AN ACT relating to taxation.

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

➔Section 1. KRS 141.066 is amended to read as follows:

(1) As used in this section:

(a) "Federal poverty level" means the Health and Human Services poverty guidelines updated periodically in the Federal Register by the United States Department of Health and Human Services under the authority of 42 U.S.C. sec. 9902(2) and available on June 30 of the taxable year;

(b) "Qualifying dependent" means a qualifying child as defined in the Internal Revenue Code, Section 152(c), and includes a child who lives in the household but cannot be claimed as a dependent if the provisions of Internal Revenue Code Section 152(e)(2) and 152(e)(4) apply;

(c) "Qualifying individual" means an individual whose filing status is single or married filing separately if during the taxable year the individual's spouse is not a member of the household;

(d) "Qualifying married couple" means a husband and wife living together who file a joint return or separately on a combined return. "Marital status" shall have the same meaning as defined in Section 7703 of the Internal Revenue Code; and

(e) "Threshold amount" means:

1. For a qualifying individual with no qualifying dependent children, the federal poverty level established for a family unit size of one (1):

2. For a qualifying individual with one (1) qualifying dependent child or a qualifying married couple with no qualifying dependent children, the federal poverty level established for a family unit size of two (2);

3. For a qualifying individual with two (2) qualifying dependent children or a qualifying married couple with one (1) qualifying dependent child, the

federal poverty level established for a family unit size of three (3);

4. For a qualifying individual with (3) or more qualifying dependent children or a qualifying married couple with two (2) or more qualifying dependent children, the federal poverty level established for a family unit size of four (4).

(2) (a) For taxable years beginning before January 1, 2005, a resident individual whose adjusted gross income does not exceed the amounts set out in paragraph (c) of this subsection shall be eligible for a nonrefundable "low income" tax credit. The credit shall be applied against the taxpayer's tax liability calculated under KRS 141.020, and shall be taken in the order established by KRS 141.0205.

(b) For a husband and wife filing jointly, the "low income" tax credit shall be computed on the basis of their joint adjusted gross income and shall be applied against their joint tax liability. For a husband and wife living together, whether filing separate returns or filing separately on a combined return, the "low income" credit shall be computed on the basis of their combined adjusted gross income, except that a separately computed gross income of less than zero shall be treated as zero, and shall be applied against their combined tax liability.

(c) The "low income" tax credit shall be computed as follows:

AMOUNT OF ADJUSTED GROSS INCOME	PERCENT OF TAX LIABILITY ALLOWED AS LOW INCOME TAX CREDIT
not over $5,000	100%
over $ 5,000 but not over $10,000	50%
over $10,000 but not over $15,000	25%
over $15,000 but not over $20,000	15%

over $20,000 but not over $25,000	5%
over $25,000	-0-

(3) (a) For taxable years beginning after December 31, 2004, qualifying taxpayers whose modified gross income is below one hundred thirty-three percent (133%) of the threshold amount shall be entitled to a nonrefundable family size tax credit. The family size tax credit shall be applied against the taxpayer's tax liability calculated under KRS 141.020. The family size tax credit shall not reduce the taxpayer's tax liability below zero.

(b) For qualifying taxpayers whose modified gross income is equal to or below one hundred percent (100%) of the threshold amount, the family size tax credit shall be equal to the taxpayer's tax liability.

(c) For qualifying taxpayers whose modified gross income exceeds the threshold amount but is below one hundred thirty-three percent (133%) of the threshold amount, the family size tax credit shall be equal to the amount of the taxpayer's individual income tax liability multiplied by a percentage as follows:

1. If modified gross income is above one hundred percent (100%) but less than or equal to one hundred four percent (104%) of the threshold amount, the credit percentage shall be ninety percent (90%);
2. If modified gross income is above one hundred four percent (104%) but less than or equal to one hundred eight percent (108%) of the threshold amount, the credit percentage shall be eighty percent (80%);
3. If modified gross income is above one hundred eight percent (108%) but less than or equal to one hundred twelve percent (112%) of the threshold amount, the credit percentage shall be seventy percent (70%);
4. If modified gross income is above one hundred twelve percent (112%) but less than or equal to one hundred sixteen percent (116%) of the

threshold amount, the credit percentage shall be sixty percent (60%);

5. If modified gross income is above one hundred sixteen percent (116%) but less than or equal to one hundred twenty percent (120%) of the threshold amount, the credit percentage shall be fifty percent (50%);
6. If modified gross income is above one hundred twenty percent (120%) but less than or equal to one hundred twenty-four percent (124%) of the threshold amount, the credit percentage shall be forty percent (40%);
7. If modified gross income is above one hundred twenty-four percent (124%) but less than or equal to one hundred twenty-seven percent (127%) of the threshold amount, the credit percentage shall be thirty percent (30%);
8. If modified gross income is above one hundred twenty-seven percent (127%) but less than or equal to one hundred thirty percent (130%) of the threshold amount, the credit percentage shall be twenty percent (20%);
9. If modified gross income is above one hundred thirty percent (130%) but less than or equal to one hundred thirty-three percent (133%) of the threshold amount, the credit percentage shall be ten percent (10%);
10. If modified gross income is above one hundred thirty-three percent (133%) of the threshold amount, the credit percentage shall be zero.

(4) For a qualifying married couple filing jointly, the family size tax credit ***allowed in subsection (3) of this section*** shall be computed on the basis of their joint modified gross income and shall be applied against their joint tax liability. For a qualifying married couple living together, whether filing separate returns or filing separately on a combined return, the family size tax credit shall be computed on the basis of their combined modified gross income, except that a separately computed modified gross income of less than zero shall be treated as zero, and shall be applied against

their combined tax liability.

(5) For taxable years beginning on and after January 1, 2016, taxpayers who are subject to the tax imposed by KRS 141.020 and who receive a federal earned income tax credit as permitted by 26 U.S.C. sec. 32 shall be allowed a refundable Kentucky earned income tax credit in addition to the family size tax credit allowed by subsection (3) of this section. The Kentucky earned income tax credit shall be equal to seven and one-half percent (7.5%) of the allowed federal earned income tax credit and shall be taken against the tax due under KRS 141.020.

➔Section 2. 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.

(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***(2) or (3)***;

(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 ***permitted***~~[allowed]~~ by KRS 141.383***; and***

(f) The earned income tax credit permitted by subsection (5) of Section 1 of this Act.

(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.

(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 3. KRS 141.120 is amended to read as follows:

(1) As used in this section, unless the context requires otherwise:

(a) "***Apportionable***~~[Business]~~ income" means***:***

1. All income ***that is apportionable under the Constitution of the United States and is not allocated under the laws of this state, including:***

a. Income arising from transactions and activity in the regular course of a trade or business***:***~~[of the corporation]~~ and~~[includes]~~

b. Income ***arising*** from tangible and intangible property if the acquisition, management, ***employment, development,*** or disposition of the property ***is or was related to the operation***~~[constitutes integral parts]~~ of the ***taxpayer's***~~[corporation's regular]~~ trade or business~~[operations]~~; ***and***

2. Any income that would be allocable to this state under the Constitution of the United States, but that is apportioned rather than allocated pursuant to the laws of this state;

(b) "Commercial domicile" means the principal place from which the trade or business of the ***taxpayer***~~[corporation]~~ is managed;

(c) "Compensation" means wages, salaries, commissions, and any other form of remuneration paid or payable to employees for personal services;

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, investment company, or any type of insurance company;

(e) "***Nonapportionable***~~[Nonbusiness]~~ income" means all income other than

apportionable~~[business]~~ income;

(f) "Public service company" means any business entity subject to taxation under KRS 136.120;

(g) "Sales" means all gross receipts of the ***taxpayer***~~[corporation]~~ not allocated under subsections (3) ***to***~~[through]~~ (7) of this section, except as provided by KRS 141.121; and

(h) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country or political subdivision thereof.

(2) Any ***taxpayer***~~[corporation]~~ which is required by KRS 141.010(14)(b) to allocate and apportion its net income shall allocate and apportion its net income as provided in this section.

(3) Rents and royalties from real, intangible or tangible personal property, capital gains and losses, interest, or patent or copyright royalties, to the extent that they constitute ***nonapportionable***~~[nonbusiness]~~ income, shall be allocated as provided in subsections (4) ***to***~~[through]~~ (7) of this section.

(4) (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible personal property are allocable to this state if and to the extent that the property is utilized in this state; or in their entirety if the ***taxpayer's***~~[corporation's]~~ commercial domicile is in this state and the ***taxpayer***~~[corporation]~~ is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the

number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the ***taxpayer***~~[corporation]~~, the tangible personalty is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

(d) Net rents and royalties from intangible personal property located in this state are allocable to this state. For purposes of this section, royalties from property leased in Kentucky shall be considered as royalties from intangible personal property.

(5) (a) Capital gains and losses from sales or other dispositions of real property located in this state are allocable to this state.

(b) Capital gains and losses from sales or other dispositions of tangible personal property are allocable to this state if the property had a situs in this state at the time of the sale, or the ***taxpayer's***~~[corporation's]~~ commercial domicile is in this state and the ***taxpayer***~~[corporation]~~ is not taxable in the state in which the property had a situs.

(c) Capital gains and losses from sales or other dispositions of intangible personal property are allocable to this state if the ***taxpayer's***~~[corporation's]~~ commercial domicile is in this state.

(6) Interest is allocable to this state if the ***taxpayer's***~~[corporation's]~~ commercial domicile is in this state.

(7) (a) Patent and copyright royalties are allocable to this state if and to the extent that the patent or copyright is utilized by the payer in this state; or if and to the extent that the patent or copyright is utilized by the payer in a state in which the ***taxpayer***~~[corporation]~~ is not taxable and the ***taxpayer's***~~[corporation's]~~ commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the ***taxpayer's***~~[corporation's]~~ commercial domicile is located.

(c) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the ***taxpayer's***~~[corporation's]~~ commercial domicile is located.

(8) Except as provided in subsection ***(15)***~~[(9)]~~ of this section, all ***apportionable***~~[business]~~ income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor ***as determined under subsection (9) of this section***, representing twenty-five percent (25%) of the fraction, plus the payroll factor ***as determined under subsection (10) of this section***, representing twenty-five percent (25%) of the fraction, plus the sales factor ***as determined under subsections (11) to (14) of this section***, representing fifty percent (50%) of the fraction, and the denominator of which is four (4), reduced by the number of factors, if any, having no denominator, provided that if the sales factor has no denominator, then the denominator shall be reduced by two (2).

(9) (a) The property factor is a fraction, the numerator of which is the average value of the ***taxpayer's***~~[corporation's]~~ real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the ***taxpayer's***~~[corporation's]~~ real and tangible personal property owned or rented and used during the tax period;

provided, however, that property which has been certified as a pollution control facility as defined in KRS 224.1-300 shall be excluded from the property factor.

(b) ~~[1.]~~ Property owned is valued at its original cost. If the original cost of any property is not determinable or is nominal or zero (0) the property shall be valued by the department pursuant to administrative regulations promulgated by the department. Property rented is valued at eight (8) times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the ***taxpayer*** ~~[corporation]~~ less any annual rental rate received by the ***taxpayer*** ~~[corporation]~~ from subrentals, provided that the rental and subrentals are reasonable. If the department determines that the annual rental or subrental rate is unreasonable, or if a nominal or zero (0) rate is charged, the department may determine and apply the rental rate as will reasonably reflect the value of the property rented by the ***taxpayer*** ~~[corporation]~~.

(c) ~~[2.]~~ The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the department may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the property.

(10) ~~[(b)]~~ The payroll factor is a fraction, the numerator of which is the total amount paid or payable in this state during the tax period by the ***taxpayer*** ~~[corporation]~~ for compensation, and the denominator of which is the total compensation paid or payable by the ***taxpayer*** ~~[corporation]~~ everywhere during the tax period. Compensation is paid or payable in this state if:

(a) ~~[1.]~~ The individual's service is performed entirely within the state;

(b) ~~[2.]~~ The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state; or

(c)~~[3.]~~ Some of the service is performed in the state and the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the state, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

(11)~~[(c) 1.]~~ The sales factor is a fraction, the numerator of which is the total sales of the ***taxpayer***~~[corporation]~~ in this state during the tax period, and the denominator of which is the total sales of the ***taxpayer***~~[corporation]~~ everywhere during the tax period.

(12)~~[2.]~~ Sales of tangible personal property are in this state if:

(a)~~[a.]~~ The property is delivered or shipped to a purchaser, other than the United States government, or to the designee of the purchaser within this state regardless of the f.o.b. point or other conditions of the sale; or

(b)~~[b.]~~ The property is shipped from an office, store, warehouse, factory, or other place of storage in this state***;*** and

1. The purchaser is the United States government***; or***

2. The taxpayer is not taxable in the state of the purchaser.

(13)~~[3.]~~ Sales, other than sales of tangible personal property, are in this state if***:***

(a) For taxable years beginning before January 1, 2016, the income-producing activity is performed in this state; or the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance***; or***

(b) For taxable years beginning on or after January 1, 2016, the taxpayer's market for sales is in this state. The taxpayer's market for sales is in this state in the case of:

1. Sale, rental, lease, or license of real property, if and to the extent the property is located in this state;

2. Rental, lease, or license of tangible personal property, if and to the extent the property is located in this state;

3. Sale of a service, if and to the extent the service is delivered to a location in this state; and

4. Intangible property:

a. That is rented, leased, or licensed, if and to the extent the property is used in this state, provided that intangible property utilized in marketing a good or service to a consumer is "used in this state" if that good or service is purchased by a consumer who is in this state; or

b. That is sold, if and to the extent the property is used in this state, provided that:

i. A contract right, government license, or similar intangible property that authorizes the holder to conduct a business activity in a specific geographic area is "used in this state" if the geographic area includes all or part of this state;

ii. Receipts from intangible property sales that are contingent on the productivity, use, or disposition of the intangible property shall be treated as receipts from the rental, lease, or licensing of the intangible property under subdivision a. of this subparagraph; and

***iii. All other receipts from a sale of intangible property shall be excluded from the numerator and denominator of the sales factor*.**

(14) (a) If the state or states of assignment under paragraph (b) of subsection (13) of

this section cannot be determined, the state or states of assignment shall be reasonably approximated.

(b) If the taxpayer is not taxable in a state to which a receipt is assigned under paragraph (b) of subsection (13) of this section, or if the state of assignment cannot be determined under paragraph (b) of subsection (13) of this section or reasonably approximated under paragraph (a) of this subsection, the receipt shall be excluded from the denominator of the receipts factor.

(15) ~~[(9)]~~ (a) If the allocation and apportionment provisions of this section do not fairly represent the extent of the ***taxpayer's*** ~~[corporation's]~~ business activity in this state, the ***taxpayer*** ~~[corporation]~~ may petition for or the department may require, in respect to all or any part of the ***taxpayer's*** ~~[corporation's]~~ business activity, if reasonable:

1. Separate accounting;
2. The exclusion of any one (1) or more of the factors;
3. The inclusion of one (1) or more additional factors which will fairly represent the ***taxpayer's*** ~~[corporation's]~~ business activity in this state; or
4. The employment of any other method to effectuate an equitable allocation and apportionment of income.

(b) A ***taxpayer*** ~~[corporation]~~ may elect the allocation and apportionment methods for the ***taxpayer's apportionable*** ~~[corporation's business]~~ income provided for in subparagraphs 1. and 2. of this paragraph. The election, if made, shall be irrevocable for a period of five ***(5)*** years.

1. All ***apportionable*** ~~[business]~~ income derived directly or indirectly from the sale of management, distribution, or administration services to or on behalf of regulated investment companies, as defined under the Internal Revenue Code of 1986, as amended, including trustees, and sponsors or participants of employee benefit plans which have accounts in a

regulated investment company, shall be apportioned to this state only to the extent that shareholders of the investment company are domiciled in this state as follows:

a. Total ***apportionable*** ~~[business]~~ income shall be multiplied by a fraction, the numerator of which shall be Kentucky receipts from the services for the tax period and the denominator of which shall be the total receipts everywhere from the services for the tax period.

b. For purposes of subdivision a. of this subparagraph, Kentucky receipts shall be determined by multiplying total receipts for the tax period from each separate investment company for which the services are performed by a fraction. The numerator of the fraction shall be the average of the number of shares owned by the investment company's shareholders domiciled in this state at the beginning of and at the end of the investment company's taxable year, and the denominator of the fraction shall be the average of the number of the shares owned by the investment company shareholders everywhere at the beginning of and at the end of the investment company's taxable year.

c. ***Nonapportionable*** ~~[Nonbusiness]~~ income shall be allocated to this state as provided in subsections (4) ***to*** ~~[through]~~ (7) of this section.

2. All ***apportionable*** ~~[business]~~ income derived directly or indirectly from the sale of securities brokerage services by a business which operates within the boundaries of any area of the Commonwealth, which on June 30, 1992, was designated as a Kentucky Enterprise Zone, as defined in KRS 154.655(2), shall be apportioned to this state only to the extent that customers of the securities brokerage firm are domiciled in this state.

The portion of~~[business]~~ income apportioned to Kentucky shall be determined by multiplying the total ***apportionable***~~[business]~~ income from the sale of these services by a fraction determined in the following manner:

a. The numerator of the fraction shall be the brokerage commissions and total margin interest paid in respect of brokerage accounts owned by customers domiciled in Kentucky for the brokerage firm's taxable year; and

b. The denominator of the fraction shall be the brokerage commissions and total margin interest paid in respect of brokerage accounts owned by all of the brokerage firm's customers for that year.

c. ***Nonapportionable***~~[Nonbusiness]~~ income shall be allocated to this state as provided in subsections (4) ***to***~~[through]~~ (7) of this section.

(16)~~[(10)]~~ Public service companies and financial organizations required by KRS 141.010(14)(b) to allocate and apportion net income shall allocate and apportion such income as follows:

(a) ***Nonapportionable***~~[Nonbusiness]~~ income shall be allocated to this state as provided in subsections (4) ***to***~~[through]~~ (7) of this section.

(b) ***Apportionable***~~[Business]~~ income shall be apportioned to this state by multiplying the ***apportionable***~~[business]~~ income by a fraction, the numerator of which is the property factor, representing twenty-five percent (25%) of the fraction, plus the payroll factor, representing twenty-five percent (25%) of the fraction, plus the sales factor, representing fifty percent (50%) of the fraction, and the denominator of which is four (4), reduced by the number of factors, if any, having no denominator, provided that if the sales factor has no denominator, then the denominator shall be reduced by two (2). The payroll

factor shall be determined as provided in subsection ***(10)***~~[(8)(b)]~~ of this section. The property factor and sales factor shall be determined as provided by administrative regulations promulgated by the department.

(c) An affiliated group electing to file a consolidated return~~[under KRS 141.200(4)]~~ or required to file a consolidated return under KRS 141.200~~[(11)]~~ that includes a public service company, a provider of communications services or multichannel video programming services as defined in KRS 136.602, or financial organization shall determine the amount of payroll to be included in the apportionment factor as provided in subsection ***(10)***~~[(8)(b)]~~ of this section. The amount of property and sales of the public service company, provider of communications services or multichannel video programming services as defined in KRS 136.602, or financial organization to be included in the apportionment factors of the affiliated group shall be determined in accordance with administrative regulations promulgated by the department under paragraph (b) of this subsection.

(17)~~[(11)]~~ For taxable years beginning on or after January 1, 2007, a ***taxpayer***~~[corporation]~~ that:

(a) Owns an interest in a limited liability pass-through entity; or

(b) Owns an interest in a general partnership organized or formed as a general partnership after January 1, 2006;

shall include the proportionate share of sales, property, and payroll of the limited liability pass-through entity or general partnership when apportioning income, and shall include the proportionate share of sales in calculating the tax due pursuant to KRS 141.0401. The phrases "an interest in a limited liability pass-through entity" and "an interest in a general partnership organized or formed as a general partnership after January 1, 2006," shall extend to each level of multiple-tiered pass-through entities.

➔Section 4. KRS 141.121 is amended to read as follows:

(1) As used in this section:

(a) "Affiliated airline" means an airline:

1. For which a qualified air freight forwarder facilitates air transportation; and

2. That is in the same affiliated group as a qualified air freight forwarder;

(b) "Affiliated group" has the same meaning as in KRS 141.200;

(c) "Kentucky revenue passenger miles" means the total revenue passenger miles within the borders of Kentucky for all flight stages that either originate or terminate in this state;

(d) "Liquid asset" means an asset, other than functional currency or funds held in bank accounts, held to provide a relatively immediate source of funds to satisfy the liquidity needs of the trade or business. "Liquid assets" include:

1. Foreign currency and trading positions therein, other than functional currency used in the regular course of the corporation's trade or business;

2. Marketable instruments, including stocks, bonds, debentures, options, warrants, and futures contracts; and

3. Mutual funds which hold liquid assets;

(e) "Marketable instrument" means an instrument that is traded in an established stock or securities market and is regularly quoted by brokers or dealers in making a market;

(f) "Overall net gain" means the total net gain from all transactions incurred at each treasury function for the entire taxable period. "Overall net gain" does not mean the net gain from a specific transaction if multiple transactions occur during the taxable period;

(g) "Passenger airline" means a person or corporation engaged primarily in the carriage by aircraft of passengers in interstate commerce;

(h) "Qualified air freight forwarder" means a person that:

1. Is engaged primarily in the facilitation of the transportation of property by air;

2. Does not itself operate aircraft; and

3. Is in the same affiliated group as an affiliated airline;

(i) "Revenue passenger miles" means miles calculated in accordance with 14 C.F.R. Part 241; and

(j) "Treasury function" means the pooling and management of liquid assets for the purpose of satisfying the cash flow needs of the trade or business and includes the following situations:

1. Providing liquidity for a corporation's business cycle; and

2. Providing a reserve for business contingencies or business acquisitions.

(2) If a corporation holds liquid assets in connection with one (1) or more treasury functions of the corporation, and the liquid assets produce ***apportionable*** ~~[business]~~ income when sold, exchanged, or otherwise disposed of, the overall net gain from those transactions for each treasury function for the tax period shall be included in the sales factor. For purposes of this subsection:

(a) Each treasury function shall be considered separately; and

(b) A corporation principally engaged in the trade or business of purchasing and selling instruments or other items included in the definition of liquid assets is not performing a treasury function with respect to that income produced.

(3) For purposes of apportioning ~~[business]~~ income to this state:

(a) Passenger airlines shall determine the property, payroll, and sales factors as follows:

1. Except as modified by this subparagraph, the property factor shall be determined as provided in KRS 141.120***(9)*** ~~[(8)(a)]~~. Aircraft operated by a passenger airline shall be included in both the numerator and

denominator of the property factor. Aircraft shall be included in the numerator of the property factor by determining the product of:

a. The total average value of the aircraft operated by the passenger airline; and

b. A fraction, the numerator of which is the Kentucky revenue passenger miles of the passenger airline for the taxable year and the denominator of which is the total revenue passenger miles of the passenger airline for the taxable year;

2. Except as modified by this subparagraph, the payroll factor shall be determined as provided in KRS 141.120***(10)*** ~~[(8)(b)]~~. Compensation paid during the tax period by a passenger airline to flight personnel shall be included in the numerator of the payroll factor by determining the product of:

a. The total amount paid during the taxable year to flight personnel; and

b. A fraction, the numerator of which is the Kentucky revenue passenger miles of the passenger airline for the taxable year and the denominator of which is the total revenue passenger miles of the passenger airline for the taxable year; and

3. Except as modified by this subparagraph, the sales factor shall be determined as provided in KRS 141.120***(11) to (14)*** ~~[(8)(c)]~~. Transportation revenues shall be included in the numerator of the sales factor by determining the product of:

a. The total transportation revenues of the passenger airline for the taxable year; and

b. A fraction, the numerator of which is the Kentucky revenue passenger miles for the taxable year and the denominator of which

is the total revenue passenger miles for the taxable year; and

(b) Qualified air freight forwarders shall determine the property, payroll, and sales factors as follows:

1. The property factor shall be determined as provided in KRS 141.120***(9)*** ~~[(8)(a)]~~;

2. The payroll factor shall be determined as provided in KRS 141.120***(10)*** ~~[(8)(b)]~~; and

3. Except as modified by this subparagraph, the sales factor shall be determined as provided in KRS 141.120***(11) to (14)*** ~~[(8)(c)]~~. Freight forwarding revenues shall be included in the numerator of the sales factor by determining the product of:

a. The total freight forwarding revenues of the qualified air freight forwarder for the taxable year; and

b. A fraction, the numerator of which is miles operated in Kentucky by the affiliated airline and the denominator of which is the total miles operated by the affiliated airline.

➔Section 5. KRS 141.200 is amended to read as follows:

(1) Subsections (2) to (7) of this section shall apply for taxable periods ending before January 1, 2005, and election periods beginning prior to January 1, 2005.

(2) As used in subsections (2) to (7) of this section, unless the context requires otherwise:

(a) "Affiliated group" means affiliated group as defined in Section 1504(a) of the Internal Revenue Code and related regulations;

(b) "Consolidated return" means a Kentucky corporation income tax return filed by members of an affiliated group in accordance with this section. The determinations and computations required by this chapter shall be made in accordance with the provisions of Section 1502 of the Internal Revenue Code

and related regulations, except as required by differences between this chapter and the Internal Revenue Code. Corporations exempt from taxation under KRS 141.040 shall not be included in the return;

(c) "Separate return" means a Kentucky corporation income tax return in which only the transactions and activities of a single corporation are considered in making all determinations and computations necessary to calculate taxable net income, tax due, and credits allowed in accordance with the provisions of this chapter;

(d) "Corporation" means "corporation" as defined in Section 7701(a)(3) of the Internal Revenue Code; and

(e) "Election period" means the ninety-six (96) month period provided for in subsection (4)(d) of this section.

(3) Every corporation doing business in this state, except those exempt from taxation under KRS 141.040, shall, for each taxable year, file a separate return unless the corporation was, for any part of the taxable year, a member of an affiliated group electing to file a consolidated return in accordance with subsection (4) of this section.

(4) (a) An affiliated group, whether or not filing a federal consolidated return, may elect to file a consolidated return which includes all members of the affiliated group.

(b) An affiliated group electing to file a consolidated return under paragraph (a) of this subsection shall be treated for all purposes as a single corporation under the provisions of this chapter. All transactions between corporations included in the consolidated return shall be eliminated in computing net income in accordance with KRS 141.010(13), and in determining the property, payroll, and sales factors in accordance with KRS 141.120. The gross receipts received by a public service company that is a member of an affiliated group shall be

excluded from the calculation of the alternative minimum calculation under the provisions of KRS 141.040. For purposes of this paragraph, "public service company" has the same meaning as provided in KRS 136.120.

(c) Any election made in accordance with paragraph (a) of this subsection shall be made on a form prescribed by the department and shall be submitted to the department on or before the due date of the return including extensions for the first taxable year for which the election is made.

(d) Notwithstanding subsections (9) to ***(14) and (20)***~~[(15)]~~ of this section, any election to file a consolidated return pursuant to paragraph (a) of this subsection shall be binding on both the department and the affiliated group for a period beginning with the first month of the first taxable year for which the election is made and ending with the conclusion of the taxable year in which the ninety-sixth consecutive calendar month expires.

(e) For each taxable year for which an affiliated group has made an election in accordance with paragraph (a) of this subsection, the consolidated return shall include all corporations which are members of the affiliated group.

(5) Each corporation included as part of an affiliated group filing a consolidated return shall be jointly and severally liable for the income tax liability computed on the consolidated return, except that any corporation which was not a member of the affiliated group for the entire taxable year shall be jointly and severally liable only for that portion of the Kentucky consolidated income tax liability attributable to that portion of the year that the corporation was a member of the affiliated group.

(6) Every corporation return or report required by this chapter shall be executed by one (1) of the following officers of the corporation: the president, vice president, secretary, treasurer, assistant secretary, assistant treasurer, or chief accounting officer. The department~~[of Revenue]~~ may require a further or supplemental report of further information and data necessary for computation of the tax.

(7) In the case of a corporation doing business in this state that carries on transactions with stockholders or with other corporations related by stock ownership, by interlocking directorates, or by some other method, the department shall require information necessary to make possible accurate assessment of the income derived by the corporation from sources within this state. To make possible such assessment, the department may require the corporation to file supplementary returns showing information respecting the business of any or all individuals and corporations related by one (1) or more of these methods to the corporation. The department may require the return to show in detail the record of transactions between the corporation and any or all other related corporations or individuals.

(8) Subsections (9) to (14) of this section shall apply for taxable years beginning on or after January 1, 2005, ***and before January 1, 2016***~~[unless otherwise provided]~~.

(9) As used in subsections (9) to (14) of this section:

(a) 1. For taxable years beginning after December 31, 2004, and before January 1, 2007, "affiliated group" means one (1) or more chains of includible corporations connected through stock ownership, membership interest, or partnership interest with a common parent corporation which is an includible corporation if:

a. The common parent owns directly an ownership interest meeting the requirements of subparagraph 2. of this paragraph in at least one (1) other includible corporation; and

b. An ownership interest meeting the requirements of subparagraph 2. of this paragraph in each of the includible corporations, excluding the common parent, is owned directly by one (1) or more of the other corporations.

2. The ownership interest of any corporation meets the requirements of this paragraph if the ownership interest encompasses at least eighty percent

(80%) of the voting power of all classes of ownership interests and has a value equal to at least eighty percent (80%) of the total value of all ownership interests;

(b) 1. For taxable years beginning after December 31, 2006, ***and before January 1, 2016,*** "affiliated group" means one (1) or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if:

a. The common parent owns directly stock meeting the requirements of subparagraph 2. of this paragraph in at least one (1) other includible corporation; and

b. Stock meeting the requirements of subparagraph 2. of this paragraph in each of the includible corporations, excluding the common parent, is owned directly by one (1) or more of the other corporations.

2. The stock of any corporation meets the requirements of this paragraph if the stock encompasses at least eighty percent (80%) of the voting power of all classes of stock and has a value equal to at least eighty percent (80%) of the total value of all stock;

(c) "Common parent corporation" means the member of an affiliated group that meets the ownership requirement of paragraph (a)1. or (b)1. of this subsection;

(d) "Foreign corporation" means a corporation that is organized under the laws of a country other than the United States and is related to a member of an affiliated group through stock ownership;

(e) "Includible corporation" means any corporation that is doing business in this state except:

1. Corporations exempt from corporation income tax under KRS

141.040(1)(a) to (i);

2. Foreign corporations;

3. Corporations with respect to which an election under Section 936 of the Internal Revenue Code is in effect for the taxable year;

4. Real estate investment trusts as defined in Section 856 of the Internal Revenue Code;

5. Regulated investment companies as defined in Section 851 of the Internal Revenue Code;

6. A domestic international sales company as defined in Section 992(a)(1) of the Internal Revenue Code;

7. Any corporation that realizes a net operating loss whose Kentucky property, payroll, and sales factors pursuant to KRS 141.120~~[(8)]~~ are de minimis;

8. Any corporation for which the sum of the property, payroll and sales factors described in KRS 141.120~~[(8)]~~ is zero; and

9. For taxable years beginning prior to January 1, 2006, and taxable years beginning on or after January 1, 2007, an S corporation as defined in Section 1361(a) of the Internal Revenue Code;

(f) "Ownership interest" means stock, a membership interest in a limited liability company, or a partnership interest in a limited partnership or limited liability partnership;

(g) "Consolidated return" means a Kentucky corporation income tax return filed by members of an affiliated group in accordance with this section. The determinations and computations required by this chapter shall be made in accordance with the provisions of the Internal Revenue Code and related regulations, except as required by differences between this chapter and the Internal Revenue Code;

(h) "Separate return" means a Kentucky corporation income tax return in which only the transactions and activities of a single corporation are considered in making all determinations and computations necessary to calculate taxable net income, tax due, and credits allowed in accordance with the provisions of this chapter; and

(i) "Stock" means stock in a corporation, or a membership interest in a limited liability company that has elected to be treated as a corporation for federal tax purposes.

(10) Every corporation doing business in this state except those exempt from taxation under KRS 141.040(1)(a) to (i) shall, for each taxable year, file a separate return unless the corporation was, for any part of the taxable year:

(a) An includible corporation in an affiliated group;

(b) A common parent corporation doing business in this state;

(c) A qualified subchapter S Subsidiary that is included in the return filed by the Subchapter S parent corporation;

(d) A qualified real estate investment trust subsidiary that is included in the return filed by the real estate investment trust parent; or

(e) A disregarded entity that is included in the return filed by its parent entity.

(11) (a) An affiliated group, whether or not filing a federal consolidated return, shall file a consolidated return which includes all includible corporations.

(b) An affiliated group required to file a consolidated return under this subsection shall be treated for all purposes as a single corporation under the provisions of this chapter. All transactions between corporations included in the consolidated return shall be eliminated in computing net income in accordance with KRS 141.010(13), and in determining the property, payroll, and sales factors in accordance with KRS 141.120. Includible corporations that have incurred a net operating loss shall not deduct an amount that exceeds, in the

aggregate, fifty percent (50%) of the income realized by the remaining includible corporations that did not realize a net operating loss. The portion of any net operating loss limited by the application of this subsection shall be available for carryforward in accordance with KRS 141.011. The department~~[of Revenue]~~ shall promulgate administrative regulations to establish the manner and extent to which net operating losses attributable to tax periods ending prior to January 1, 2005, may offset income of affiliated groups. The gross receipts received by a public service company that is a member of an affiliated group shall be excluded from the calculation of the alternative minimum calculation under KRS 141.040. For purposes of this paragraph, "public service company" has the same meaning as provided in KRS 136.120.

(12) Each includible corporation included as part of an affiliated group filing a consolidated return shall be jointly and severally liable for the income tax liability computed on the consolidated return, except that any includible corporation which was not a member of the affiliated group for the entire taxable year shall be jointly and severally liable only for that portion of the Kentucky consolidated income tax liability attributable to that portion of the year that the corporation was a member of the affiliated group.

(13) Every corporation return or report required by this chapter shall be executed by one (1) of the following officers or management of the corporation: the president, vice president, secretary, treasurer, assistant secretary, assistant treasurer, chief accounting officer, manager, member, or partner. The Department of Revenue may require a further or supplemental report of further information and data necessary for computation of the tax.

(14) In the case of a corporation doing business in this state that carries on transactions with stockholders, members or partners, or with other corporations related by ownership, by interlocking directorates, or by some other method, the department

shall require that information necessary to make possible an accurate assessment of the income derived by the corporation from sources within this state be provided. To make possible this assessment, the department may require the corporation to file supplementary returns showing information respecting the business of any or all individuals and corporations related by one (1) or more of these methods to the corporation. The department may require the return to show in detail the record of transactions between the corporation and any or all other related corporations or individuals.

(15) ***(a) Subsections (15) to (19) of this section shall apply to taxable years beginning on or after January 1, 2016.***

(b) As used in subsections (15) to (19) of this section:

1. "Combined group" means the group of all persons whose income and apportionment factors are required to be taken into account as provided in subsection (16) of this section in determining the taxpayer's share of the income or loss apportionable to this state;

2. "Tax haven" has the same meaning as in Section 6 of this Act; and

3. "Unitary business" means a single economic enterprise that is either made up of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated, or interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.

(16) (a) A taxpayer engaged in a unitary business with one (1) or more other taxpayers shall become a member of a combined group and shall file a combined report which includes:

1. The income of all taxpayers that are members of the unitary business;

2. The apportionment factors of all taxpayers that are members of the unitary business; and

3. Any other information required by the department.

(b) The department shall, by administrative regulation, require that the combined report include the income and apportionment factors of any person not included as provided in paragraph (a) of this subsection, but that is a member of a combined group, in order to reflect proper apportionment of income from the entire unitary business. The administrative regulation shall include the authority to require combination of persons that are not subject to tax under KRS 141.020 or Section 6 of this Act.

(c) If the department determines that the reported income or loss of a taxpayer engaged in a unitary business with any person not included as provided in paragraph (a) of this subsection represents an avoidance or evasion of tax by the taxpayer, the department may, on a case-by-case-basis, require all or any part of the income and apportionment factors of that person to be included in the combined report.

(d) The apportionment factors shall be computed as required by Section 3 of this Act.

(17) (a) The combined report filed by a combined group shall take into account the entire income and apportionment factors of any member which:

1. Is incorporated in the United States or formed under the laws of any state of the United States, the District of Columbia, or any territory or possession of the United States;

2. Has, regardless of the place incorporated or formed, an average of the property, payroll, and sales factors within the United States equal to or greater than twenty percent (20%); or

3. Is:

a. A domestic international sales corporation as described in Sections 991 to 994 of the Internal Revenue Code;

b. A foreign sales corporation as described in Sections 921 to 927 of the Internal Revenue Code in effect on September 30, 2000;

c. An export trade corporation as described in Sections 970 to 971 of the Internal Revenue Code; or

d. Doing business in a tax haven.

(b) 1. Any member that is a controlled foreign corporation, as defined in Internal Revenue Code Section 957, shall include the income of that member that is defined in Section 942 of the Internal Revenue Code, including lower-tier subsidiaries' distributions of that income which were previously taxed, determined without regard to federal treaties, and the apportionment factors related to that income. Any income received by a controlled foreign corporation shall be excluded if the income was subject to an effective rate of income tax imposed by a foreign country greater than ninety percent (90%) of the maximum rate of income tax specified in Section 11 of the Internal Revenue Code.

2. Any member that earns more than twenty percent (20%) of its income, directly or indirectly, from intangible property or service-related activities that are deductible against the apportionable income of other members of the combined group shall be included to the extent of that income and the apportionment factors related thereto.

(c) Any member not described in paragraph (a) or (b) of this subsection shall include the portion of its income derived from or attributable to sources within the United States, as determined under the Internal Revenue Code, without regard to federal treaties, and its apportionment factors related

thereto.

(18) (a) 1. The use of a combined report does not disregard the separate identities of the members within a combined group. Each taxpayer within a combined group is responsible for tax based on its taxable income or loss apportioned or allocated to this state, which shall include the taxpayer's:

a. Share of any income apportionable to this state of each of the combined groups of which it is a member as determined in paragraph (b) of this subsection;

b. Share of any income apportionable to this state of a distinct business activity conducted within and without the state wholly by the taxpayer;

c. Income from a business conducted wholly by the taxpayer entirely within this state;

d. Income sourced to this state from the sale or exchange of capital assets;

e. Nonapportionable income or loss allocable to this state;

f. Income or loss allocated or apportioned in an earlier year, required to be taken into account in the taxable year, other than a net operating loss; and

g. Net operating loss carryover. If the computation results in a loss of a member within the combined group, that taxpayer has a Kentucky net operating loss, subject to KRS 141.011. The net operating loss shall be applied as a deduction in a subsequent year only if that taxpayer has net income, whether or not the taxpayer is or was a member of a combined group in that subsequent year.

2. a. No tax credit earned by one (1) member of the combined group, but not fully used by or allowed to that member, shall be used in whole or in part by another member of the combined group or applied in whole or in part against the total income of the combined group.

b. A post-apportionment deduction carried over into a subsequent year to the member that incurred the deduction, and available as a deduction to that member in the subsequent year, shall be considered in the computation of the income of that member in the subsequent year, regardless of the composition of that income as apportioned, allocated, or wholly within this state.

(b) 1. The taxpayer's share of the income apportionable to this state of each combined group of which the taxpayer is a member shall be the product of:

a. The apportionable income of the combined group as determined in paragraph (c) of this subsection; and

b. The taxpayer's apportionment percentage as determined in Section 3 of this Act, including in the property, payroll, and sales factor numerators, the taxpayer's property, payroll, and sales, respectively, associated with the combined group's unitary business in this state; and including in the denominator, the property, payroll, and sales of all members of the combined group including the taxpayer, which property, payroll, and sales are associated with the combined group's unitary business wherever located.

2. The property, payroll, and sales of a partnership shall be included in the determination of the partner's apportionment percentage in

proportion to a ratio, the numerator of which is the amount of the partner's distributive share of the partnership's unitary income included in the income of the combined group in accordance with paragraph (c) of this subsection and the denominator of which is the amount of the partnership's total unitary income.

(c) 1. The total income of a combined group is the sum of net income for each member of the combined group.

2. If a unitary business includes income from a partnership, the income to be included in the total income of the combined group shall be the member of the combined group's direct and indirect distributive share of the partnership's unitary income.

3. Apportionable income from an intercompany transaction between members of the same combined group shall be deferred in a manner similar to 26 C.F.R. sec. 1.1502-13.

(19) As a filing convenience, and without changing the respective liability of the group members, members of a combined group may annually elect to designate one (1) taxpayer of the combined group to file a combined return in the form and manner prescribed by the department, in lieu of filing their own respective returns, provided that the taxpayer designated to file the single return consents to act as surety with respect to the tax liability of all other taxpayers properly included in the combined report, and agrees to act as agent on behalf of those taxpayers for the year of the election for tax matters relating to the combined report for that year. If for any reason the surety is unwilling or unable to perform its responsibilities, tax liability shall be assessed against the taxpayer members.

(20) For any taxable year ending on or after December 31, 1995, ***and beginning before January 1, 2016,*** except as provided under this section and KRS 141.205, nothing in this chapter shall be construed as allowing or requiring the filing of:

(a) A combined return under the unitary business concept; or

(b) A consolidated return.

~~[(16) No assessment of additional tax due for any taxable year ending on or before December 31, 1995, made after December 22, 1994, and based on requiring a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return, shall be effective or recognized for any purpose.~~

~~(17) No claim for refund or credit of a tax overpayment for any taxable year ending on or before December, 31, 1995, made by an amended return or any other method after December 22, 1994, and based on a change from any initially filed separate return or returns to a combined return under the unitary business concept or to a consolidated return, shall be effective or recognized for any purpose.~~

~~(18) No corporation or group of corporations shall be allowed to file a combined return under the unitary business concept or a consolidated return for any taxable year ending before December 31, 1995, unless on or before December 22, 1994, the corporation or group of corporations filed an initial or amended return under the unitary business concept or consolidated return for a taxable year ending before December 22, 1994.]~~

(21) ~~[(19)]~~ This section shall not be construed to limit or otherwise impair the department's authority under KRS 141.205.

➔Section 6. KRS 141.205 is amended to read as follows:

(1) As used in this section:

(a) "Intangible property" means franchises, patents, patent applications, trade names, trademarks, service marks, copyrights, trade secrets, and similar types of intangible assets;

(b) "Intangible expenses" includes the following only to the extent that the amounts are allowed as deductions or costs in determining taxable net income

before the application of any net operating loss deduction provided under Chapter 1 of the Internal Revenue Code:

1. Expenses, losses, and costs for, related to, or in connection directly or indirectly with the direct or indirect acquisition, use, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property;
2. Losses related to, or incurred in connection directly or indirectly with, factoring transactions or discounting transactions;
3. Royalty, patent, technical, and copyright fees;
4. Licensing fees; and
5. Other similar expenses and costs;

(c) "Intangible interest expense" means only those amounts which are directly or indirectly allowed as deductions under Section 163 of the Internal Revenue Code for purposes of determining taxable income under that code, to the extent that the amounts are directly or indirectly for, related to, or connected to the direct or indirect acquisition, use, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property;

(d) "Management fees" includes but is not limited to expenses and costs paid for services pertaining to accounts receivable and payable, employee benefit plans, insurance, legal, payroll, data processing, purchasing, tax, financial and securities, accounting, reporting and compliance services or similar services, only to the extent that the amounts are allowed as a deduction or cost in determining taxable net income before application of the net operating loss deduction for the taxable year provided under Chapter 1 of the Internal Revenue Code;

(e) "Affiliated group" has the same meaning as provided in KRS 141.200;

(f) "Foreign corporation" means a corporation that is organized under the laws of

a country other than the United States and that would be a related member if it were a domestic corporation;

(g) "Related member" means a person that, with respect to the entity during all or any portion of the taxable year, is:

1. A person or entity that has, directly or indirectly, at least fifty percent (50%) of the equity ownership interest in the taxpayer, as determined under Section 318 of the Internal Revenue Code;
2. A component member as defined in Section 1563(b) of the Internal Revenue Code;
3. A person to or from whom there is attribution of stock ownership in accordance with Section 1563(e) of the Internal Revenue Code; or
4. A person that, notwithstanding its form of organization, bears the same relationship to the taxpayer as a person described in subparagraphs 1. to 3. of this paragraph;

(h) "Recipient" means a related member or foreign corporation to whom the item of income that corresponds to the intangible interest expense, the intangible expense, or the management fees, is paid;

(i) "Unrelated party" means a person that has no direct, indirect, beneficial or constructive ownership interest in the recipient; and in which the recipient has no direct, indirect, beneficial or constructive ownership interest;

(j) "Disclosure" means that the entity shall provide the following information to the department~~[of Revenue]~~ with its tax return regarding a related party transaction:

1. The name of the recipient;
2. The state or country of domicile of the recipient;
3. The amount paid to the recipient; and
4. A description of the nature of the payment made to the recipient;

(k) "Other related party transaction" means a transaction which:

1. Is undertaken by an entity which was not required to file a consolidated return under KRS 141.200;

2. Is undertaken by an entity, directly or indirectly, with one (1) or more of its stockholders, members, partners, or affiliated entities; and

3. Is not within the scope of subsections (2) and (3) of this section;

(l) "Related party costs" means intangible expense, intangible interest expense, management fees and any costs or expenses associated with other related party transactions;~~[and]~~

(m) "Entity" means any taxpayer other than a natural person***;***

(n) "Reportable transaction" means any transaction or arrangement:

1. Having the potential for avoidance or evasion of the tax imposed by KRS 141.020 or Section 7 of this Act and Section 8 of this Act, whether through:

a. Deduction;

b. Credit;

c. Exclusion or omission of any income;

d. Manipulation of any allocation or apportionment rule; or

e. The securing of any other tax benefit;

2. Described in 26 C.F.R. sec. 1.6011-4;

3. Identified as a tax avoidance transaction for purposes of 26 U.S.C. sec. 6011;

4. Lacking economic substance, including the creation of an entity lacking a valid nontax business purpose; or

5. With an entity that is incorporated in a tax haven; and

(o) "Tax haven" means:

1. Andorra;

2. Anguilla;

3. Antigua;

4. Aruba;

5. The Bahamas;

6. Bahrain;

7. Barbados;

8. Barbuda;

9. Belize;

10. Bermuda;

11. British Virgin Islands;

12. Caicos Islands;

13. Cayman Islands;

14. Cook Islands;

15. Cyprus;

16. Dominica;

17. Gibraltar;

18. Grenada;

19. Grenadines;

20. Guernsey-Sark-Alderney;

21. Isle of Man;

22. Jersey;

23. Liberia;

24. Liechtenstein;

25. Luxembourg;

26. Malta;

27. Marshall Islands;

28. Mauritius;

29. Monaco;

30. Montserrat;

31. Nauru;

32. Netherlands Antilles;

33. Nevis;

34. Niue;

35. Panama;

36. Samoa;

37. San Marion;

38. Seychelles;

39. St. Kitts;

40. St. Lucia;

41. St. Vincent;

42. Turks;

43. U.S. Virgin Islands; or

44. Vanuatu.

(2) An entity subject to the tax imposed by this chapter shall not be allowed to deduct an intangible expense, an intangible interest expense, or a management fee directly or indirectly paid, accrued or incurred to, or in connection directly or indirectly with one (1) or more direct or indirect transactions with one (1) or more related members or with a foreign corporation as defined in subsection (1) of this section, or with an entity that would be included in the affiliated group based upon ownership interest if it were organized as a corporation.

(3) The disallowance of deductions provided by subsection (2) of this section shall not apply if:

(a) The entity and the recipient are both included in the same consolidated Kentucky corporation income tax return for the relevant taxable year; or

(b) The entity makes a disclosure, and establishes by a preponderance of the evidence that:

1. The payment made to the recipient was subject to, in its state or country of commercial domicile, a net income tax, or a franchise tax measured by, in whole or in part, net income. If the recipient is a foreign corporation, the foreign nation shall have in force a comprehensive income tax treaty with the United States; and
2. The recipient is engaged in substantial business activities separate and apart from the acquisition, use, licensing, management, ownership, sale, exchange, or any other disposition of intangible property, or in the financing of related members, as evidenced by the maintenance of permanent office space and full-time employees dedicated to the maintenance and protection of intangible property; and
3. The transaction giving rise to the intangible interest expense, intangible expense, or management fees between the entity and the recipient was made at a commercially reasonable rate and at terms comparable to an arm's-length transaction; or

(c) The entity makes a disclosure, and establishes by preponderance of the evidence that the recipient regularly engages in transactions with one (1) or more unrelated parties on terms identical to that of the subject transaction; or

(d) The entity and the department~~[of Revenue]~~ agree in writing to the application or use of an alternative method of apportionment under KRS 141.120***(15)***~~[(9)]~~.

(4) An entity subject to the tax imposed by this chapter may deduct expenses or costs associated with an other related party transaction only in an amount equal to the amount which would have resulted if the other related party transaction had been carried out at arm's length. In any dispute between the department and the entity

with respect to the amount which would have resulted if the transaction had been carried out at arm's length, the entity shall bear the burden of establishing the amount by a preponderance of the evidence.

(5) Nothing in this section shall be deemed to prohibit an entity from deducting a related party cost in an amount permitted by this section, provided that the entity has incurred related party costs equal to or greater than the amounts permitted by this section.

(6) If it is determined by the department that the amount of a deduction claimed by an entity with respect to a related party cost is greater than the amount permitted by this section, the net income of the entity shall be adjusted to reflect the amount of the related party cost permitted by this section.

(7) For ***taxable years***~~[tax periods]~~ ending before January 1, 2005, in the case of entities not required to file a consolidated or combined return under subsection (1) of this section that carried on transactions with stockholders or affiliated entities directly or indirectly, the department shall adjust the net income of such entities to an amount that would result if such transactions were carried on at arm's length.

(8) For taxable years beginning on or after January 1, 2016:

(a) Any person that is subject to the taxes imposed by this chapter and that has participated in a reportable transaction shall disclose the reportable transaction on:

1. The return filed for the taxable year in which the reportable transaction occurred;

2. Any amended return for the taxable year in which the reportable transaction occurred; and

3. Any return for any other taxable year reflecting a reduction in tax resulting from the reportable transaction.

(b) Any income resulting from a reportable transaction shall be included in the

computation of gross income defined in KRS 141.010(9) or (12).

(c) Any deduction, credit, exclusion, or any other tax benefit accruing from a reportable transaction shall be disallowed.

(d) For purposes of Section 3 of this Act, income shifted to a tax haven, to the extent taxable under this chapter, shall be income subject to apportionment.

(e) Any person failing to include information on any return or report any income related to a reportable transaction shall pay a ten percent (10%) penalty on the tax liability ultimately due for the taxable year, in addition to any other penalty levied pursuant to KRS 131.180 or 141.990.

(f) No privilege of confidentiality shall apply to any written communication which is between a tax practitioner and any other person related to the promotion of the direct or indirect participation of that person in any reportable transaction.

(9) The department may require any person to submit an accounting, in spreadsheet format, to provide full disclosure for the taxable year of the:

(a) Income reported to each state or nation;

(b) Tax liability for each state or nation;

(c) Method used for allocating or apportioning income to the states or nations; and

(d) Identity of any group of taxpayers filing within a single report or return for any state or nation.

(10) Beginning July 1, 2017, the department shall report biennially to the Interim Joint Committee on Appropriations and Revenue with an update of countries that may be considered a tax haven as defined in subsection (1) of this section.

➔Section 7. KRS 141.040 is amended to read as follows:

(1) Every corporation doing business in this state, except those corporations listed in paragraphs (a) to (i) of this subsection, shall pay for each taxable year a tax to be

computed by the taxpayer on taxable net income or the alternative minimum calculation computed under this section at the rates specified in this section:

(a) Financial institutions, as defined in KRS 136.500, except bankers banks organized under KRS 286.3-135;

(b) Savings and loan associations organized under the laws of this state and under the laws of the United States and making loans to members only;

(c) Banks for cooperatives;

(d) Production credit associations;

(e) Insurance companies, including farmers or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;

(f) Corporations or other entities exempt under Section 501 of the Internal Revenue Code;

(g) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit;

(h) Corporations whose only owned or leased property located in this state is located at the premises of a printer with which it has contracted for printing, provided that:

1. The property consists of the final printed product, or copy from which the printed product is produced; and

2. The corporation has no individuals receiving compensation in this state as provided in KRS 141.120***(10)*** ~~[(8)(b)]~~; and

(i) For all taxable years except those beginning after December 31, 2004, and before January 1, 2007, S corporations.

(2)~~[For tax years ending before January 1, 1990, the following rates shall apply:~~

~~(a) Three percent (3%) of the first twenty-five thousand dollars ($25,000) of taxable net income;~~

~~(b) Four percent (4%) of the amount of taxable net income in excess of twenty-~~

~~five thousand dollars ($25,000), but not in excess of fifty thousand dollars ($50,000);~~

~~(c) Five percent (5%) of the amount of taxable net income in excess of fifty thousand dollars ($50,000), but not in excess of one hundred thousand dollars ($100,000);~~

~~(d) Six percent (6%) of the amount of taxable net income in excess of one hundred thousand dollars ($100,000), but not in excess of two hundred fifty thousand dollars ($250,000); and~~

~~(e) Seven and twenty-five one hundredths percent (7.25%) of the amount of taxable net income in excess of two hundred fifty thousand dollars ($250,000).~~

~~(3) For tax years beginning after December 31, 1989, and before January 1, 2005, the following rates shall apply:~~

~~(a) Four percent (4%) of the first twenty-five thousand dollars ($25,000) of taxable net income;~~

~~(b) Five percent (5%) of the amount of taxable net income in excess of twenty-five thousand dollars ($25,000) but not in excess of fifty thousand dollars ($50,000);~~

~~(c) Six percent (6%) of the amount of taxable net income in excess of fifty thousand dollars ($50,000), but not in excess of one hundred thousand dollars ($100,000);~~

~~(d) Seven percent (7%) of the amount of taxable net income in excess of one hundred thousand dollars ($100,000), but not in excess of two hundred fifty thousand dollars ($250,000); and~~

~~(e) Eight and twenty-five one hundredths percent (8.25%) of the amount of taxable net income in excess of two hundred fifty thousand dollars ($250,000).~~

~~(4) For tax years beginning before January 1, 1990, and ending after December 31, 1989, the tax shall be the sum of the amounts determined in paragraphs (a) and (b) as follows:~~

~~(a) Apply the tax rates in subsection (2) of this section to the taxable net income for the year and multiply the result by a fraction, the numerator of which is the number of days from the first day of the taxable year through December 31, 1989, and the denominator of which is the total number of days of the taxable year; and~~

~~(b) Apply the tax rates in subsection (3) of this section to the taxable net income for the year and multiply the result by a fraction, the numerator of which is the number of days from January 1, 1990, through the last day of the taxable year and the denominator of which is the total number of days of the taxable year.~~

~~(5) For taxable years beginning after December 31, 2004, and before January 1, 2007, corporations subject to the tax imposed by this section shall pay the greater of the tax computed under paragraph (a) of this subsection, the tax computed under paragraph (b)1. or 2. of this subsection, or the minimum tax imposed by subsection (7) of this section. The tax computed under this subsection is as follows:~~

~~(a) 1. Four percent (4%) of the first fifty thousand dollars ($50,000) of taxable net income;~~

~~2. Five percent (5%) of taxable net income over fifty thousand dollars ($50,000) up to one hundred thousand dollars ($100,000); and~~

~~3. Seven percent (7%) of taxable net income over one hundred thousand dollars ($100,000); or~~

~~(b) An alternative minimum calculation of an amount equal to the lesser of the amount computed under subparagraph 1. or 2. of this paragraph:~~

~~1. The gross receipts calculation contained in subsection (11) of this section; or~~

~~2. The gross profits calculation contained in subsection (12) of this section.~~

~~(6)]~~ For taxable years beginning on or after January 1, 2007, the following rates shall apply:

(a) Four percent (4%) of the first fifty thousand dollars ($50,000) of taxable net income;

(b) Five percent (5%) of taxable net income over fifty thousand dollars ($50,000) up to one hundred thousand dollars ($100,000); and

(c) Six percent (6%) of taxable net income over one hundred thousand dollars ($100,000).

~~[(7) For taxable years beginning on or after January 1, 2005, and before January 1, 2007, a minimum of one hundred seventy-five dollars ($175) shall be due for the taxable year from each corporation subject to the tax imposed by this section, regardless of the application of any tax credits provided under this chapter or any other provision of the Kentucky Revised Statutes for which the business entity may qualify.]~~

~~[(8) The alternative minimum calculation portion of the tax computation provided in subsection (5) of this section shall not apply to:~~

~~(a) Public service corporations subject to tax under KRS 136.120;~~

~~(b) Open-end registered investment companies organized under the laws of this state and registered under the Investment Company Act of 1940;~~

~~(c) Any property or facility which has been certified as a fluidized bed energy production facility as defined in KRS 211.390;~~

~~(d) An alcohol production facility as defined in KRS 247.910; and~~

~~(e) For taxable years beginning after December 31, 2005, and before January 1, 2007, political organizations as defined in Internal Revenue Code Section 527 and related regulations.]~~

~~[(9) For taxable years beginning after December 31, 2004, and before January 1, 2007:~~

~~(a) As used in this subsection, "qualified exempt organization" means an entity listed in subsection (1)(a) to (h) of this section and shall not include any entity whose exempt status has been disallowed by the Internal Revenue Service.~~

~~(b) Notwithstanding any other provisions of this section or KRS 141.010, any corporation of the type listed in KRS 141.010(24)(b)2. to 8. that is owned in whole or in part by a qualified exempt organization shall, in calculating its taxable net income, gross receipts, or Kentucky gross profits, exclude the proportionate share of its taxable net income, gross receipts, or Kentucky gross profits attributable to the ownership interest of the qualified exempt organization.~~

~~(c) Any corporation that reduces taxable net income, gross receipts, or Kentucky gross profits in accordance with paragraph (b) of this subsection shall disregard the ownership interest of the qualified exempt organization in determining the amount of credit available under KRS 141.420.~~

~~(d) The Department of Revenue may promulgate an administrative regulation to further define "qualified exempt organization" to include an entity for which exemption is constitutionally or legally required, or to exclude any entity created primarily for tax avoidance purposes with no legitimate business purpose.]~~

~~[(10) For taxable years beginning after December 31, 2004, and before January 1, 2007:]~~

~~[(a) To the extent that a corporation identified in KRS 141.010(24)(b)2. to 8. is doing business in this state, any member, shareholder or partner of the corporation may elect to pay, on behalf of the corporation, his, her or its proportionate share of the tax imposed by this section against the corporation. If an election is made, the electing member, shareholder or partner shall be treated in the same manner as the corporation regarding the proportionate part of the tax paid by the member, shareholder or partner. An election made~~

~~pursuant to this subsection shall not:]~~

~~[1. Be used by the Department of Revenue or the taxpayer to assert that the party making the election is doing business in Kentucky;~~

~~2. Result in an increase of the amount of credit allowable under KRS 141.420; or~~

~~3. Apply to any corporation that is required to be included in a consolidated return under KRS 141.200(2) to (5) and (9) to (12).~~

~~(b) The Department of Revenue shall prescribe forms and promulgate regulations to execute and administer the provisions of this subsection.]~~

~~[(11) The alternative minimum calculation for gross receipts shall be:~~

~~(a) For taxable years beginning on or after January 1, 2005, and before January 1, 2006, nine and one-half cents ($0.095) per one hundred dollars ($100) of the corporation's Kentucky gross receipts; and~~

~~(b) For taxable years beginning on or after January 1, 2006, and before January 1, 2007:~~

~~1. If the corporation's gross receipts from all sources are three million dollars ($3,000,000) or less, the alternative minimum calculation shall be zero;~~

~~2. If the corporation's gross receipts from all sources are greater than three million dollars ($3,000,000) but less than six million dollars ($6,000,000), the alternative minimum calculation shall be nine and one-half cents ($0.095) per one hundred dollars ($100) of the corporation's Kentucky gross receipts, reduced by an amount equal to two thousand eight hundred fifty dollars ($2,850) multiplied by a fraction, the numerator of which is six million dollars ($6,000,000) less the amount of the corporation's Kentucky gross receipts for the taxable year, and the denominator of which is three million dollars ($3,000,000), but in no~~

~~case shall the result be less than zero;~~

~~3. If the corporation's gross receipts from all sources are equal to or greater than six million dollars ($6,000,000), the alternative minimum calculation shall be nine and one-half cents ($0.095) per one hundred dollars ($100) of the corporation's Kentucky gross receipts.]~~

~~[In determining eligibility for the reductions contained in this paragraph when the alternative minimum calculation is computed on a consolidated return, the gross receipts of the affiliated group shall include the total gross receipts from all sources of the affiliated group, including eliminating entries for transactions among the group.]~~

~~[(12) The alternative minimum calculation for gross profits shall be:~~

~~(a) For taxable years beginning on or after January 1, 2005, and before January 1, 2006, seventy-five cents ($0.75) per one hundred dollars ($100) of the corporation's Kentucky gross profits; and~~

~~(b) For taxable years beginning on or after January 1, 2006, and before January 1, 2007:~~

~~1. If the corporation's gross profits from all sources are three million dollars ($3,000,000) or less, the tax shall be zero;]~~

~~[2. If the corporation's gross profits from all sources are at least three million dollars ($3,000,000) but less than six million dollars ($6,000,000), the tax shall be seventy-five cents ($0.75) per one hundred dollars ($100) of the corporation's Kentucky gross profits, reduced by an amount equal to twenty-two thousand five hundred dollars ($22,500) multiplied by a fraction, the numerator of which is six million dollars ($6,000,000) less the amount of the corporation's Kentucky gross profits, and the denominator of which is three million dollars ($3,000,000), but in no case shall the result be less than zero;]~~

~~[3. If the corporation's gross profits from all sources are equal to or greater than six million dollars ($6,000,000), the tax shall be seventy-five cents ($0.75) per one hundred dollars ($100) on all of the corporation's Kentucky gross profits.]~~

~~[In determining eligibility for the reductions contained in this paragraph when the alternative minimum calculation is computed on a consolidated return, the gross profits of the affiliated group shall include the total gross profits from all sources of the affiliated group, including eliminating entries for transactions among the group.]~~

~~[(13) As used in subsections (11) and (12) of this section:~~

~~(a) "Kentucky gross receipts" means an amount equal to the computation of the numerator of the sales factor under the provisions of KRS 141.120(8)(c);~~

~~(b) "Gross receipts from all sources" means an amount equal to the computation of the denominator of the sales factor under the provisions of KRS 141.120(8)(c); and~~

~~(c) The terms defined in KRS 141.0401(1)(d) to (l) shall have the same meaning as provided in KRS 141.0401.]~~

(3) ~~[(14)]~~ (a) For taxable years beginning on or after January 1, 2007, an S corporation shall pay income tax on the same items of income and in the same manner as required for federal purposes, except to the extent required by differences between this chapter and the federal income tax law and regulations.

(b) 1. If the S corporation is required under Section 1363(d) of the Internal Revenue Code to submit installments of tax on the recapture of LIFO benefits, installments to pay the Kentucky tax due shall be paid on or before the due date of the S corporation's return, as extended, if applicable.

2. Notwithstanding KRS 141.170(3), no interest shall be assessed on the

installment payment for the period of extension.

(c) If the S corporation is required under Section 1374 or 1375 of the Internal Revenue Code to pay tax on built-in gains or on passive investment income, the amount of tax imposed by this subsection shall be computed by applying the highest rate of tax for the taxable year.

➔Section 8. KRS 141.0401 is amended to read as follows:

(1) As used in this section:

(a) "Kentucky gross receipts" means an amount equal to the computation of the numerator of the sales factor under the provisions of KRS 141.120***(11) to (14)***~~[(8)(c)]~~, KRS 141.120***(15)***~~[(9)]~~, any administrative regulations related to the computation of the sales factor, and KRS 141.121 and includes the proportionate share of Kentucky gross receipts of all wholly or partially owned limited liability pass-through entities, including all layers of a multi-layered pass-through structure;

(b) "Gross receipts from all sources" means an amount equal to the computation of the denominator of the sales factor under the provisions of KRS 141.120***(11) to (14)***~~[(8)(c)]~~, KRS 141.120***(15)***~~[(9)]~~, any administrative regulations related to the computation of the sales factor, and KRS 141.121 and includes the proportionate share of gross receipts from all sources of all wholly or partially owned limited liability pass-through entities, including all layers of a multi-layered pass-through structure;

(c) "Combined group" means all members of an affiliated group as defined in KRS 141.200(9)(b) and all limited liability pass-through entities that would be included in an affiliated group if organized as a corporation;

(d) "Cost of goods sold" means:

1. Amounts that are:

a. Allowable as cost of goods sold pursuant to the Internal Revenue

Code and any guidelines issued by the Internal Revenue Service relating to cost of goods sold, unless modified by this paragraph; and

b. Incurred in acquiring or producing the tangible product generating the Kentucky gross receipts.

2. For manufacturing, producing, reselling, retailing, or wholesaling activities, cost of goods sold shall only include costs directly incurred in acquiring or producing the tangible product. In determining cost of goods sold:

a. Labor costs shall be limited to direct labor costs as defined in paragraph (f) of this subsection;

b. Bulk delivery costs as defined in paragraph (g) of this subsection may be included; and

c. Costs allowable under Section 263A of the Internal Revenue Code may be included only to the extent the costs are incurred in acquiring or producing the tangible product generating the Kentucky gross receipts. Notwithstanding the foregoing, indirect labor costs allowable under Section 263A shall not be included;

3. For any activity other than manufacturing, producing, reselling, retailing, or wholesaling, no costs shall be included in cost of goods sold.

As used in this paragraph, "guidelines issued by the Internal Revenue Service" includes regulations, private letter rulings, or any other guidance issued by the Internal Revenue Service that may be relied upon by taxpayers under reliance standards established by the Internal Revenue Service;

(e) 1. "Kentucky gross profits" means Kentucky gross receipts reduced by returns and allowances attributable to Kentucky gross receipts, less the cost of goods sold attributable to Kentucky gross receipts. If the amount

of returns and allowances attributable to Kentucky gross receipts and the cost of goods sold attributable to Kentucky gross receipts is zero, then "Kentucky gross profits" means Kentucky gross receipts; and

2. "Gross profits from all sources" means gross receipts from all sources reduced by returns and allowances attributable to gross receipts from all sources, less the cost of goods sold attributable to gross receipts from all sources. If the amount of returns and allowances attributable to gross receipts from all sources and the cost of goods sold attributable to gross receipts from all sources is zero, then gross profits from all sources means gross receipts from all sources;

(f) "Direct labor" means labor that is incorporated into the tangible product sold or is an integral part of the manufacturing process;

(g) "Bulk delivery costs" means the cost of delivering the product to the consumer if:

1. The tangible product is delivered in bulk and requires specialized equipment that generally precludes commercial shipping; and

2. The tangible product is taxable under KRS 138.220;

(h) "Manufacturing" and "producing" means:

1. Manufacturing, producing, constructing, or assembling components to produce a significantly different or enhanced end tangible product;

2. Mining or severing natural resources from the earth; or

3. Growing or raising agricultural or horticultural products or animals;

(i) "Real property" means land and anything growing on, attached to, or erected on it, excluding anything that may be severed without injury to the land;

(j) "Reselling," "retailing," and "wholesaling" mean the sale of a tangible product;

(k) "Tangible personal property" means property, other than real property, that has

physical form and characteristics; and

(l) "Tangible product" means real property and tangible personal property;

(2) (a) For taxable years beginning on or after January 1, 2007, an annual limited liability entity tax shall be paid by every corporation and every limited liability pass-through entity doing business in Kentucky on all Kentucky gross receipts or Kentucky gross profits except as provided in this subsection. A small business exclusion from this tax shall be provided based on the reduction contained in this subsection. The tax shall be the greater of the amount computed under paragraph (b) of this subsection or one hundred seventy-five dollars ($175), regardless of the application of any tax credits provided under this chapter or any other provisions of the Kentucky Revised Statutes for which the business entity may qualify.

(b) The limited liability entity tax shall be the lesser of subparagraph 1. or 2. of this paragraph:

1. a. If the corporation's or limited liability pass-through entity's gross receipts from all sources are three million dollars ($3,000,000) or less, the limited liability entity tax shall be zero;

b. If the corporation's or limited liability pass-through entity's gross receipts from all sources are greater than three million dollars ($3,000,000) but less than six million dollars ($6,000,000), the limited liability entity tax shall be nine and one-half cents ($0.095) per one hundred dollars ($100) of the corporation's or limited liability pass-through entity's Kentucky gross receipts reduced by an amount equal to two thousand eight hundred fifty dollars ($2,850) multiplied by a fraction, the numerator of which is six million dollars ($6,000,000) less the amount of the corporation's or limited liability pass-through entity's Kentucky gross receipts for

the taxable year, and the denominator of which is three million dollars ($3,000,000), but in no case shall the result be less than zero;

c. If the corporation's or limited liability pass-through entity's gross receipts from all sources are equal to or greater than six million dollars ($6,000,000), the limited liability entity tax shall be nine and one-half cents ($0.095) per one hundred dollars ($100) of the corporation's or limited liability pass-through entity's Kentucky gross receipts.

2. a. If the corporation's or limited liability pass-through entity's gross profits from all sources are three million dollars ($3,000,000) or less, the limited liability entity tax shall be zero;

b. If the corporation's or limited liability pass-through entity's gross profits from all sources are at least three million dollars ($3,000,000) but less than six million dollars ($6,000,000), the limited liability entity tax shall be seventy-five cents ($0.75) per one hundred dollars ($100) of the corporation's or limited liability pass-through entity's Kentucky gross profits, reduced by an amount equal to twenty-two thousand five hundred dollars ($22,500) multiplied by a fraction, the numerator of which is six million dollars ($6,000,000) less the amount of the corporation's or limited liability pass-through entity's Kentucky gross profits, and the denominator of which is three million dollars ($3,000,000), but in no case shall the result be less than zero;

c. If the corporation's or limited liability pass-through entity's gross profits from all sources are equal to or greater than six million dollars ($6,000,000), the limited liability entity tax shall be

seventy-five cents ($0.75) per one hundred dollars ($100) of all of the corporation's or limited liability pass-through entity's Kentucky gross profits.

In determining eligibility for the reductions contained in this paragraph, a member of a combined group shall consider the combined gross receipts and the combined gross profits from all sources of the entire combined group, including eliminating entries for transactions among the group.

(c) A credit shall be allowed against the tax imposed under paragraph (a) of this subsection for the current year to a corporation or limited liability pass-through entity that owns an interest in a limited liability pass-through entity. The credit shall be the proportionate share of tax calculated under this subsection by the lower-level pass-through entity, as determined after the amount of tax calculated by the pass-through entity has been reduced by the minimum tax of one hundred seventy-five dollars ($175). The credit shall apply across multiple layers of a multi-layered pass-through entity structure. The credit at each layer shall include the credit from each lower layer, after reduction for the minimum tax of one hundred seventy-five dollars ($175) at each layer.

(d) The department may promulgate administrative regulations to establish a method for calculating the cost of goods sold attributable to Kentucky.

(3) A nonrefundable credit based on the tax calculated under subsection (2) of this section shall be allowed against the tax imposed by KRS 141.020 or 141.040. The credit amount shall be determined as follows:

(a) The credit allowed a corporation subject to the tax imposed by KRS 141.040 shall be equal to the amount of tax calculated under subsection (2) of this section for the current year after subtraction of any credits identified in KRS 141.0205, reduced by the minimum tax of one hundred seventy-five dollars

($175), plus any credit determined in paragraph (b) of this subsection for tax paid by wholly or partially owned limited liability pass-through entities. The amount of credit allowed to a corporation based on the amount of tax paid under subsection (2) of this section for the current year shall be applied to the income tax due from the corporation's activities in this state. Any remaining credit from the corporation shall be disallowed.

(b) The credit allowed members, shareholders, or partners of a limited liability pass-through entity shall be the members', shareholders', or partners' proportionate share of the tax calculated under subsection (2) of this section for the current year after subtraction of any credits identified in KRS 141.0205, as determined after the amount of tax paid has been reduced by the minimum tax of one hundred seventy-five dollars ($175). The credit allowed to members, shareholders, or partners of a limited liability pass-through entity shall be applied to income tax assessed on income from the limited liability pass-through entity. Any remaining credit from the limited liability pass-through entity shall be disallowed.

(4) Each taxpayer subject to the tax imposed in this section shall file a return, on forms prepared by the department, on or before the fifteenth day of the fourth month following the close of the taxpayer's taxable year. Any tax remaining due after making the payments required in KRS 141.042 shall be paid by the original due date of the return.

(5) The department shall prescribe forms and promulgate administrative regulations as needed to administer the provisions of this section.

(6) The tax imposed by subsection (2) of this section shall not apply to:

(a) Financial institutions, as defined in KRS 136.500, except banker's banks organized under KRS 287.135 or 286.3-135;

(b) Savings and loan associations organized under the laws of this state and under

the laws of the United States and making loans to members only;

(c) Banks for cooperatives;

(d) Production credit associations;

(e) Insurance companies, including farmers' or other mutual hail, cyclone, windstorm, or fire insurance companies, insurers, and reciprocal underwriters;

(f) Corporations or other entities exempt under Section 501 of the Internal Revenue Code;

(g) Religious, educational, charitable, or like corporations not organized or conducted for pecuniary profit;

(h) Corporations whose only owned or leased property located in this state is located at the premises of a printer with which it has contracted for printing, provided that:

1. The property consists of the final printed product, or copy from which the printed product is produced; and

2. The corporation has no individuals receiving compensation in this state as provided in KRS 141.120***(10)***~~[(8)(b)]~~;

(i) Public service corporations subject to tax under KRS 136.120;

(j) Open-end registered investment companies organized under the laws of this state and registered under the Investment Company Act of 1940;

(k) Any property or facility which has been certified as a fluidized bed energy production facility as defined in KRS 211.390;

(l) An alcohol production facility as defined in KRS 247.910;

(m) Real estate investment trusts as defined in Section 856 of the Internal Revenue Code;

(n) Regulated investment companies as defined in Section 851 of the Internal Revenue Code;

(o) Real estate mortgage investment conduits as defined in Section 860D of the

Internal Revenue Code;

(p) Personal service corporations as defined in Section 269A(b)(1) of the Internal Revenue Code;

(q) Cooperatives described in Sections 521 and 1381 of the Internal Revenue Code, including farmers' agricultural and other cooperatives organized or recognized under KRS Chapter 272, advertising cooperatives, purchasing cooperatives, homeowners associations including those described in Section 528 of the Internal Revenue Code, political organizations as defined in Section 527 of the Internal Revenue Code, and rural electric and rural telephone cooperatives; or

(r) Publicly traded partnerships as defined by Section 7704(b) of the Internal Revenue Code that are treated as partnerships for federal tax purposes under Section 7704(c) of the Internal Revenue Code, or their publicly traded partnership affiliates. "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.

(7) (a) As used in this subsection, "qualified exempt organization" means an entity listed in subsection (6)(a) to (r) of this section and shall not include any entity whose exempt status has been disallowed by the Internal Revenue Service.

(b) Notwithstanding any other provisions of this section, any limited liability pass-through entity that is owned in whole or in part by a qualified exempt organization shall, in calculating its Kentucky gross receipts or Kentucky gross profits, exclude the proportionate share of its Kentucky gross receipts or Kentucky gross profits attributable to the ownership interest of the qualified exempt organization.

(c) Any limited liability pass-through entity that reduces Kentucky gross receipts or Kentucky gross profits in accordance with paragraph (b) of this subsection shall disregard the ownership interest of the qualified exempt organization in determining the amount of credit available under subsection (3) of this section.

(d) The department~~[of Revenue]~~ may promulgate an administrative regulation to further define "qualified exempt organization" to include an entity for which exemption is constitutionally or legally required, or to exclude any entity created primarily for tax avoidance purposes with no legitimate business purpose.

(8) The credit permitted by subsection (3) of this section shall flow through multiple layers of limited liability pass-through entities and shall be claimed by the taxpayer who ultimately pays the tax on the income of the limited liability pass-through entity.

➔Section 9. KRS 141.206 is amended to read as follows:

(1) As used in this section unless the context requires otherwise:

(a) For taxable years beginning after December 31, 2004, and before January 1, 2007, "pass-through entity" means a general partnership not subject to the tax imposed by KRS 141.040, including 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 and its publicly traded partnership affiliates. "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; and

(b) For all other taxable years, "pass-through entity" means pass-through entity as

defined in KRS 141.010.

(2) Every pass-through entity doing business in this state shall, on or before the fifteenth day of the fourth month following the close of its annual accounting period, file a copy of its federal tax return with the form prescribed and furnished by the department.

(3) Pass-through entities shall determine net income in the same manner as in the case of an individual under KRS 141.010(9) to (11) and the adjustment required under Sections 703(a) and 1363(b) of the Internal Revenue Code. Computation of net income under this section and the computation of the partner's, member's, or shareholder's distributive share shall be computed as nearly as practicable identical with those required for federal income tax purposes except to the extent required by differences between this chapter and the federal income tax law and regulations.

(4) Individuals, estates, trusts, or corporations doing business in this state as a partner, member, or shareholder in a pass-through entity shall be liable for income tax only in their individual, fiduciary, or corporate capacities, and no income tax shall be assessed against the net income of any pass-through entity, except as required for S corporations by KRS 141.040***(3)*** ~~[(14)]~~.

(5) (a) Every pass-through entity required to file a return under subsection (2) of this section, except publicly traded partnerships as defined in KRS 141.0401(6)(r), shall withhold Kentucky income tax on the distributive share, whether distributed or undistributed, of each:

1. Nonresident individual partner, member, or shareholder; and
2. Corporate partner or member that is doing business in Kentucky only through its ownership interest in a pass-through entity.

(b) Withholding shall be at the maximum rate provided in KRS 141.020 or 141.040.

(6) (a) Effective for taxable years beginning after December 31, 2011, every pass-

through entity required to withhold Kentucky income tax as provided by subsection (5) of this section shall make a declaration and payment of estimated tax for the taxable year if:

1. For a nonresident individual partner, member, or shareholder, the estimated tax liability can reasonably be expected to exceed five hundred dollars ($500); or
2. For a corporate partner or member that is doing business in Kentucky only through its ownership interest in a pass-through entity, the estimated tax liability can reasonably be expected to exceed five thousand dollars ($5,000).

(b) The declaration and payment of estimated tax shall contain the information and shall be filed as provided in KRS 141.207.

(7) (a) If a pass-through entity demonstrates to the department that a partner, member, or shareholder has filed an appropriate tax return for the prior year with the department, then the pass-through entity shall not be required to withhold on that partner, member, or shareholder for the current year unless the exemption from withholding has been revoked pursuant to paragraph (b) of this subsection.

(b) An exemption from withholding shall be considered revoked if the partner, member, or shareholder does not file and pay all taxes due in a timely manner. An exemption so revoked shall be reinstated only with permission of the department. If a partner, member, or shareholder who has been exempted from withholding does not file a return or pay the tax due, the department may require the pass-through entity to pay to the department the amount that should have been withheld, up to the amount of the partner's, member's, or shareholder's ownership interest in the entity. The pass-through entity shall be entitled to recover a payment made pursuant to this paragraph from the

partner, member, or shareholder on whose behalf the payment was made.

(8) In determining the tax under this chapter, a resident individual, estate, or trust that is a partner, member, or shareholder in a pass-through entity shall take into account the partner's, member's, or shareholder's total distributive share of the pass-through entity's items of income, loss, deduction, and credit.

(9) In determining the tax under this chapter, a nonresident individual, estate, or trust that is a partner, member, or shareholder in a pass-through entity required to file a return under subsection (2) of this section shall take into account:

(a) 1. If the pass-through entity is doing business only in this state, the partner's, member's, or shareholder's total distributive share of the pass-through entity's items of income, loss, and deduction; or

2. If the pass-through entity is doing business both within and without this state, the partner's, member's, or shareholder's distributive share of the pass-through entity's items of income, loss, and deduction multiplied by the apportionment fraction of the pass-through entity as prescribed in subsection (12) of this section; and

(b) The partner's, member's, or shareholder's total distributive share of credits of the pass-through entity.

(10) A corporation that is subject to tax under KRS 141.040 and is a partner or member in a pass-through entity shall take into account the corporation's distributive share of the pass-through entity's items of income, loss, and deduction and:

(a) For taxable years beginning prior to January 1, 2007, the items of income, loss, and deduction, when applicable, shall be multiplied by the apportionment fraction of the pass-through entity as prescribed in subsection (12) of this section; or

(b) For taxable years beginning on or after January 1, 2007:

1. A corporation that owns an interest in a limited liability pass-through

entity or that owns an interest in a general partnership organized or formed as a general partnership after January 1, 2006, shall include the proportionate share of the sales, property, and payroll of the limited liability pass-through entity or general partnership in computing its own apportionment factor;

2. A corporation that owns an interest in a general partnership organized or formed on or before January 1, 2006, shall follow the provisions of paragraph (a) of this subsection; and

(c) Credits from the partnership.

(11) (a) If a pass-through entity is doing business both within and without this state, the pass-through entity shall compute and furnish to each partner, member, or shareholder the numerator and denominator of each factor of the apportionment fraction determined in accordance with subsection (12) of this section.

(b) For purposes of determining an apportionment fraction under paragraph (a) of this subsection, if the pass-through entity is:

1. Doing business both within and without this state; and

2. A partner or member in another pass-through entity;

then the pass-through entity shall be deemed to own the pro rata share of the property owned or leased by the other pass-through entity, and shall also include its pro rata share of the other pass-through entity's payroll and sales.

(c) The phrases "a partner or member in another pass-through entity" and "doing business both within and without this state" shall extend to each level of multiple-tiered pass-through entities.

(d) The attribution to the pass-through entity of the pro rata share of property, payroll and sales from its role as a partner or member in another pass-through entity will also apply when determining the pass-through entity's ultimate

apportionment factor for property, payroll and sales as required under subsection (12) of this section.

(12) A pass-through entity doing business within and without the state shall compute an apportionment fraction, the numerator of which is the property factor, representing twenty-five percent (25%) of the fraction, plus the payroll factor, representing twenty-five percent (25%) of the fraction, plus the sales factor, representing fifty percent (50%) of the fraction, with each factor determined in the same manner as provided in KRS 141.120~~[(8)]~~, and the denominator of which is four (4), reduced by the number of factors, if any, having no denominator, provided that if the sales factor has no denominator, then the denominator shall be reduced by two (2).

(13) Resident individuals, estates, or trusts that are partners in a partnership, members of a limited liability company electing partnership tax treatment for federal income tax purposes, owners of single member limited liability companies, or shareholders in an S corporation which does not do business in this state are subject to tax under KRS 141.020 on federal net income, gain, deduction, or loss passed through the partnership, limited liability company, or S corporation.

(14) An S corporation election made in accordance with Section 1362 of the Internal Revenue Code for federal tax purposes is a binding election for Kentucky tax purposes.

(15) (a) Nonresident individuals shall not be taxable on investment income distributed by a qualified investment partnership. For purposes of this subsection, a "qualified investment partnership" means a pass-through entity that, during the taxable year, holds only investments that produce income that would not be taxable to a nonresident individual if held or owned individually.

(b) A qualified investment partnership shall be subject to all other provisions relating to a pass-through entity under this section and shall not be subject to the tax imposed under KRS 141.040 or 141.0401.

(16) (a) 1. A pass-through entity may file a composite income tax return on behalf of electing nonresident individual partners, members, or shareholders.

2. The pass-through entity shall report and pay on the composite income tax return income tax at the highest marginal rate provided in this chapter on any portion of the partners', members', or shareholders' pro rata or distributive shares of income of the pass-through entity from doing business in this state or deriving income from sources within this state. Payments made pursuant to subsection (6) of this section shall be credited against any tax due.

3. The pass-through entity filing a composite return shall still make estimated tax payments if required to do so by subsection (6) of this section, and shall remain subject to any penalty provided by KRS 131.180 or 141.990 for any declaration underpayment or any installment not paid on time.

4. The partners', members', or shareholders' pro rata or distributive share of income shall include all items of income or deduction used to compute adjusted gross income on the Kentucky return that is passed through to the partner, member, or shareholder by the pass-through entity, including but not limited to interest, dividend, capital gains and losses, guaranteed payments, and rents.

(b) A nonresident individual partner, member, or shareholder whose only source of income within this state is distributive share income from one (1) or more pass-through entities may elect to be included in a composite return filed pursuant to this section.

(c) A nonresident individual partner, member, or shareholder that has been included in a composite return may file an individual income tax return and shall receive credit for tax paid on the partner's behalf by the pass-through

entity.

(d) A pass-through entity shall deliver to the department a return upon a form prescribed by the department showing the total amounts paid or credited to its electing nonresident individual partners, members, or shareholders, the amount paid in accordance with this subsection, and any other information the department may require. A pass-through entity shall furnish to its nonresident partner, member, or shareholder annually, but not later than the fifteenth day of the fourth month after the end of its taxable year, a record of the amount of tax paid on behalf of the partner, member, or shareholder on a form prescribed by the department.

➔Section 10. KRS 141.420 is amended to read as follows:

For taxable years beginning after December 31, 2004, and before January 1, 2007:

(1) (a) Every corporation identified in KRS 141.010(24)(b)2. to 8. that is doing business in this state shall, on or before the fifteenth day of the fourth month following the close of its annual accounting period, file a copy of its applicable federal return with the form prescribed and furnished by the department.

(b) For a corporation filing a return under paragraph (a) of this subsection, the individual partner's, member's, or shareholder's distributive share of net income, gain, loss, or deduction shall be computed as nearly as practicable in a manner identical to that required for federal income tax purposes except to the extent required by differences between this chapter and the federal income tax law and regulations.

(2) (a) Resident individuals who are members, partners, or shareholders of a corporation required to file a return under subsection (1)(a) of this section shall report and pay tax on the distributive share of net income, gain, loss, or deduction as determined in subsection (1)(b) of this section.

(b) Nonresident individuals who are members, partners, or shareholders of a corporation required to file a return under subsection (1)(a) of this section shall report and pay tax on the distributive share of net income, gain, loss, or deduction as determined in subsection (1)(b) of this section multiplied by the apportionment fraction in KRS 141.120~~[(8)]~~.

(3) (a) Resident and nonresident individuals who are members, shareholders, or partners of a corporation required to file a return under paragraph (a) of subsection (1) of this section shall be entitled to a nonrefundable credit against the tax imposed under KRS 141.020.

(b) The credit determined under this subsection shall be the member's, shareholder's, or partner's proportionate share of the tax due from the corporation as determined under KRS 141.040, before the application of any credits identified in KRS 141.0205(5) and reduced by the required minimum imposed by KRS ***141.0401(2)(a)***~~[141.040(7)]~~.

(c) Notwithstanding the provisions of paragraph (a) of this subsection, for taxable years beginning after December 31, 2004, and before January 1, 2007, the portion of the credit computed under paragraph (b) of this subsection that exceeds the credit that would have been utilized if the corporation's income were taxed at the rates in KRS 141.020 shall be refundable. The refundable portion of the credit shall be the individual member's, shareholder's, or partner's proportionate share of the amount computed by multiplying the amount the corporation's income exceeds two hundred sixteen thousand six hundred dollars ($216,600) by one percent (1%).

(d) The credit determined under paragraphs (a) and (b) of this subsection shall not operate to reduce the member's, shareholder's, or partner's tax due to an amount that is less than what would have been payable were the income attributable to doing business in this state by the corporation ignored.

(e) If a corporation identified in KRS 141.010(24)(b)1. to 8. is a partner, shareholder, or member of another corporation identified in KRS 141.010(24)(b)2. to 8., the amount of income, gain, loss, deduction, refundable credit, or nonrefundable credit that the entity receives from the entity in which it is a partner, shareholder, or member shall proportionately pass through to the corporation's individual partners, members, or shareholders based upon the distributive share ratio. The phrase "a corporation identified in KRS 141.010(24)(b)1. to 8. is a partner, shareholder, or member of another corporation identified in KRS 141.010(24)(b)2. to 8." shall extend through each level of multitiered ownership.

(f) The nonrefundable and refundable credits provided by this section shall be allowed only to the extent that the tax is paid by the corporation. If after the credits are disallowed the corporation subsequently pays the tax due, the nonrefundable and refundable credits shall then be allowed.

(4) For purposes of computing the basis of an ownership interest or stock in a corporation identified in KRS 141.010(24)(b)2. to 8., the basis attributable to a member, partner, or shareholder shall be adjusted by the distributive share of the items of net income, gain, loss and deduction as though the items had been passed through to the member, partner, or shareholder.

(5) Except as otherwise provided in this chapter, distributions by or from a corporation shall be treated in the same manner as they are treated for federal tax purposes.

➔Section 11. KRS 136.310 is amended to read as follows:

(1) Every federally or state chartered savings and loan association, savings bank, and other similar institution authorized to transact business in this state, with property and payroll within and without this state, shall, during January of each year, file with the Department of Revenue a report containing information and in such form as the department may require.

(2) The Department of Revenue shall fix the fair cash value, as of January 1 of each year, of the capital attributable to Kentucky in each financial institution included in subsection (1) of this section. The methodology employed by the department shall be a three (3) step process as follows:

(a) 1. The total value of deposits maintained in Kentucky less any amounts where the amount borrowed by a member equals or exceeds the amount deposited by that member shall be determined.

2. The total value of deposits maintained in Kentucky shall be determined by the same method used for filing the summary of deposits report with the Federal Deposit Insurance Corporation;

(b) 1. The Kentucky apportioned value of capital shall be determined by including undivided profits, surplus, general reserves, and paid-up stock.

2. For Agricultural Credit Associations chartered by the Farm Credit Administration, capital shall be computed by deducting the book value of the association's investment in any other wholly owned institution chartered by the Farm Credit Administration that is either subject to the tax imposed by KRS 136.300 or this section or that is exempt from state taxation by federal law.

3. The Kentucky value of capital shall be determined by a fraction, the numerator of which is the receipts factor plus the outstanding loan balance factor plus the payroll factor, and the denominator of which is three (3); and

(c) 1. The values determined in ***paragraphs*** ~~[steps]~~ (a) and (b) of this subsection shall be added together to determine total Kentucky capital and then reduced by the influence of ownership in tax-exempt United States obligations to determine Kentucky taxable capital.

2. The influence of tax-exempt United States obligations is to be

determined from the reports of condition filed with the applicable supervisory agency as follows: the average amount of tax-exempt United States obligations for the calendar year, over the average amount of total assets for the calendar year multiplied by total Kentucky capital.

3. The department shall immediately notify each institution of the value so fixed.

(3) The receipts factor specified in subsection (2)(b) of this section is a fraction, the numerator of which is all receipts derived from loans and other sources negotiated through offices or derived from customers in Kentucky, and the denominator of which is total business receipts for the preceding calendar year.

(4) (a) The outstanding loan balance factor specified in subsection (2)(b) of this section is a fraction, the numerator of which is the average balance of outstanding loans negotiated from offices or made to customers in Kentucky, and the denominator of which is the average balance of all outstanding loans.

(b) 1. The average outstanding loan balance is determined by adding the outstanding loan balance at the beginning of the preceding calendar year to the outstanding loan balance at the end of the preceding calendar year and dividing by two (2).

2. If the yearly beginning balance and ending balance results in an inequitable factor, the average outstanding loan balance may be computed on a monthly average balance.

(5) The payroll factor specified in subsection (2)(b) of this section shall be determined for the preceding calendar year under the provisions of KRS 141.120***(10)*** ~~[(8)(b)]~~ and administrative regulations promulgated according to KRS Chapter 13A.

(6) (a) By July 1 succeeding the filing of the report as provided in subsection (1) of this section, each financial institution included in subsection (1) of this section shall pay directly into the State Treasury a tax of one dollar ($1) for each one

thousand dollars ($1,000) paid in on its Kentucky taxable capital as fixed in subsection (2)(c) of this section.

(b) The institution shall not be required to pay local taxes upon its capital stock, surplus, undivided profits, notes, mortgages, or other credits, and the tax provided by this section shall be in lieu of all taxes for state purposes on intangible property of the institution, nor shall any depositor of the institution be required to list his deposits for taxation under KRS 132.020.

(c) Failure to make reports and pay taxes as provided in this section shall subject the institution to the same penalties imposed for such failure on the part of the other corporations.

(7) If a financial institution included in subsection (1) of this section selects, it may deduct taxes imposed in subsection (6) of this section from the dividends paid or credited to a nonborrowing shareholder.

(8) (a) Every Agricultural Credit Association chartered by the Farm Credit Administration being authorized to transact business in Kentucky but having no employees located within or without the state shall be subject to the same tax imposed pursuant to either KRS 136.300 or this section as that imposed upon its wholly owned Production Credit Association subsidiary.

(b) For purposes of computing Kentucky apportioned value of capital pursuant to subsection (2) of this section, those Agricultural Credit Associations subject to the tax imposed by this section shall utilize that Kentucky apportionment fraction computed and utilized by its wholly owned Production Credit Association subsidiary for the same report period.

➔Section 12. KRS 136.530 is amended to read as follows:

(1) The receipts factor is a fraction, the numerator of which is the receipts of the financial institution in this Commonwealth during the taxable year as determined by subsection (2) of this section and the denominator of which is the receipts of the

financial institution within and without this Commonwealth during the taxable year. Receipts shall include the following:

(a) Receipts from the lease or rental of real property owned by the financial institution;

(b) Receipts from the lease or rental of tangible personal property owned by the financial institution;

(c) Interest and fees or penalties in the nature of interest from loans secured by real property;

(d) Interest and fees or penalties in the nature of interest from loans not secured by real property;

(e) Net gains from the sale of loans. Net gains from the sale of loans includes income recorded under the coupon stripping rules of Section 1286 of the Internal Revenue Code;

(f) Interest and fees or penalties in the nature of interest from credit card receivables and receipts from fees charged to card holders, such as annual fees;

(g) Net gains, but not less than zero (0), from the sale of credit card receivables;

(h) All credit card issuer's reimbursement fees;

(i) Receipts from merchant discount. Receipts from merchant discount shall be computed net of any cardholder charge backs, but shall not be reduced by any interchange transaction fees or by any issuer's reimbursement fees paid to another for charges made by its card holders;

(j) Loan servicing fees derived from loans secured by real property;

(k) Loan servicing fees derived from loans not secured by real property;

(l) Interest, dividends, net gains, but not less than zero (0), and other income from investment assets and activities and from trading assets and activities. Investment assets and activities and trading assets and activities include but

are not limited to investment securities, trading account assets, federal funds, securities purchased and sold under agreements to resell or repurchase, options, futures contracts, forward contracts, notional principal contracts such as swaps, equities, and foreign currency transactions. The receipts factor shall include the following amounts:

1. The amount by which interest from federal funds sold and securities purchased under resale agreements exceeds interest expense on federal funds purchased and securities sold under repurchase agreements; and
2. The amount by which interest, dividends, gains, and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book, and foreign currency transactions, exceed amounts paid in lieu of interest, amounts paid in lieu of dividends, and losses from these assets and activities;

(m) All receipts derived from sales that would be included in the factor established by KRS 141.120***(11) to (14)***~~[(8)(c)]~~; and

(n) Receipts from services not otherwise specifically listed.

(2) A determination of whether receipts should be included in the numerator of the fraction shall be made as follows:

(a) Receipts from the lease or rental of real property owned by the financial institution shall be included in the numerator if the property is located within this Commonwealth or receipts from the sublease of real property if the property is located within this Commonwealth.

(b) 1. Except as described in subparagraph 2. of this paragraph, receipts from the lease or rental of tangible personal property owned by the financial institution shall be included in the numerator if the property is located within this Commonwealth when it is first placed in service by the lessee.

2. Receipts from the lease or rental of transportation property owned by the financial institution are included in the numerator of the receipts factor to the extent that the property is used in this Commonwealth. The extent an aircraft will be deemed to be used in this Commonwealth and the amount of receipts that is to be included in the numerator of this Commonwealth's receipts factor is determined by multiplying all the receipts from the lease or rental of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in this Commonwealth and the denominator of which is the total number of landings of the aircraft. If the extent of the use of any transportation property within this Commonwealth cannot be determined, then the property shall be deemed to be used wholly in the state in which the property has its principal base of operations. A motor vehicle shall be deemed to be used wholly in the state in which it is registered.

(c) 1. Interest and fees or penalties in the nature of interest from loans secured by real property shall be included in the numerator if the property is located within this Commonwealth. If the property is located both within this Commonwealth and one (1) or more other states, receipts shall be included if more than fifty percent (50%) of the fair market value of the real property is located within this Commonwealth. If more than fifty percent (50%) of the fair market value of the real property is not located within any one (1) state, then the receipts described in this subparagraph shall be included in the numerator if the borrower is located in this Commonwealth.

2. The determination of whether the real property securing a loan is located within this Commonwealth shall be made as of the time the original agreement was made, and any subsequent substitutions of collateral shall

be disregarded.

(d) Interest and fees or penalties in the nature of interest from loans not secured by real property shall be included in the numerator if the borrower is located in this Commonwealth.

(e) Net gains from the sale of loans shall be included in the numerator as provided in subparagraphs 1. and 2. of this paragraph. Net gains from the sale of loans includes income recorded under the coupon stripping rules of Section 1286 of the Internal Revenue Code.

1. The amount of net gains, but not less than zero (0), from the sale of loans secured by real property included in the numerator is determined by multiplying net gains by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to paragraph (c) of this subsection and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.

2. The amount of net gains, but not less than zero (0), from the sale of loans not secured by real property included in the numerator is determined by multiplying net gains by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to paragraph (d) of this subsection and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

(f) Interest and fees or penalties in the nature of interest from credit card receivables and receipts from fees charged to card holders, such as annual fees, shall be included in the numerator if the billing address of the card holder is in this Commonwealth.

(g) Net gains, but not less than zero (0), from the sale of credit card receivables to

be included in the numerator shall be determined by multiplying the amount established in paragraph (g) of subsection (1) of this section by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to paragraph (f) of this subsection and the denominator of which is the financial institution's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(h) Credit card issuer's reimbursement fees to be included in the numerator shall be determined by multiplying the amount established in paragraph (h) of subsection (1) of this section by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to paragraph (f) of this subsection and the denominator of which is the financial institution's total amount of interest and fees or penalties in the nature of interest from credit card receivables and fees charged to card holders.

(i) Receipts from merchant discount shall be included in the numerator if the commercial domicile of the merchant is in this Commonwealth. Receipts from merchant discount shall be computed net of any cardholder charge backs but shall not be reduced by any interchange transaction fees or by any issuer's reimbursement fees paid to another for charges made by its card holders.

(j) 1. a. Loan servicing fees derived from loans secured by real property to be included in the numerator shall be determined by multiplying the amount determined under paragraph (j) of subsection (1) of this section by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to paragraph (c) of this subsection and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans secured by real property.

b. Loan servicing fees derived from loans not secured by real property to be included in the numerator shall be determined by multiplying the amount determined under paragraph (k) of subsection (1) of this section by a fraction the numerator of which is the amount included in the numerator of the receipts factor pursuant to paragraph (d) of this subsection and the denominator of which is the total amount of interest and fees or penalties in the nature of interest from loans not secured by real property.

2. In circumstances in which the financial institution receives loan servicing fees for servicing either the secured or the unsecured loans of another, the numerator of the receipts factor shall include the fees if the borrower is located in this Commonwealth.

(k) Receipts from services not otherwise apportioned under this section shall be included in the numerator if the service is performed in this Commonwealth. If the service is performed both within and without this Commonwealth, the numerator of the receipts factor includes receipts from services not otherwise apportioned under this section, if a greater proportion of the income-producing activity is performed in this Commonwealth based on cost of performance.

(l) 1. The numerator of the receipts factor includes interest, dividends, net gains, but not less than zero (0), and other income from investment assets and activities and from trading assets and activities described in paragraph (l) of subsection (1) of this section that are attributable to this Commonwealth.

a. The amount of interest, dividends, net gains, but not less than zero (0), and other income from investment assets and activities in the investment account to be attributed to this Commonwealth and

included in the numerator is determined by multiplying all income from the assets and activities by a fraction the numerator of which is the average value of the assets that are properly assigned to a regular place of business of the financial institution within this Commonwealth and the denominator of which is the average value of all the assets.

b. The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this Commonwealth and included in the numerator is determined by multiplying the amount described in subparagraph 1. of paragraph (l) of subsection (1) of this section from funds and securities by a fraction the numerator of which is the average value of federal funds sold and securities purchased under agreements to resell which are properly assigned to a regular place of business of the financial institution within this Commonwealth and the denominator of which is the average value of all funds and securities.

c. The amount of interest, dividends, gains, and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book, and foreign currency transactions, but excluding amounts described in subdivisions a. and b. of this subparagraph, attributable to this Commonwealth and included in the numerator is determined by multiplying the amount described in subparagraph 2. of paragraph (l) of subsection (1) of this section by a fraction the numerator of which is the average value of trading assets which are properly

assigned to a regular place of business of the financial institution within this Commonwealth and the denominator of which is the average value of all assets.

d. For purposes of this subparagraph, average value shall be determined using the rules for determining the average value of tangible personal property set forth in KRS 136.535(3) and (4).

2. In lieu of using the method set forth in subparagraph 1. of this paragraph, the financial institution may elect, or the department may require in order to fairly represent the business activity of the financial institution in this Commonwealth, the use of the method set forth in this subparagraph.

a. The amount of interest, dividends, net gains, but not less than zero (0), and other income from investment assets and activities in the investment account to be attributed to this Commonwealth and included in the numerator is determined by multiplying all income from assets and activities by a fraction the numerator of which is the gross income from assets and activities which are properly assigned to a regular place of business of the financial institution within this Commonwealth and the denominator of which is the gross income from all assets and activities.

b. The amount of interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements attributable to this Commonwealth and included in the numerator is determined by multiplying the amount described in subparagraph 1. of paragraph (l) of subsection (1) of this section from funds and securities by a fraction the numerator of which is the gross income from funds

and securities which are properly assigned to a regular place of business of the financial institution within this Commonwealth and the denominator of which is the gross income from all funds and securities.

c. The amount of interest, dividends, gains, and other income from trading assets and activities, including but not limited to assets and activities in the matched book, in the arbitrage book and foreign currency transactions, but excluding amounts described in subdivisions a. and b. of this subparagraph, attributable to this Commonwealth and included in the numerator is determined by multiplying the amount described in subparagraph 2. of paragraph (l) of subsection (1) of this section by a fraction the numerator of which is the gross income from trading assets and activities which are properly assigned to a regular place of business of the financial institution within this Commonwealth and the denominator of which is the gross income from all assets and activities.

3. If the financial institution elects or is required by the department to use the method set forth in subparagraph 2. of this paragraph, it shall use this method on all subsequent returns unless the financial institution receives prior permission from the department to use, or the department requires, a different method.

4. The financial institution shall have the burden of proving that an investment asset or activity or trading asset or activity was properly assigned to a regular place of business outside this Commonwealth by demonstrating that the day-to-day decisions regarding the asset or activity occurred at a regular place of business outside this Commonwealth. Where the day-to-day decisions regarding an

investment asset or activity or trading asset or activity occur at more than one (1) regular place of business and one (1) regular place of business is in this Commonwealth and one (1) regular place of business is outside this Commonwealth, the asset or activity shall be considered to be located at the regular place of business of the financial institution where the investment or trading policies or guidelines with respect to the asset or activity are established. Unless the financial institution demonstrates to the contrary, the policies and guidelines shall be presumed to be established at the commercial domicile of the financial institution.

(m) The numerator of the receipts factor includes all other receipts derived from sales as determined pursuant to the provisions set forth in KRS 141.120***(11) to (14)***~~[(8)(c)]~~.

(n) 1. All receipts that would be assigned under this section to a state in which the financial institution is not taxable shall be included in the numerator of the receipts factor, if the financial institution's commercial domicile is in this Commonwealth.

2. For purposes of subparagraph 1. of this paragraph, "taxable" means either:

a. That a financial institution is subject in another state to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, a corporate stock tax including a bank shares tax, a single business tax, an earned surplus tax, or any tax which is imposed upon or measured by net income; or

b. That another state has statutory authority to subject the financial institution to any of the taxes in subdivision a. of this

subparagraph, whether in fact the state does or does not impose the tax.

➔Section 13. This Act applies to taxable years beginning on or after January 1, 2016.