision rendered on Sept. 26, 2003, the Kentucky Board of Tax Appeals (KBTA) rejected the taxpayer's argument. The KBTA first observed the "[l]iability accounts are properly included in capital as surplus" and that "KRS 136.070(2) requires that capital accounts 'be reported at the value reflected on financial statements prepared for book purposes as of the last day of the calendar or fiscal year.'" In this case, the asset accounts and liability accounts in question were "listed separately on [the taxpayer's] financial statements." To offset the asset accounts against the liability accounts would effectively exempt or exclude from capital portions of the liability accounts. This would be contrary to the corporation license tax statute, the KBTA ruled.

This case is not over. The taxpayer has appealed the KBTA's decision to the Franklin Circuit Court.

Sales and Use Tax—In *Open MRI, LLC v. Revenue Cabinet*, K02-R-18, K02-R-19 and K03-R-7, the taxpayer was engaged in the business of generating magnetic resonance imaging (MRI) images and providing medical reports for use by physicians in the diagnosis and treatment of patients. The taxpayer asserted that the MRI equipment it purchased was exempt from sales and use tax as "machinery for new and expanded industry" under KRS 139.170 and KRS 139.480(10) and properly classified for ad valorem tax purposes as "machinery actually engaged in manufacturing" under KRS 132.020(1) and 132.200(4).

The MRI procedure performed by the taxpayer is instigated by a referral from a physician directing which parts of the patient's body should be examined by the MRI procedure. A medical history is taken from the patient as part of the procedure and in some cases, the patient is injected with a dye. The MRI equipment surrounds the patient with a magnetic field, projects radio waves into the area of the body selected for examination, and a computer measures the reactions of the patient's cells to those stimuli.

The images resulting from this procedure are generated by the taxpayer's MRI equipment on both acetate film and in digital form and the taxpayer stores them digitally. The images are sent to a group of independent radiologists, who analyze

the images and provide written reports setting forth their findings. The reports are provided to the taxpayer and the referring physician. The radiologist retains the image, but only 50 percent of the referring physicians request it. The image and the written report become part of the patient's medical record. The taxpayer does not make separate charges for the image and the radiologist's review and analysis.

The KBTA also noted that while the definition of manufacturing contemplates a product ready for sale, the taxpayer did not hold a retail permit or collect sales tax on the alleged sales of the images. Further, only half of the physicians requesting the MRI procedure actually asked for the images to be sent to them.

In a decision rendered on Oct. 10, 2003, the KBTA ruled that the taxpayer was not entitled to an exemption from sales and use tax. Exemptions from taxation are disfavored and should be strictly construed. In this case, the MRI equipment was used in the rendition of professional medical services and not manufacturing. Furthermore, the taxpayer's locations were not plant facilities as required by the exemption. For the same reasons, the MRI equipment was not entitled to be classified for ad valorem tax purposes as "machinery actually engaged in manufacturing."

This decision is not yet final. The taxpayer has 30 days to appeal to the circuit court.

Kentucky Tax Alert is a bimonthly publication printed on recycled paper, the costs of which are paid from state funds.

Comments, suggestions and mailing list additions or corrections should be addressed to the Public Information and Communication Services Branch, Revenue Cabinet, Station 14, Frankfort, Kentucky 40620, (502) 564-4592.

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Visit KRC online at www.revenue.ky.gov



**KENTUCKY INCOME TAX
FORMS REQUISITION**

**FROM: Revenue Cabinet
Frankfort, KY 40620**

The label at right will be used to mail your forms. **Do not detach.**
Please prepare a duplicate address below for our files.

Name _____
Street _____
City, State _____
and ZIP _____
Phone (____) _____
Date Ordered _____

TO: Name _____
Street _____
City, State _____
and ZIP Code _____

Check one: Individual Attorney CPA Tax Practitioner Other _____

Package K (contains all individual, fiduciary, partnership, corporation and S corporation income tax forms, schedules and instructions) Quantity **➤** _____

FORMS	I	N	C	S	ISSUANCE NO.	QUANTITY
740—Kentucky Individual Income Tax Return					42A740	*
740/740-EZ—Instructions					42A740-S11	
740-EZ—Kentucky Individual Income Tax Return					42A740-EZ	*
740-X—Amended Kentucky Individual Income Tax Return					42A740-X	
740-NP—Nonresident or Part-Year Resident Income Tax Return					42A740-S9	
Schedules A & ME (740-NP)—Itemized Deductions/Moving Expense and Reimbursement					42A740-S9 (A & ME)	
740-NP Packet					42A740-S10	
740-NP-R—Nonresident Income Tax Return—Reciprocal State					42A740-S9-R	
740-ES—2004 Estimated Tax Voucher					42A740-ES	*
740-ES—Instructions					42A740-S4	
Schedule A (740)—Itemized Deductions					Schedule A	*
Schedule J—Kentucky Farm Income Averaging					42A740-J	*
Schedule M—Kentucky Federal Adjusted Gross Income Modifications					42A740-M	*
Schedule P—Pension Income Exclusion					42A740-P	*
Schedule TC—Tax Computation Schedule					42A740-TC	*
Schedule UTC—Unemployment Tax Credit					42A740-UTC	*
1045-K—Kentucky Net Operating Loss Application for Income Tax Refund					42A740-S20	*
1045-K—Instructions					42A740-S20(l)	
2210-K—Underpayment of Estimated Tax by Individuals					42A740-S1	*
4972-K—Kentucky Tax on Lump-Sum Distributions					42A740-S21	*
8453-K—Kentucky Individual Income Tax Declaration for Electronic Filing					42A740-S22	
740-V—Kentucky Electronic Payment Voucher					42A740-S23	
8582-K—Kentucky Passive Activity Loss Limitations					42A740-S18	*
Application for Extension of Time to File Return (Individual, Partnership, Fiduciary)					40A102	

Total Forms—Page 1
Total Forms—Page 2
Total Forms Provided at No Charge -
Total Forms ➤

**Forms shaded and marked with an asterisk(*) are provided at no charge.*

Package K _____ x \$6.00 (each additional \$5.00)
Total Forms _____ x \$ _____ each (see Forms Cost Schedule below)
Envelopes _____ x \$3.50 per group of 100
Subtotal
Sales Tax (6%) (Kentucky residents only)

TOTAL ➤

1 - 24	NC
25 - 74	\$.09 each
75 - 100	.07
101 - 200	.06
201 - 500	.05
over 500	.04

Make check payable to: Kentucky State Treasurer
Mail order form and check to: Kentucky Revenue Cabinet
FORMS
P.O. Box 518
Frankfort, Kentucky 40602-0518

FORMS	ISSUANCE NO.	QUANTITY
Kentucky Individual Income Tax Installment Agreement Request	12A200	
741—Kentucky Fiduciary Income Tax Return	42A741	
741—Instructions	42A741(I)	
741-D—Capital Gains and Losses	42A741-D	
Schedule K-1 (741)—Beneficiary's Share of Income, Deductions, Credits, etc.	42A741 (K-1)	
765—Kentucky Partnership Income Return	42A765	
765—Instructions	42A765(I)	
Schedule K-1 (765)—Partner's Share of Income, Credits, Deductions, etc.	42A765 (K-1)	
720—Kentucky Corporation Income and License Tax Return	41A720	*
720—Instructions	41A720(I)	
720S—Kentucky S Corporation Income and License Tax Return	41A720S	*
720S—Instructions	41A720S(I)	
Schedule K-1 (720S)—Shareholder's Share of Income, Credit, Deductions, etc.	41A720S (K-1)	*
720X—Amended Kentucky Corporation Income Tax and Corporation License Tax Return	41A720X	
720ES—Corporation Estimated Income Tax Voucher	41A720ES	*
720ES—Instructions	41A720-S4	
Schedule A (720)—Apportionment and Allocation	41A720A	*
Application for Extension of Time to File KY Corporation Income and License Tax Return	41A720SL	*
Schedule EZC—Kentucky Enterprise Zone Tax Credit	41A720EZC	*
Schedule HH—Housing for Homeless Families Deduction	41A720HH	*
Schedule RC—Application for Income Tax Credit for Recycling and/or Composting Equipment	41A720RC	*
Schedule RC(C)—Continuation Sheet for Schedule RC	41A720RC(C)	*
Schedule RC (K-1)—Pro Rata/Distributive Share of Recycling Equipment Tax Credit	41A720RC (K-1)	*
722—Election to File Consolidated Kentucky Corporation Income Tax Return	41A722	*
851-K—Kentucky Affiliations and Payment Schedule	41A851-K	*
Total Forms—Page 2 (enter here and on page 1)		➤
ENVELOPES (Available in groups of 100 only)		
Refund 6" x 9" Blue —Enter number of groups here and on page 1		➤
Payment 6" x 9" Yellow—Enter number of groups here and on page 1		➤

***Forms shaded and marked with an asterisk(*) are provided at no charge.**

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