

103 KAR 16:340.Completed contract method.

RELATES TO: KRS 141.120

STATUTORY AUTHORITY: KRS 131.130, 141.120

NECESSITY, FUNCTION, AND CONFORMITY: KRS 141.120 provides for the division of income of interstate business for tax purposes. KRS 131.130(1) authorizes the department to promulgate administrative regulations to administer and interpret Kentucky's tax laws. This administrative regulation explains how the apportionable income allocation and apportionment factors shall be calculated when net income is reported on a completed contract basis.

Section 1. Definitions. (1) "Completed contract method of accounting" means a method of accounting whereby apportionable income from long-term contracts is reported for the taxable year in which the contract is finally completed and accepted.

(2) "Gross contract price" means the percentage of the entire contract that has been completed, from the commencement of the contract to the date of withdrawal, dissolution, or cessation of business.

(3) "Long-term contracts" means contracts covering a period in excess of one (1) year from the date of execution of the contract to the date on which the contract is finally completed and accepted.

Section 2. General. If a corporation uses the completed contract method of accounting, the apportionable income earned within Kentucky shall be determined by the use of the apportionment factor determined pursuant to KRS 141.120, as modified by the special rules for apportionable income derived from long term contracts established in Sections 3 to 5 of this administrative regulation.

Section 3. Sales Factor. The numerator and denominator of the sales factor shall be determined pursuant to KRS 141.120(9) and the following special rules:

(1) Gross receipts derived from the performance of a contract shall be attributable to Kentucky if the construction project is located in Kentucky. If the construction project is located partly within and partly without Kentucky, the gross receipts attributable to Kentucky shall be based upon the ratio which construction costs for the project in Kentucky incurred during the taxable year bear to the total of construction costs for the entire project during the taxable year.

(2) The sales factor shall include the portion of the gross receipts (progress billings) received or accrued, whichever is applicable, during the taxable year attributable to each contract.

Section 4.(1) The completed contract method of accounting shall require that the reporting of income (or loss) be deferred until the year in which the construction project is completed or accepted.

(2) Accordingly, a separate computation shall be made for each contract completed during the taxable year, regardless of whether the project is located within or without Kentucky, to determine the amount of income, which is attributable to sources within Kentucky.

(3) The amount of income from each contract completed during the taxable year apportioned to this state, plus other apportionable income apportioned to this state such as interest income, rents, royalties, income from short-term contracts, etc., plus all non-apportionable income allocated to Kentucky, shall be the measure of tax for the taxable year.

(4) The amount of income (or loss) from each contract which is derived from sources within Kentucky using the completed contract method of accounting shall be computed as follows:

(a) The amount of income (or loss) shall be determined in the taxable year in which the contract is completed.

(b) The income (or loss) determined by paragraph (a) of this subsection shall be apportioned to Kentucky by the following method:

1. A fraction shall be determined for each year during which the contract was in progress. The numerator shall be the amount of construction costs paid or accrued in each year during which the contract was in progress and the denominator shall be the total of all construction costs for the project.

2. The amount of total income (or loss) from the contract determined under paragraph (a) of this subsection shall be multiplied by the total percentage determined by subparagraph 1 of this paragraph. The resulting income (or loss) shall be the amount of apportionable income from the contract derived from sources within Kentucky.

Section 5. Computation for Year of Withdrawal, Dissolution or Cessation of Business. (1) Use of the completed contract method of accounting shall require that income derived from sources within Kentucky from incomplete contracts in progress outside Kentucky on the date of withdrawal, dissolution, or cessation of business in Kentucky be included in the measure of tax for the taxable year during which the corporation withdraws, dissolves, or ceases doing business in this state.

(2) The amount of income (or loss) from each contract to be apportioned to Kentucky by the apportionment method established in Section 4(4)(b) of this administrative regulation shall be determined as follows:

(a) The amount of apportionable income (or loss) for each contract shall be the amount by which the gross contract price from each contract exceeds all expenditures made during the period in connection with each contract.

(b) In so doing, account shall be taken of the material and supplies on hand at the beginning and end of the taxable year for use in each contract. (32 Ky.R. 2204; 33 Ky.R. 76; eff. 8-7-2006; 45 Ky.R. 1316, 2065; eff. 2-1-2019.)