

AN ACT relating to tax credits to promote quality education in Kentucky.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

➔SECTION 1. A NEW SECTION OF KRS CHAPTER 141 IS CREATED TO READ AS FOLLOWS:

- (1) (a) Effective for taxable years beginning on or after January 1, 2015, but before January 1, 2019, a nonrefundable tax credit shall be allowed against the tax imposed by KRS 141.020 or 141.040 and 141.0401, with the ordering of credits as provided in Section 4 of this Act, for cash contributions made during a taxable year to the Commonwealth school improvement fund established in KRS 158.805.
- (b) If the taxpayer is a pass-through entity, the taxpayer shall apply the credit against the limited liability entity tax imposed by KRS 141.0401, and shall also pass the credit through to its members, partners, or shareholders in the same proportion as the distributive share of income or loss is passed through.
- (c) The tax credit amount shall be equal to the lesser of fifty percent (50%) of the total contributions made to the Commonwealth school improvement fund established in KRS 158.805 during the taxable year or two hundred thousand dollars (\$200,000) per taxpayer per taxable year.
- (d) The aggregate value of all credits provided under this section shall not exceed thirty-five million dollars (\$35,000,000) for fiscal year 2015-2016 and each fiscal year thereafter.
- (2) (a) Authorizations for tax credits under this section shall be awarded on a first-come, first-served basis, within the limitations set forth in this section.
- (b) The application for the credit shall be void if the application is received after the tax credit cap established in subsection (1)(d) of this section has been reached.

- (3) To administer the tax credit and the tax credit cap established in subsection (1)(d) of this section, the department shall:
- (a) Create the application to be filed by the taxpayer seeking the credit;
 - (b) Create a Web site listing the amount of the total credit allocated to date, the date the last processed application was received, and the remaining credit available to taxpayers making contributions to the Commonwealth school improvement fund;
 - (c) Allow the date and time stamp from the application to establish the order in which the application was received;
 - (d) Notify the taxpayer of the allowable credit available by the issuance of a tax credit allocation letter, which the taxpayer shall submit with the taxpayer's return when claiming the credit; and
 - (e) Promulgate administrative regulations to establish the process and procedures for taxpayers to apply for the tax credit.
- (4) A taxpayer pursuing a tax credit under this section shall:
- (a) Make a cash contribution to the Commonwealth school improvement fund established in KRS 158.805;
 - (b) Obtain a receipt for the cash contribution from the Kentucky Board of Education; and
 - (c) File an application for a tax credit authorization with the department.
- (5) (a) If a taxpayer takes the credit provided under this section, the taxpayer shall not be entitled to a charitable contribution deduction for the contributions on which the credit has been taken.
- (b) If a taxpayer does not request a tax credit as provided under this section, or if charitable contributions are made in excess of those taken by the taxpayer for the tax credit established in this section, the contributions shall be treated in the same manner as normal charitable contributions under this

chapter.

(6) A tax credit not used in the tax year the contribution was made shall not be carried forward or carried back and shall not be refundable or transferable.

(7) The department shall submit a report to the Legislative Research Commission on or before November 1 of each year that includes the number of taxpayers authorized to take the credit, the total amount of credit authorized for all taxpayers, the average amount of credit authorized, and the amount of tax credit claimed on returns filed.

➔SECTION 2. A NEW SECTION OF KRS CHAPTER 141 IS CREATED TO READ AS FOLLOWS:

(1) As used in this section:

(a) "Annual receipts" means the total amount of contributions received by a qualified tuition assistance organization during the qualified tuition assistance organization's calendar or fiscal year for tuition assistance programs;

(b) "Contribution" means a donation of cash or personal property, the value of which is the fair market value of the personal property at the time the donation is made;

(c) "Eligible student" means a school-age student who resides in Kentucky, is enrolled in a school, and is a member of a household with an annual household income of not more than sixty thousand dollars (\$60,000), provided the annual household income threshold shall be increased by ten thousand dollars (\$10,000) for each additional eligible student or additional dependent of the household;

(d) "Household" means:

1. An individual living alone;
2. An individual living with a spouse;

3. One (1) or more parents living with their unemancipated minor children who are related by blood, marriage, or legal adoption; or
 4. An individual living with adults or unemancipated minor children in the household who are dependents of that individual;
- (e) "Household income" means all money or property received by all members of the household of whatever nature and from whatever source derived, excluding:
1. Periodic payments for sickness and disability other than regular wages received during a period of sickness or disability;
 2. Disability, retirement, or other payments arising under workers' compensation laws, occupational disease laws, or similar legislation by any government;
 3. Payments commonly recognized as old age or retirement benefits paid to persons retired from service after reaching a specific age or after a stated period of employment;
 4. Payments commonly known as public assistance or unemployment compensation payments by a governmental agency;
 5. Payments made in reimbursement of actual expenses;
 6. Payments made by employers or labor unions for programs covering hospitalization, sickness, disability or death, supplemental unemployment benefits, strike benefits, and retirement; and
 7. Compensation received by United States service members exempted under KRS 141.010(10)(u);
- (f) "Qualified tuition assistance organization" means a nonprofit organization that:
1. Is exempt from federal taxation under Section 501(c)(3) of the Internal Revenue Code;

2. Distributes at least ninety percent (90%) of its annual receipts to a tuition assistance program; and
 3. Is certified by the department as eligible to receive contributions which qualify for the tax credit established under subsections (2) and (3) of this section;
- (g) "School" means a public or nonpublic kindergarten, or a public or nonpublic elementary or secondary school located within the state;
- (h) "School age" means the earliest admission age to a school's kindergarten program or, if no kindergarten program is provided, the school's earliest admission age for beginners, until the student graduates from high school or at the end of the school year in which the student reaches twenty-one (21) years of age, whichever occurs first;
- (i) "Taxpayer" means a person subject to the tax imposed under KRS 136.505, 141.020, 141.040, or 141.0401; and
- (j) "Tuition assistance program" means a program that:
1. Provides tuition assistance:
 - a. To more than one (1) eligible student to attend a school located in Kentucky. Tuition assistance may include any fees required, but shall not exceed the actual amount of tuition charged by the school in which the student is enrolled, or the actual amount of tuition charged by the school to students who do not receive tuition assistance; and
 - b. Without limiting availability to only students of one (1) school;
 2. Has policies in place concerning rebates or refunds of tuition money for students who withdraw from a school prior to the end of the period for which the tuition has been paid; and
 3. Has a policy in place that maintains the confidentiality of information

pertaining to student eligibility, including income information.

(2) A tuition assistance tax credit is hereby established.

(3) (a) Effective for taxable years beginning on or after January 1, 2015, but before January 1, 2019, a nonrefundable tax credit shall be allowed against the tax imposed by KRS 141.020 or 141.040 and 141.0401, with the ordering of credits as provided in Section 4 of this Act, for contributions made during a taxable year to one (1) or more qualified tuition assistance organizations.

(b) If the taxpayer is a pass-through entity, the taxpayer shall apply the credit against the limited liability entity tax imposed by KRS 141.0401, and shall also pass the credit through to its members, partners, or shareholders in the same proportion as the distributive share of income or loss is passed through.

(c) The tax credit amount shall be equal to the lesser of fifty percent (50%) of the total contributions made to qualified tuition assistance organizations during the taxable year, or two hundred thousand dollars (\$200,000) per taxpayer per taxable year.

(d) The aggregate value of all credits provided under this section shall not exceed fifteen million dollars (\$15,000,000) for fiscal year 2015-2016 and each fiscal year thereafter.

(4) (a) Authorizations for tax credits under this section shall be awarded on a first-come, first-served basis, within the limitations set forth in this section.

(b) The application for the credit shall be void if the application is received after the tax credit cap established in subsection (3)(d) of this section has been reached.

(5) To administer the tax credit and the tax credit cap established in subsection (3)(d) of this section, the department shall:

(a) Create the application to be filed by the taxpayer seeking the credit;

- (b) Create a Web site listing the amount of the total credit allocated to date, the date the last processed application was received, and the remaining credit available to taxpayers making contributions to tuition assistance organizations;
- (c) Allow the date and time stamp from the application to establish the order in which the application was received;
- (d) Notify the taxpayer of the allowable credit available by the issuance of a tax credit allocation letter, which the taxpayer shall submit with the taxpayer's return when claiming the credit; and
- (e) Promulgate administrative regulations to establish:
1. The procedures and timelines for nonprofit organizations to receive approval as qualified tuition assistance organizations on an annual basis. The regulations shall include a requirement that the nonprofit organization submit with its application:
 - a. A copy of the organization's income tax exemption under Section 501(c)(3) of the Internal Revenue Code;
 - b. A description of the tuition assistance program operated by the organization. The description shall include a discussion of the application and review process and income verification procedures utilized by the organization; and
 - c. Any other information the department may require to verify the organization's qualification to participate;
 2. The process and procedures for taxpayers to apply for tax credit authorizations;
 3. The reporting requirements for qualified tuition assistance organizations, including:
 - a. An annual monitoring report outlining:

- i. The number of eligible students in kindergarten through eighth grade receiving tuition assistance, the total tuition received, and the average tuition assistance received by each eligible student;
 - ii. The number of eligible students in ninth through twelfth grade receiving tuition assistance, the total tuition received, and the average tuition assistance received by each eligible student; and
 - iii. The name of the school the eligible student attended, the name of the county in which the school is located, and the student's grade; and
 - b. Independent financial audits to verify use of annual receipts; and
 - 4. Any other procedures necessary to implement this section.
- (6) The department shall notify a nonprofit organization of its approval or disapproval as a qualified tuition assistance organization within sixty (60) days after the organization has submitted the required information.
- (7) (a) The department shall publish on its Web site an up-to-date list of qualified tuition assistance organizations.
- (b) The department shall make the list available to the Department of Education, which shall also publish the list on its Web site.
- (c) If a qualified tuition assistance organization fails to contribute at least ninety percent (90%) of its annual receipts to one (1) or more approved tuition assistance programs, or if the department determines that the organization no longer meets the requirements of this section, the department shall remove the organization from the list.
- (d) Only contributions to qualified tuition assistance organizations on the list

maintained by the department shall be recognized for tax credits under this section. Contributions made to a tuition assistance organization that has been removed from the department's list of qualified tuition assistance organizations shall not be recognized for the tax credit.

(8) (a) Qualified tuition assistance organizations shall be responsible for awarding financial aid in accordance with this section.

(b) Qualified tuition assistance organizations shall:

1. Award financial aid to eligible students and shall maintain an annual list of persons receiving financial aid, including the amounts received, the name of the school the eligible student attended, and the county in which the school is located; and

2. Provide a receipt to the taxpayer for the contribution made.

(c) Qualified tuition assistance organizations shall not:

1. Award financial assistance to a dependent of the organization's board of directors or staff; or

2. Accept a contribution from a taxpayer if the taxpayer designates that the contribution shall be used to award any financial assistance to a particular student or group of students.

(9) A taxpayer pursuing a tax credit under this section shall:

(a) Make a contribution to a qualified tuition assistance organization;

(b) Obtain a receipt for the contribution from the qualified tuition assistance organization; and

(c) File an application for a tax credit authorization with the department.

(10) (a) If a taxpayer takes the credit provided under this section, the taxpayer shall not be entitled to a charitable contribution deduction for the contributions on which the credit has been taken.

(b) If a taxpayer does not request a tax credit as provided under this section, or

if charitable contributions are made in excess of those taken by the taxpayer for the tax credit established in this section, the contributions shall be treated in the same manner as normal charitable contributions under this chapter.

(11) The department shall not approve a tax credit for activities that are part of a taxpayer's normal course of business.

(12) A tax credit not used in the tax year the contribution was made shall not be carried forward or carried back and shall not be refundable or transferable.

(13) To assist the members of the General Assembly in determining the impact of the tax credit established by this section on the quality of education in this state, the department shall submit a report to the Legislative Research Commission on or before November 1 of each year that includes:

(a) The number of taxpayers authorized to take the credit and the average amount of credit authorized; and

(b) A compilation of the information provided to the department by the qualified tuition assistance organizations in the annual monitoring reports required by subsection (5)(e)3. of this section.

➔Section 3. KRS 141.010 is amended to read as follows:

As used in this chapter, unless the context requires otherwise:

- (1) "Commissioner" means the commissioner of the Department of Revenue;
- (2) "Department" means the Department of Revenue;
- (3) "Internal Revenue Code" means the Internal Revenue Code in effect on December 31, 2013, exclusive of any amendments made subsequent to that date, other than amendments that extend provisions in effect on December 31, 2013, that would otherwise terminate, and as modified by KRS 141.0101;
- (4) "Dependent" means those persons defined as dependents in the Internal Revenue Code;

- (5) "Fiduciary" means "fiduciary" as defined in Section 7701(a)(6) of the Internal Revenue Code;
- (6) "Fiscal year" means "fiscal year" as defined in Section 7701(a)(24) of the Internal Revenue Code;
- (7) "Individual" means a natural person;
- (8) "Modified gross income" means the greater of:
 - (a) Adjusted gross income as defined in Section 62 of the Internal Revenue Code of 1986, including any subsequent amendments in effect on December 31 of the taxable year, and adjusted as follows:
 - 1. Include interest income derived from obligations of sister states and political subdivisions thereof; and
 - 2. Include lump-sum pension distributions taxed under the special transition rules of Pub. L. No. 104-188, sec. 1401(c)(2); or
 - (b) Adjusted gross income as defined in subsection (10) of this section and adjusted to include lump-sum pension distributions taxed under the special transition rules of Pub. L. No. 104-188, sec. 1401(c)(2);
- (9) "Gross income," in the case of taxpayers other than corporations, means "gross income" as defined in Section 61 of the Internal Revenue Code;
- (10) "Adjusted gross income," in the case of taxpayers other than corporations, means gross income as defined in subsection (9) of this section minus the deductions allowed individuals by Section 62 of the Internal Revenue Code and as modified by KRS 141.0101 and adjusted as follows, except that deductions shall be limited to amounts allocable to income subject to taxation under the provisions of this chapter, and except that nothing in this chapter shall be construed to permit the same item to be deducted more than once:
 - (a) Exclude income that is exempt from state taxation by the Kentucky Constitution and the Constitution and statutory laws of the United States and

Kentucky;

- (b) Exclude income from supplemental annuities provided by the Railroad Retirement Act of 1937 as amended and which are subject to federal income tax by Public Law 89-699;
- (c) Include interest income derived from obligations of sister states and political subdivisions thereof;
- (d) Exclude employee pension contributions picked up as provided for in KRS 6.505, 16.545, 21.360, 61.560, 65.155, 67A.320, 67A.510, 78.610, and 161.540 upon a ruling by the Internal Revenue Service or the federal courts that these contributions shall not be included as gross income until such time as the contributions are distributed or made available to the employee;
- (e) Exclude Social Security and railroad retirement benefits subject to federal income tax;
- (f) Include, for taxable years ending before January 1, 1991, all overpayments of federal income tax refunded or credited for taxable years;
- (g) Deduct, for taxable years ending before January 1, 1991, federal income tax paid for taxable years ending before January 1, 1990;
- (h) Exclude any money received because of a settlement or judgment in a lawsuit brought against a manufacturer or distributor of "Agent Orange" for damages resulting from exposure to Agent Orange by a member or veteran of the Armed Forces of the United States or any dependent of such person who served in Vietnam;
- (i) 1. For taxable years ending prior to December 31, 2005, exclude the applicable amount of total distributions from pension plans, annuity contracts, profit-sharing plans, retirement plans, or employee savings plans.

The "applicable amount" shall be:

- a. Twenty-five percent (25%), but not more than six thousand two hundred fifty dollars (\$6,250), for taxable years beginning after December 31, 1994, and before January 1, 1996;
 - b. Fifty percent (50%), but not more than twelve thousand five hundred dollars (\$12,500), for taxable years beginning after December 31, 1995, and before January 1, 1997;
 - c. Seventy-five percent (75%), but not more than eighteen thousand seven hundred fifty dollars (\$18,750), for taxable years beginning after December 31, 1996, and before January 1, 1998; and
 - d. One hundred percent (100%), but not more than thirty-five thousand dollars (\$35,000), for taxable years beginning after December 31, 1997.
2. For taxable years beginning after December 31, 2005, exclude up to forty-one thousand one hundred ten dollars (\$41,110) of total distributions from pension plans, annuity contracts, profit-sharing plans, retirement plans, or employee savings plans.
 3. As used in this paragraph:
 - a. "Distributions" includes but is not limited to any lump-sum distribution from pension or profit-sharing plans qualifying for the income tax averaging provisions of Section 402 of the Internal Revenue Code; any distribution from an individual retirement account as defined in Section 408 of the Internal Revenue Code; and any disability pension distribution;
 - b. "Annuity contract" has the same meaning as set forth in Section 1035 of the Internal Revenue Code; and
 - c. "Pension plans, profit-sharing plans, retirement plans, or employee savings plans" means any trust or other entity created or organized

under a written retirement plan and forming part of a stock bonus, pension, or profit-sharing plan of a public or private employer for the exclusive benefit of employees or their beneficiaries and includes plans qualified or unqualified under Section 401 of the Internal Revenue Code and individual retirement accounts as defined in Section 408 of the Internal Revenue Code;

- (j)
 - 1.
 - a. Exclude the portion of the distributive share of a shareholder's net income from an S corporation subject to the franchise tax imposed under KRS 136.505 or the capital stock tax imposed under KRS 136.300; and
 - b. Exclude the portion of the distributive share of a shareholder's net income from an S corporation related to a qualified subchapter S subsidiary subject to the franchise tax imposed under KRS 136.505 or the capital stock tax imposed under KRS 136.300.
 - 2. The shareholder's basis of stock held in a S corporation where the S corporation or its qualified subchapter S subsidiary is subject to the franchise tax imposed under KRS 136.505 or the capital stock tax imposed under KRS 136.300 shall be the same as the basis for federal income tax purposes;
- (k) Exclude, to the extent not already excluded from gross income, any amounts paid for health insurance, or the value of any voucher or similar instrument used to provide health insurance, which constitutes medical care coverage for the taxpayer, the taxpayer's spouse, and dependents, or for any person authorized to be provided excludable coverage by the taxpayer pursuant to the federal Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111-148, or the Health Care and Education Reconciliation Act of 2010 Pub. L. No. 111-152, during the taxable year. Any amounts paid by the taxpayer for health

insurance that are excluded pursuant to this paragraph shall not be allowed as a deduction in computing the taxpayer's net income under subsection (11) of this section;

- (l) Exclude income received for services performed as a precinct worker for election training or for working at election booths in state, county, and local primary, regular, or special elections;
- (m) Exclude any amount paid during the taxable year for insurance for long-term care as defined in KRS 304.14-600;
- (n) Exclude any capital gains income attributable to property taken by eminent domain;
- (o) Exclude any amount received by a producer of tobacco or a tobacco quota owner from the multistate settlement with the tobacco industry, known as the Master Settlement Agreement, signed on November 22, 1998;
- (p) Exclude any amount received from the secondary settlement fund, referred to as "Phase II," established by tobacco companies to compensate tobacco farmers and quota owners for anticipated financial losses caused by the national tobacco settlement;
- (q) Exclude any amount received from funds of the Commodity Credit Corporation for the Tobacco Loss Assistance Program as a result of a reduction in the quantity of tobacco quota allotted;
- (r) Exclude any amount received as a result of a tobacco quota buydown program that all quota owners and growers are eligible to participate in;
- (s) Exclude state Phase II payments received by a producer of tobacco or a tobacco quota owner;
- (t) Exclude all income from all sources for active duty and reserve members and officers of the Armed Forces of the United States or National Guard who are killed in the line of duty, for the year during which the death occurred and the

year prior to the year during which the death occurred. For the purposes of this paragraph, "all income from all sources" shall include all federal and state death benefits payable to the estate or any beneficiaries;~~and~~

- (u) For taxable years beginning on or after January 1, 2010, exclude all military pay received by active duty members of the Armed Forces of the United States, members of reserve components of the Armed Forces of the United States, and members of the National Guard, including compensation for state active duty as described in KRS 38.205; *and*

- (v) *Exclude any amount received by an eligible student, or by an individual on behalf of an eligible student, as tuition assistance from a tuition assistance organization as provided by Section 2 of this Act for taxable years beginning on or after January 1, 2015;*

(11) "Net income," in the case of taxpayers other than corporations, means adjusted gross income as defined in subsection (10) of this section, minus:

- (a) The deduction allowed by KRS 141.0202;
- (b) Any amount paid for vouchers or similar instruments that provide health insurance coverage to employees or their families;
- (c) For taxable years beginning on or after January 1, 2010, the amount of domestic production activities deduction calculated at six percent (6%) as allowed in Section 199(a)(2) of the Internal Revenue Code for taxable years beginning before 2010; and
- (d) 1. All the deductions allowed individuals by Chapter 1 of the Internal Revenue Code as modified by KRS 141.0101 except:
 - a. Any deduction allowed by the Internal Revenue Code for state or foreign taxes measured by gross or net income, including state and local general sales taxes allowed in lieu of state and local income taxes under the provisions of Section 164(b)(5) of the Internal

Revenue Code;

- b. Any deduction allowed by the Internal Revenue Code for amounts allowable under KRS 140.090(1)(h) in calculating the value of the distributive shares of the estate of a decedent, unless there is filed with the income return a statement that such deduction has not been claimed under KRS 140.090(1)(h);
- c. The deduction for personal exemptions allowed under Section 151 of the Internal Revenue Code and any other deductions in lieu thereof;
- d. For taxable years beginning on or after January 1, 2010, the domestic production activities deduction allowed under Section 199 of the Internal Revenue Code;
- e. Any deduction for amounts paid to any club, organization, or establishment which has been determined by the courts or an agency established by the General Assembly and charged with enforcing the civil rights laws of the Commonwealth, not to afford full and equal membership and full and equal enjoyment of its goods, services, facilities, privileges, advantages, or accommodations to any person because of race, color, religion, national origin, or sex, except nothing shall be construed to deny a deduction for amounts paid to any religious or denominational club, group, or establishment or any organization operated solely for charitable or educational purposes which restricts membership to persons of the same religion or denomination in order to promote the religious principles for which it is established and maintained;
- f. Any deduction directly or indirectly allocable to income which is

- either exempt from taxation or otherwise not taxed under this chapter;
- g. The itemized deduction limitation established in 26 U.S.C. sec. 68 shall be determined using the applicable amount from 26 U.S.C. sec. 68 as it existed on December 31, 2006; and
 - h. A taxpayer may elect to claim the standard deduction allowed by KRS 141.081 instead of itemized deductions allowed pursuant to 26 U.S.C. sec. 63 and as modified by this section; and
2. Nothing in this chapter shall be construed to permit the same item to be deducted more than once;
- (12) "Gross income," in the case of corporations, means "gross income" as defined in Section 61 of the Internal Revenue Code and as modified by KRS 141.0101 and adjusted as follows:
- (a) Exclude income that is exempt from state taxation by the Kentucky Constitution and the Constitution and statutory laws of the United States;
 - (b) Exclude all dividend income received after December 31, 1969;
 - (c) Include interest income derived from obligations of sister states and political subdivisions thereof;
 - (d) Exclude fifty percent (50%) of gross income derived from any disposal of coal covered by Section 631(c) of the Internal Revenue Code if the corporation does not claim any deduction for percentage depletion, or for expenditures attributable to the making and administering of the contract under which such disposition occurs or to the preservation of the economic interests retained under such contract;
 - (e) Include in the gross income of lessors income tax payments made by lessees to lessors, under the provisions of Section 110 of the Internal Revenue Code, and exclude such payments from the gross income of lessees;

- (f) Include the amount calculated under KRS 141.205;
- (g) Ignore the provisions of Section 281 of the Internal Revenue Code in computing gross income;
- (h) Exclude income from "safe harbor leases" (Section 168(f)(8) of the Internal Revenue Code);
- (i) Exclude any amount received by a producer of tobacco or a tobacco quota owner from the multistate settlement with the tobacco industry, known as the Master Settlement Agreement, signed on November 22, 1998;
- (j) Exclude any amount received from the secondary settlement fund, referred to as "Phase II," established by tobacco companies to compensate tobacco farmers and quota owners for anticipated financial losses caused by the national tobacco settlement;
- (k) Exclude any amount received from funds of the Commodity Credit Corporation for the Tobacco Loss Assistance Program as a result of a reduction in the quantity of tobacco quota allotted;
- (l) Exclude any amount received as a result of a tobacco quota buydown program that all quota owners and growers are eligible to participate in;
- (m) For taxable years beginning after December 31, 2004, and before January 1, 2007, exclude the distributive share income or loss received from a corporation defined in subsection (24)(b) of this section whose income has been subject to the tax imposed by KRS 141.040. The exclusion provided in this paragraph shall also apply to a taxable year that begins prior to January 1, 2005, if the tax imposed by KRS 141.040 is paid on the distributive share income by a corporation defined in subparagraphs 2. to 8. of subsection (24)(b) of this section with a return filed for a period of less than twelve (12) months that begins on or after January 1, 2005, and ends on or before December 31, 2005. This paragraph shall not be used to delay payment of the

- tax imposed by KRS 141.040; and
- (n) Exclude state Phase II payments received by a producer of tobacco or a tobacco quota owner;
- (13) "Net income," in the case of corporations, means "gross income" as defined in subsection (12) of this section minus:
- (a) The deduction allowed by KRS 141.0202;
 - (b) Any amount paid for vouchers or similar instruments that provide health insurance coverage to employees or their families;
 - (c) For taxable years beginning on or after January 1, 2010, the amount of domestic production activities deduction calculated at six percent (6%) as allowed in Section 199(a)(2) of the Internal Revenue Code for taxable years beginning before 2010; and
 - (d) All the deductions from gross income allowed corporations by Chapter 1 of the Internal Revenue Code and as modified by KRS 141.0101, except:
 - 1. Any deduction for a state tax which is computed, in whole or in part, by reference to gross or net income and which is paid or accrued to any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or to any foreign country or political subdivision thereof;
 - 2. The deductions contained in Sections 243, 244, 245, and 247 of the Internal Revenue Code;
 - 3. The provisions of Section 281 of the Internal Revenue Code shall be ignored in computing net income;
 - 4. Any deduction directly or indirectly allocable to income which is either exempt from taxation or otherwise not taxed under the provisions of this chapter, and nothing in this chapter shall be construed to permit the same item to be deducted more than once;

5. Exclude expenses related to "safe harbor leases" (Section 168(f)(8) of the Internal Revenue Code);
 6. Any deduction for amounts paid to any club, organization, or establishment which has been determined by the courts or an agency established by the General Assembly and charged with enforcing the civil rights laws of the Commonwealth, not to afford full and equal membership and full and equal enjoyment of its goods, services, facilities, privileges, advantages, or accommodations to any person because of race, color, religion, national origin, or sex, except nothing shall be construed to deny a deduction for amounts paid to any religious or denominational club, group, or establishment or any organization operated solely for charitable or educational purposes which restricts membership to persons of the same religion or denomination in order to promote the religious principles for which it is established and maintained;
 7. Any deduction prohibited by KRS 141.205;
 8. Any dividends-paid deduction of any captive real estate investment trust; and
 9. For taxable years beginning on or after January 1, 2010, the domestic production activities deduction allowed under Section 199 of the Internal Revenue Code;
- (14) (a) "Taxable net income," in the case of corporations that are taxable in this state, means "net income" as defined in subsection (13) of this section;
- (b) "Taxable net income," in the case of corporations that are taxable in this state and taxable in another state, means "net income" as defined in subsection (13) of this section and as allocated and apportioned under KRS 141.120. A corporation is taxable in another state if, in any state other than Kentucky, the

corporation is required to file a return for or pay a net income tax, franchise tax measured by net income, franchise tax for the privilege of doing business, or corporate stock tax;

- (c) "Taxable net income," in the case of homeowners' associations as defined in Section 528(c) of the Internal Revenue Code, means "taxable income" as defined in Section 528(d) of the Internal Revenue Code. Notwithstanding the provisions of subsection (3) of this section, the Internal Revenue Code sections referred to in this paragraph shall be those code sections in effect for the applicable tax year; and
- (d) "Taxable net income," in the case of a corporation that meets the requirements established under Section 856 of the Internal Revenue Code to be a real estate investment trust, means "real estate investment trust taxable income" as defined in Section 857(b)(2) of the Internal Revenue Code, except that a captive real estate investment trust shall not be allowed any deduction for dividends paid;
- (15) "Person" means "person" as defined in Section 7701(a)(1) of the Internal Revenue Code;
- (16) "Taxable year" means the calendar year or fiscal year ending during such calendar year, upon the basis of which net income is computed, and in the case of a return made for a fractional part of a year under the provisions of this chapter or under regulations prescribed by the commissioner, "taxable year" means the period for which the return is made;
- (17) "Resident" means an individual domiciled within this state or an individual who is not domiciled in this state, but maintains a place of abode in this state and spends in the aggregate more than one hundred eighty-three (183) days of the taxable year in this state;
- (18) "Nonresident" means any individual not a resident of this state;

- (19) "Employer" means "employer" as defined in Section 3401(d) of the Internal Revenue Code;
- (20) "Employee" means "employee" as defined in Section 3401(c) of the Internal Revenue Code;
- (21) "Number of withholding exemptions claimed" means the number of withholding exemptions claimed in a withholding exemption certificate in effect under KRS 141.325, except that if no such certificate is in effect, the number of withholding exemptions claimed shall be considered to be zero;
- (22) "Wages" means "wages" as defined in Section 3401(a) of the Internal Revenue Code and includes other income subject to withholding as provided in Section 3401(f) and Section 3402(k), (o), (p), (q), and (s) of the Internal Revenue Code;
- (23) "Payroll period" means "payroll period" as defined in Section 3401(b) of the Internal Revenue Code;
- (24) (a) For taxable years beginning before January 1, 2005, and after December 31, 2006, "corporation" means "corporation" as defined in Section 7701(a)(3) of the Internal Revenue Code; and
- (b) For taxable years beginning after December 31, 2004, and before January 1, 2007, "corporations" means:
1. "Corporations" as defined in Section 7701(a)(3) of the Internal Revenue Code;
 2. S corporations as defined in Section 1361(a) of the Internal Revenue Code;
 3. A foreign limited liability company as defined in KRS 275.015;
 4. A limited liability company as defined in KRS 275.015;
 5. A professional limited liability company as defined in KRS 275.015;
 6. A foreign limited partnership as defined in KRS 362.2-102(9);
 7. A limited partnership as defined in KRS 362.2-102(14);

8. A limited liability partnership as defined in KRS 362.155(7) or in 362.1-101(7) or (8);
9. A real estate investment trust as defined in Section 856 of the Internal Revenue Code;
10. A regulated investment company as defined in Section 851 of the Internal Revenue Code;
11. A real estate mortgage investment conduit as defined in Section 860D of the Internal Revenue Code;
12. A financial asset securitization investment trust as defined in Section 860L of the Internal Revenue Code; and
13. Other similar entities created with limited liability for their partners, members, or shareholders.

For purposes of this paragraph, "corporation" shall not include any publicly traded partnership as defined by Section 7704(b) of the Internal Revenue Code that is treated as a partnership for federal tax purposes under Section 7704(c) of the Internal Revenue Code or its publicly traded partnership affiliates. As used in this paragraph, "publicly traded partnership affiliates" shall include any limited liability company or limited partnership for which at least eighty percent (80%) of the limited liability company member interests or limited partner interests are owned directly or indirectly by the publicly traded partnership;

- (25) "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 (1) or more individuals performing services in this state;
 - (e) Maintaining an interest in a pass-through entity 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 deriving income directly or indirectly from a single-member limited liability company that is doing business in this state and is disregarded as an entity separate from its single member for federal income tax purposes; or
- (g) Directing activities at Kentucky customers for the purpose of selling them goods or services.

Nothing in this subsection shall be interpreted in a manner that goes beyond the limitations imposed and protections provided by the United States Constitution or Pub. L. No. 86-272;

- (26) "Pass-through entity" means any partnership, S corporation, limited liability company, limited liability partnership, limited partnership, or similar entity recognized by the laws of this state that is not taxed for federal purposes at the entity level, but instead passes to each partner, member, shareholder, or owner their proportionate share of income, deductions, gains, losses, credits, and any other similar attributes;
- (27) "S corporation" means "S corporation" as defined in Section 1361(a) of the Internal Revenue Code;
- (28) "Limited liability pass-through entity" means any pass-through entity that affords any of its partners, members, shareholders, or owners, through function of the laws of this state or laws recognized by this state, protection from general liability for actions of the entity; and
- (29) "Captive real estate investment trust" means a real estate investment trust as defined in Section 856 of the Internal Revenue Code that meets the following requirements:
 - (a) 1. The shares or other ownership interests of the real estate investment trust are not regularly traded on an established securities market; or
 - 2. The real estate investment trust does not have enough shareholders or

owners to be required to register with the Securities and Exchange Commission; and

- (b) 1. The maximum amount of stock or other ownership interest that is owned or constructively owned by a corporation equals or exceeds:
- a. Twenty-five percent (25%), if the corporation does not occupy property owned, constructively owned, or controlled by the real estate investment trust; or
 - b. Ten percent (10%), if the corporation occupies property owned, constructively owned, or controlled by the real estate investment trust.

The total ownership interest of a corporation shall be determined by aggregating all interests owned or constructively owned by a corporation;

2. For the purposes of this paragraph:
- a. "Corporation" means a corporation taxable under KRS 141.040, and includes an affiliated group as defined in KRS 141.200, that is required to file a consolidated return pursuant to the provisions of KRS 141.200; and
 - b. "Owned or constructively owned" means owning shares or having an ownership interest in the real estate investment trust, or owning an interest in an entity that owns shares or has an ownership interest in the real estate investment trust. Constructive ownership shall be determined by looking across multiple layers of a multilayer pass-through structure; and
- (c) The real estate investment trust is not owned by another real estate investment trust.

➔Section 4. KRS 141.0205 is amended to read as follows:

If a taxpayer is entitled to more than one (1) of the tax credits allowed against the tax imposed by KRS 141.020, 141.040, and 141.0401, the priority of application and use of the credits shall be determined as follows:

- (1) The nonrefundable business incentive credits against the tax imposed by KRS 141.020 shall be taken in the following order:
 - (a) 1. For taxable years beginning after December 31, 2004, and before January 1, 2007, the corporation income tax credit permitted by KRS 141.420(3)(a);
 2. For taxable years beginning after December 31, 2006, the limited liability entity tax credit permitted by KRS 141.0401;
- (b) The economic development credits computed under KRS 141.347, 141.381, 141.384, 141.400, 141.401, 141.402, 141.403, 141.407, 141.415, 154.12-2088, and 154.27-080;
- (c) The qualified farming operation credit permitted by KRS 141.412;
- (d) The certified rehabilitation credit permitted by KRS 171.397(1)(a);
- (e) The health insurance credit permitted by KRS 141.062;
- (f) The tax paid to other states credit permitted by KRS 141.070;
- (g) The credit for hiring the unemployed permitted by KRS 141.065;
- (h) The recycling or composting equipment credit permitted by KRS 141.390;
- (i) The tax credit for cash contributions in investment funds permitted by KRS 154.20-263 in effect prior to July 15, 2002, and the credit permitted by KRS 154.20-258;
- (j) The coal incentive credit permitted under KRS 141.0405;
- (k) The research facilities credit permitted under KRS 141.395;
- (l) The employer GED incentive credit permitted under KRS 164.0062;
- (m) The voluntary environmental remediation credit permitted by KRS 141.418;
- (n) The biodiesel and renewable diesel credit permitted by KRS 141.423;

- (o) The environmental stewardship credit permitted by KRS 154.48-025;
 - (p) The clean coal incentive credit permitted by KRS 141.428;
 - (q) The ethanol credit permitted by KRS 141.4242;
 - (r) The cellulosic ethanol credit permitted by KRS 141.4244;
 - (s) The energy efficiency credits permitted by KRS 141.436;
 - (t) The railroad maintenance and improvement credit permitted by KRS 141.385;
 - (u) The Endow Kentucky credit permitted by KRS 141.438;
 - (v) The New Markets Development Program credit permitted by KRS 141.434;
 - (w) The food donation credit permitted by KRS 141.392;
 - (x) The distilled spirits credit permitted by KRS 141.389;~~and~~
 - (y) The angel investor credit permitted by KRS 141.396;
 - (z) *The Commonwealth school improvement credit permitted by Section 1 of this Act; and*
 - (aa) *The tuition assistance credit permitted by Section 2 of this Act.*
- (2) After the application of the nonrefundable credits in subsection (1) of this section, the nonrefundable personal tax credits against the tax imposed by KRS 141.020 shall be taken in the following order:
- (a) The individual credits permitted by KRS 141.020(3);
 - (b) The credit permitted by KRS 141.066;
 - (c) The tuition credit permitted by KRS 141.069;
 - (d) The household and dependent care credit permitted by KRS 141.067; and
 - (e) The new home credit permitted by KRS 141.388.
- (3) After the application of the nonrefundable credits provided for in subsection (2) of this section, the refundable credits against the tax imposed by KRS 141.020 shall be taken in the following order:
- (a) The individual withholding tax credit permitted by KRS 141.350;
 - (b) The individual estimated tax payment credit permitted by KRS 141.305;

- (c) For taxable years beginning after December 31, 2004, and before January 1, 2007, the corporation income tax credit permitted by KRS 141.420(3)(c);
 - (d) The certified rehabilitation credit permitted by KRS 171.3961 and 171.397(1)(b); and
 - (e) The film industry tax credit allowed by KRS 141.383.
- (4) The nonrefundable credit permitted by KRS 141.0401 shall be applied against the tax imposed by KRS 141.040.
- (5) The following nonrefundable credits shall be applied against the sum of the tax imposed by KRS 141.040 after subtracting the credit provided for in subsection (4) of this section, and the tax imposed by KRS 141.0401 in the following order:
- (a) The economic development credits computed under KRS 141.347, 141.381, 141.384, 141.400, 141.401, 141.402, 141.403, 141.407, 141.415, 154.12-2088, and 154.27-080;
 - (b) The qualified farming operation credit permitted by KRS 141.412;
 - (c) The certified rehabilitation credit permitted by KRS 171.397(1)(a);
 - (d) The health insurance credit permitted by KRS 141.062;
 - (e) The unemployment credit permitted by KRS 141.065;
 - (f) The recycling or composting equipment credit permitted by KRS 141.390;
 - (g) The coal conversion credit permitted by KRS 141.041;
 - (h) The enterprise zone credit permitted by KRS 154.45-090, for taxable periods ending prior to January 1, 2008;
 - (i) The tax credit for cash contributions to investment funds permitted by KRS 154.20-263 in effect prior to July 15, 2002, and the credit permitted by KRS 154.20-258;
 - (j) The coal incentive credit permitted under KRS 141.0405;
 - (k) The research facilities credit permitted under KRS 141.395;
 - (l) The employer GED incentive credit permitted under KRS 164.0062;

- (m) The voluntary environmental remediation credit permitted by KRS 141.418;
- (n) The biodiesel and renewable diesel credit permitted by KRS 141.423;
- (o) The environmental stewardship credit permitted by KRS 154.48-025;
- (p) The clean coal incentive credit permitted by KRS 141.428;
- (q) The ethanol credit permitted by KRS 141.4242;
- (r) The cellulosic ethanol credit permitted by KRS 141.4244;
- (s) The energy efficiency credits permitted by KRS 141.436;
- (t) The ENERGY STAR home or ENERGY STAR manufactured home credit permitted by KRS 141.437;
- (u) The railroad maintenance and improvement credit permitted by KRS 141.385;
- (v) The railroad expansion credit permitted by KRS 141.386;
- (w) The Endow Kentucky credit permitted by KRS 141.438;
- (x) The New Markets Development Program credit permitted by KRS 141.434;
- (y) The food donation credit permitted by KRS 141.392;~~and~~
- (z) The distilled spirits credit permitted by KRS 141.389;

(aa) The Commonwealth school improvement credit permitted by Section 1 of this Act; and

(ab) The tuition assistance credit permitted by Section 2 of this Act.

- (6) After the application of the nonrefundable credits in subsection (5) of this section, the refundable credits shall be taken in the following order:
- (a) The corporation estimated tax payment credit permitted by KRS 141.044;
 - (b) The certified rehabilitation credit permitted by KRS 171.3961 and 171.397(1)(b); and
 - (c) The film industry tax credit allowed in KRS 141.383.

➔SECTION 5. A NEW SECTION OF KRS 136.500 TO 136.575 IS CREATED TO READ AS FOLLOWS:

(1) Effective for tax years beginning on or after January 1, 2015, but before January

1, 2019, a financial institution shall be allowed a nonrefundable tax credit against the tax imposed by KRS 136.505 for cash contributions made during a tax year to the Commonwealth school improvement fund as provided in Section 1 of this Act. The credit shall be allowed in accordance with the requirements set forth in Section 1 of this Act.

(2) Effective for tax years beginning on or after January 1, 2015, but before January 1, 2019, a financial institution shall be allowed a nonrefundable tax credit against the tax imposed by KRS 136.505 for contributions made during a tax year to one (1) or more qualified tuition assistance organizations as defined in Section 2 of this Act. The credit shall be allowed in accordance with the requirements set forth in Section 2 of this Act.