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REGULATIONS COMPILER

1 FINANCE AND ADMINISTRATION CABINET

2 Department of Revenue

3 (Amendment)

4 103 KAR 16:060. Income classification; apportionable[~~business~~] and
5 nonapportionable[~~nonbusiness~~].

6 RELATES TO: KRS 141.010[~~(3)~~], 141.120

7 STATUTORY AUTHORITY: KRS 131.130[~~(4)~~]

8 NECESSITY, FUNCTION, AND CONFORMITY: KRS 131.130(1) authorizes the
9 department to promulgate administrative regulations necessary to administer and enforce

10 Kentucky's tax laws. KRS 141.120 contains provisions for assigning to Kentucky the
11 apportionable[~~business~~] income and non-apportionable[~~nonbusiness~~] income of multistate
12 corporations. Income for purposes of classification as apportionable or non-apportionable includes
13 gains and losses. Apportionable income is apportioned among jurisdictions by use of a formula.
14 Non-apportionable income is specifically assigned or allocated to one or more specific
15 jurisdictions pursuant to express rules. An item of income is classified as apportionable income if
16 it falls within the definition of apportionable income. An item of income is non-apportionable
17 income only if it does not meet the definitional requirements for being classified as apportionable
18 income. This administrative regulation establishes criteria for classification of corporate income
19 into its apportionable[~~business~~] and non-apportionable[~~nonbusiness~~] components, allocates
20 expenses for non-apportionable[~~nonbusiness~~] income, and clarifies that Kentucky follows both the
21 transactional and functional tests. The examples used throughout this regulation are illustrative

1 only and are limited to the facts they contain.

2 Section 1. Definitions. (1) "Acquisition" means the act of obtaining an interest in property.

3 (2) "Allocation" means non-apportionable~~[nonbusiness]~~ income specifically assigned or
4 allocated to one (1) or more specific jurisdictions.

5 (3) Apportionable income" is defined in KRS 141.120(1)(a).

6 (4) "Apportionment" means apportionable~~[business]~~ income divided among jurisdictions by
7 use of the ~~[three (3)]~~apportionment factor ~~[formula]~~ provided in KRS 141.120.~~[(8)].~~

8 ~~—(4) "Business income" is defined in KRS 141.120(1)(a).]~~

9 (5) "Disposition" means the act or the power to relinquish or transfer an interest in or control
10 over property to another, in whole or in part.

11 ~~(6) "Integral part" means property that constitutes a part of the composite whole of the trade
12 or business, each part of which gives value to every other part, in a manner which materially
13 contributes to the production of business income.~~

14 ~~—(7) "Management" means the oversight, direction, or control, directly or by delegation, of the
15 property for the use or benefit of the trade or business.~~

16 (7) "Non-apportionable income"~~[(8) "Nonbusiness income"]~~ is defined in KRS
17 141.120(1)(d)~~[(e)]~~.

18 (8) "Trade or business," as used in the definition of apportionable income and in the application
19 of that definition means the unitary business of the taxpayer, part of which is conducted within
20 Kentucky.

21 Section 2. Determination of Apportionable~~[Business]~~ Income. In determining whether income
22 is apportionable~~[business]~~ income, the Department of Revenue shall apply both the transactional
23 test and the functional test as established in Sections 3 and 4 of this administrative regulation. The

1 classification of income by the labels occasionally used, such as manufacturing income,
2 compensation for services, sales income, interest, dividends, rents, royalties, gains, income derived
3 from accounts receivable, operating income, non-operating income, etc., is of no aid in
4 determining whether income is apportionable or nonapportionable income.

5 Section 3. Transactional Test. Apportionable income includes income arising from transactions
6 and activity in the regular course of the taxpayer's trade or business~~[Under the transactional test,~~
7 ~~income shall be considered business income if the income arises from transactions and activities~~
8 ~~in the regular course of the taxpayer's trade or business]~~ in accordance with this section.

9 (1) If the transaction or activity ~~is~~~~[shall be]~~ in the regular course of the taxpayer's trade or
10 business, part of which trade or business is conducted within Kentucky, the resulting income of
11 the transaction or activity is apportionable~~[business]~~ income for Kentucky. Income may be
12 apportionable~~[business]~~ income even though the actual transaction or activity that gives rise to the
13 income does not occur in Kentucky.

14 (2) For a transaction or activity to be in the regular course of the taxpayer's trade or business,
15 the transaction or activity ~~is~~~~[shall]~~ not ~~[be-]~~required to be one that frequently occurs in the trade or
16 business.

17 (a) Most, but not all, frequently occurring transactions or activities will~~[shall]~~ be in the regular
18 course of that trade or business and will~~[shall;], therefore, satisfy the transactional test.~~

19 (b) It ~~is~~~~[shall be]~~ sufficient to classify a transaction or activity as being in the regular course of
20 a trade or business, if it is reasonable to conclude transactions of that type are:

- 21 1. Customary in the kind of trade or business being conducted; or
- 22 2. Within the scope of what that kind of trade or business does.

23 (c) If a taxpayer frequently or customarily engages in investment activities, if those activities

1 are for the taxpayer's [mere-]financial betterment rather than[not] for the operations of the trade
2 or business, those activities shall not satisfy the transactional test.

3 (d) The transactional test includes[shall include], but is not limited to:

4 1. Income from sales of inventory, property held for sale to customers, and services which
5 are commonly sold by the trade or business; and

6 2. Income from the sale of property used in the production of apportionable[business] income
7 of a kind that is sold and replaced with some regularity, even if replaced less frequently than once
8 a year.

9 (3) The corporation shall classify income as apportionable[business] or non-
10 apportionable[nonbusiness] income on a consistent basis. If the corporation is not consistent, it
11 shall disclose in its Kentucky return the nature and extent of the inconsistency.

12 Section 4. Functional Test. Apportionable[Business] income also includes[shall include]
13 income from tangible and intangible property, including any direct or indirect interest in, control
14 over, or use in the property held directly, beneficially, by contract, or otherwise, that~~[materially]~~
15 contributes to the production of apportionable[business] income, if the acquisition, management,
16 employment, development, or[and] disposition of the property is or was related to the
17 operation[constitute integral parts] of the taxpayer's~~[regular]~~ trade or business~~[operations]~~.

18 (1) Under the functional test, apportionable[business] income shall not be required to be
19 derived from transactions or activities that are in the regular course of the taxpayer's own particular
20 trade or business.

21 (a) Except as provided in paragraph (b) of this subsection, it shall be sufficient if the property
22 from which the income is derived is, or was a[an integral,] functional,[or] operative component,
23 or related to or used in the taxpayer's trade or business operations, or otherwise materially

1 contributed to the production of apportionable~~[business]~~ income of the trade or business, part of
2 which trade or business is or was conducted within this state.

3 (b) Property that has been converted to an investment purpose~~[nonbusiness-use]~~ through the
4 passage of a sufficiently lengthy period of time (generally, five (5) years shall be sufficient) or that
5 has been removed as an operational asset and is instead held by the taxpayer's trade or business
6 exclusively for investment purposes, shall be deemed to have lost its character as a business asset.

7 (c) Property that was related to a~~[an-integral]~~ part of the trade or business shall not be
8 considered converted to investment purposes merely because it is placed for sale.

9 Example (i): Taxpayer purchases a chain of 100 retail stores for the purpose of merging those
10 store operations with its existing business. Five of the retail stores are redundant under the
11 taxpayer's business plan and are sold six months after acquisition. Even though the five stores
12 were never integrated into the taxpayer's trade or business, the income is apportionable because
13 the property's acquisition was related to the taxpayer's trade or business.

14 Example (ii): Taxpayer is in the business of developing adhesives for industrial and
15 construction uses. In the course of its business, it accidentally creates a weak but non-toxic
16 adhesive and patents the formula, awaiting future applications. Another manufacturer uses the
17 formula to create temporary body tattoos. Taxpayer wins a patent infringement suit against the
18 other manufacturer. The entire damages award, including interest and punitive damages,
19 constitutes apportionable income.

20 Example (iii): Taxpayer is engaged in the oil refining business and maintains a cash reserve
21 for buying and selling oil on the spot market as conditions warrant. The reserve is held in overnight
22 "repurchase agreement" accounts of U.S. treasuries with a local bank. The interest on those
23 amounts is apportionable income because the reserves are necessary for the taxpayer's business

1 operations. Over time, the cash in the reserve account grows to the point that it exceeds any
2 reasonably expected requirement for acquisition of oil or other short-term capital needs and is held
3 pending subsequent business investment opportunities. The interest received on the excess amount
4 is non-apportionable income.

5 Example (iv): A manufacturer decides to sell one of its redundant factories to a real estate
6 developer and transfers the ownership of the factory to a special purpose subsidiary, SaleCo
7 (Taxpayer) immediately prior to its sale to the real estate developer. The parties elect to treat the
8 sale as a disposition of assets under IRC 338(h)(10), resulting in Taxpayer recognizing a capital
9 gain on the sale. The capital gain is apportionable income. Note: although the gain is apportionable,
10 application of the standard apportionment formula in KRS 141.120 may not fairly reflect the
11 taxpayer's business presence in any state, necessitating a resort to equitable apportionment
12 pursuant to KRS 141.120 (12)(a).

13 (2)(a) Income that is derived from isolated sales, leases, assignments, licenses, and other
14 infrequently occurring dispositions, transfers, or transactions involving property, including
15 transactions made in the full or partial liquidation or the winding-up of any portion of the trade or
16 business, is apportionable~~shall be business~~ income, if the property is or was related to~~used in~~
17 the taxpayer's trade or business operations, unless the property has been converted to investment
18 purposes~~nonbusiness use~~.

19 (b) Income from the licensing of an intangible asset, such as a patent, copyright, trademark,
20 service mark, know-how, trade secrets, or the like, that was developed or acquired for use by the
21 taxpayer in its trade or business~~operations~~, constitutes~~shall constitute~~ apportionable~~business~~
22 income whether or not the licensing itself constituted the operation of a trade or business, and
23 whether or not the taxpayer remains in the same trade or business from or for which the intangible

1 asset was developed or acquired.

2 (3) Under the functional test, income from intangible property is apportionable~~[shall be~~
3 ~~business]~~ income when~~[if]~~ the intangible property serves~~[shall serve]~~ an operational function as
4 opposed to solely an investment function. The intangible property serves an operational function
5 if it is or was held in furtherance of the taxpayer's trade or business as evidenced by the objective
6 characteristics of the intangible property's use or acquisition and its relation to the taxpayer and
7 the taxpayer's activities. The functional test shall not be satisfied if the holding of the property is
8 limited to solely an investment function for a period of five (5) years or more.

9 (4) If the acquisition, management, employment, development, or disposition of the property
10 is or was related to the operation~~[held for furtherance]~~ of the taxpayer's trade or business, then
11 income from that property is apportionable~~[may be business]~~ income, even though the actual
12 transaction or activity involving that property that gives rise to the income does not occur in
13 Kentucky.

14 Example (i): A manufacturer purchases raw materials to be incorporated into the product it
15 offers for sale. The nature of the raw materials is such that the purchase price is subject to extreme
16 price volatility. In order to protect itself from extreme price increases (or decreases), the
17 manufacturer enters into future contracts pursuant to which the manufacturer can either purchase
18 a set amount of the raw materials for a fixed price, within a specified time period, or resell the
19 future contracts. Any gain on the sale of the future contracts would be considered apportionable
20 income, regardless of whether the contracts were either made or resold in Kentucky.

21 Example (ii): A national retailer produces substantial revenue related to the operation of its
22 trade or business. It invests a large portion of the revenue in fixed income securities which are
23 divided into three categories: (a) short-term securities held pending use of the funds in the

1 taxpayer's trade or business; (b) short-term securities held pending acquisition of other companies
2 or favorable developments in the long-term money market, and (c) long-term securities held as an
3 investment. Interest income on the short-term securities held pending use of the funds in the
4 taxpayer's trade or business (a) is apportionable because the funds represent working capital
5 necessary to the operations of the taxpayer's trade or business. Interest income derived from the
6 other investment securities ((b) and (c)) is not apportionable as those securities were not held in
7 furtherance of the taxpayer's trade or business.

8 (5)(a) An item of property shall be presumed to be related~~[integral]~~ to the taxpayer's trade or
9 business operations if the taxpayer:

- 10 1. Takes a deduction from~~[-business]~~ income that is apportioned to Kentucky; or
- 11 2. Includes the original cost in the property factor, if applicable.

12 (b) No~~[A]~~ presumption arises~~[shall not arise]~~ from the absence of an action described in
13 paragraph (a) of this subsection.

14 (6) Application of the functional test is generally~~[shall be]~~ unaffected by the form of the
15 property (e.g., tangible or intangible property, real or personal property).

16 (a) Income arising from an intangible interest as, for example, corporate stock or other
17 intangible interest in an entity~~[a-business]~~ or a group of assets, is apportionable~~[shall be-business]~~
18 income when~~[if]~~ the intangible itself or the property underlying or associated with the intangible
19 is or was related to the operation of~~[an integral, functional, or operative component to]~~ the
20 taxpayer's trade or business~~[-operations]~~.

21 (b) While apportionment of income derived from transactions involving intangible property~~[~~
22 ~~as-business income]~~ may be supported by a finding that the issuer of the intangible property and
23 the taxpayer are engaged in the same trade or business, establishment of a~~[-similar]~~ relationship is

1 ~~not[shall not be]~~ the exclusive basis for concluding that the income is subject to apportionment. It
2 ~~is[shall be]~~ sufficient to support the finding of apportionable[apportioned] income if the holding
3 of the intangible interest served[-as] an operational rather than an investment function[asset].

4 Section 5. Examples of Apportionable and Non-apportionable Income.

5 (1) Rents from real and tangible personal property. Rental income from real and tangible
6 property is apportionable income if the property with respect to which the rental income was
7 received is or was used in the taxpayer's trade or business.

8 Example (i): The taxpayer operates a multistate car rental business. The income from car
9 rentals is apportionable income.

10 Example (ii): The taxpayer is engaged in the heavy construction business in which it uses
11 equipment such as cranes, tractors, and earth-moving vehicles. The taxpayer makes short-term
12 leases of the equipment when particular pieces of equipment are not needed on any particular
13 project. The rental income is apportionable income.

14 Example (iii): The taxpayer operates a multistate chain of men's clothing stores. The taxpayer
15 purchases a five-story office building for use in connection with its trade or business. It uses the
16 street floor as one of its retail stores and the second and third floors for its general corporate
17 headquarters. The remaining two floors are held for future use in the trade or business and are
18 leased to tenants on a sort-term basis in the meantime. The rental income is apportionable income.

19 Example (iv): The taxpayer operates a multistate chain of grocery stores. It purchases as an
20 investment an office building in another state with surplus funds and leases the entire building to
21 others. The net rental income is not apportionable income of the grocery store trade or business.
22 Therefore, the net rental income is non-apportionable income.

23 Example (v): The taxpayer operates a multistate chain of men's clothing stores. The taxpayer

1 invests in a 20-story office building and uses the street floor as one of its retail stores and the
2 second floor for its general corporate headquarters. The remaining 18 floors are leased to others.
3 The rental of the eighteen floors is not done in furtherance of but rather is separate from the
4 operation of the taxpayer's trade or business. The net rental income is not apportionable income of
5 the clothing store trade or business. Therefore, the net rental income is non-apportionable income.

6 Example (vi): The taxpayer constructed a plant for use in its multistate manufacturing business
7 and 20 years later the plant was closed and put up for sale. The plant was rented for a temporary
8 period from the time it was closed by the taxpayer until it was sold 18 months later. The rental
9 income is apportionable income and the gain on the sale of the plant is apportionable income.

10 (2) Gains or losses from sales of assets. Gain or loss from the sale, exchange or other
11 disposition of real property or of tangible or intangible personal property constitutes apportionable
12 income if the property while owned by the taxpayer was related to the operation of the taxpayer's
13 trade or business.

14 Example (i): In conducting its multistate manufacturing business, the taxpayer systematically
15 replaces automobiles, machines, and other equipment used in the trade or business. The gains or
16 losses resulting from those sales constitute apportionable income.

17 Example (ii): The taxpayer constructed a plant for use in its multistate manufacturing business
18 and 20 years later sold the property at a gain while it was in operation by the taxpayer. The gain is
19 apportionable income.

20 Example (iii): Same as (ii) except that the plant was closed and put up for sale but was not in
21 fact sold until a buyer was found 18 months later. The gain is apportionable income.

22 Example (iv): Same as (ii) except that the plant was rented while being held for sale. The rental
23 income is apportionable income and the gain on the sale of the plant is apportionable income.

1 (3) Interest. Interest income is apportionable income where the intangible with respect to
2 which the interest was received arose out of or was created in the regular course of the taxpayer's
3 trade or business, or the purpose of acquiring and holding the intangible is related to the operation
4 of the taxpayer's trade or business.

5 Example (i): The taxpayer operates a multistate chain of department stores, selling for cash
6 and on credit. Service charges, interest, or time-price differentials and the like are received with
7 respect to installment sales and revolving charge accounts. These amounts are apportionable
8 income.

9 Example (ii): The taxpayer conducts a multistate manufacturing business. During the year the
10 taxpayer receives a federal income tax refund pertaining to the taxpayer's trade or business and
11 collects a judgment against a debtor of the business. Both the tax refund and the judgment bear
12 interest. The interest income is apportionable income.

13 Example (iii): The taxpayer is engaged in a multistate manufacturing and wholesaling business.
14 In connection with that business, the taxpayer maintains special accounts to cover such items as
15 workmen's compensation claims, rain and storm damage, machinery replacement, etc. The funds
16 in those accounts earned interest. Similarly, the taxpayer temporarily invests funds intended for
17 payment of federal, state and local tax obligations pertaining to the taxpayer's trade or business.
18 The interest income is apportionable income.

19 Example (iv): The taxpayer is engaged in a multistate money order and traveler's check
20 business. In addition to the fees received in connection with the sale of the money orders and
21 traveler's checks, the taxpayer earns interest income by the investment of the funds pending their
22 redemption. The interest income is apportionable income.

23 Example (v): The taxpayer is engaged in a multistate manufacturing and selling business. The

1 taxpayer usually has working capital and extra cash totaling \$200,000 which it regularly invests in
2 short-term interest bearing securities. The interest income is apportionable income.

3 Example (vi): In January, the taxpayer sold all of the stock of a subsidiary for \$20,000,000.
4 The funds are placed in an interest-bearing account pending a decision by management as to how
5 the funds are to be utilized. The funds are not pledged for use in the business. The interest income
6 for the entire period between the receipt of the funds and their subsequent utilization or distribution
7 to shareholders is non-apportionable income.

8 (4) Patent and copyright royalties. Patent and copyright royalties are apportionable income
9 where the patent or copyright with respect to which the royalties were received arose out of or was
10 created in the regular course of the taxpayer's trade or business or where the acquiring and holding
11 the patent or copyright is or was related to the operation of the taxpayer's trade or business, or
12 contributes to the production of apportionable income of the trade or business.

13 Example (i): The taxpayer is engaged in the multistate business of manufacturing and selling
14 industrial chemicals. In connection with that business, the taxpayer obtained patents on certain of
15 its products. The taxpayer licensed the production of the chemicals in foreign countries, in return
16 for which the taxpayer receives royalties. The royalties received by the taxpayer are apportionable
17 income.

18 Example (ii): The taxpayer is engaged in the music publishing trade or business and holds
19 copyrights on numerous songs. The taxpayer acquires the assets of a smaller publishing company,
20 including music copyrights. These acquired copyrights are thereafter used by the taxpayer in its
21 trade or business. Any royalties received on these copyrights are apportionable income.

22 Section 6. Relationship of Transactional and Functional Tests to the U.S. Constitution. The
23 Due Process Clause and the Commerce Clause of the U.S. Constitution restrict states from

1 apportioning income that has no rational relationship with the taxing state. Satisfaction of either
2 the transactional test or the functional test complies~~[shall comply]~~ with this constitutional
3 requirement, because each test requires~~[shall require]~~ that the transaction or activity (in the case
4 of the transactional test) or the property (in the case of the functional test) be tied to the same trade
5 or business that is being conducted within this state.

6 [~~Section 6. For taxable years beginning after December 31, 2004, corporations defined in KRS
7 141.010(24)(a) to (h), limited liability entities, limited partnerships, and S corporations, shall
8 include as part of their calculation of taxable income, separately stated items of distributive share
9 income. The separately stated items of distributive share income shall be deemed business income
10 if the items meet the transactional test, functional test, or a holding period of less than five (5)
11 years in the case of an investment.~~]

12 Section 7. Expenses Related to Non-apportionable~~[Nonbusiness]~~ or Nontaxable Income. (1)
13 KRS 141.039010(213)(cd) requires that any deduction allowed under Chapter 1 of the Internal
14 Revenue Code shall be reduced by expenses directly or indirectly related to nontaxable or non-
15 apportionable~~[nonbusiness]~~ income. If actual expenses, including interest, salaries, general and
16 administrative, and other stewardship expenses, is not related directly to the income, one (1) of the
17 following formulas shall be used:

18 (a) Ratio of non-apportionable~~[nonbusiness]~~/nontaxable assets to total assets times interest
19 expense. Interest expense shall represent all expenses incurred in the stewardship or maintenance
20 of non-apportionable~~[nonbusiness]~~ or nontaxable assets. Other expenses may be used which more
21 fairly reflect expenses attributable to the income or assets producing the non-
22 apportionable~~[nonbusiness]~~/nontaxable income. Assets shall be valued at cost, and the investment
23 account shall exclude equity;

1 (b) ~~[If the total nonbusiness/nontaxable income does not exceed fifty (50) percent of the total~~
2 ~~gross receipts, the expenses not deductible under paragraph (a) of this subsection may be reduced~~
3 ~~proportionately but not to exceed fifty (50) percent of the calculated expenses;~~

4 ~~—(c) 1.75 percent of the cost of assets producing nonbusiness/nontaxable income;~~

5 ~~—(d)]~~Ratio of non-apportionable~~[nonbusiness]~~/nontaxable income to total gross receipts times
6 interest expense, officers' salaries, and general administrative expenses. The sum of these or any
7 reasonable combination of these expenses; or

8 ~~(c)]~~(e) A flat percentage, one (1) percent to 100 percent, of non-
9 apportionable~~[nonbusiness]~~/nontaxable income. The percentage used shall be reasonable and
10 reflect the expenses attributable to the stewardship or maintenance of the assets producing the
11 income.

12 (2) KRS 141.039(2)(c)~~[141.010(13)(d)]~~ requires a corporation to relate expenses to non-
13 apportionable~~[nonbusiness]~~ and nontaxable income. The formulas listed in subsection (1)(a) to (e)
14 of this section for determining related expenses shall be used by the corporation or assist the
15 corporation in developing a method more suitable to its particular situation.

16 Section 8. Proration of Deductions. Any allowable deduction that applies to both
17 apportionable~~[business]~~ and non-apportionable~~[nonbusiness]~~ income or to more than one (1) trade
18 or business shall be prorated to those classes of income or trades or businesses by the formulas
19 listed in Section 7 6 of this administrative regulation.

20 Section 9. Revenue Policy 41P150 "~~Expenses Related to Nonbusiness Nontaxable Income~~,"
21 ~~shall be withdrawn, since the policy has been incorporated into this administrative regulation.~~

22 ~~—Section 10.~~The amendments to this administrative regulation shall apply to tax periods
23 beginning on or after January 1, 2018~~[2005]~~.

103 KAR 16:060

APPROVED:

Daniel Bork
DANIEL BORK, COMMISSIONER
Department of Revenue
Finance and Administration Cabinet

10-12-2018
DATE APPROVED BY AGENCY

PUBLIC HEARING AND PUBLIC COMMENT PERIOD

A public hearing on this administrative regulation will be held on November 26, 2018 at 10:00 a.m. in Room 8A, State Office Building, 501 High Street, Frankfort, KY 40601. Individuals interested in being heard at this hearing shall notify this agency in writing by five (5) workdays prior to the hearing, of their intent to attend. If no notification of intent to attend the hearing is received by that date, the hearing may be cancelled. This hearing is open to the public. Any person who wishes to be heard will be given an opportunity to comment on the proposed administrative regulation. A transcript of the public hearing will not be made unless a written request for a transcript is made. If you do not wish to be heard at the public hearing, you may submit written comments on the proposed administrative regulation. Written comments will be accepted through November 30, 2018. Send written notification of intent to be heard at the public hearing or written comments on the proposed administrative regulation to the contact person.

CONTACT PERSON: Lisa Swiger, Revenue Tax Policy/Research Consultant II, Department of Revenue, 501 High Street, Station 1, Frankfort, Kentucky, 40601, (502) 564-9526 (telephone), (502) 564-3875(fax), Lisa.Swiger@ky.gov(email).

REGULATORY IMPACT ANALYSIS AND TIERING STATEMENT

Regulation Number: 103 KAR 16:060

Contact Person: Lisa Swiger
Phone Number: (502)564-9526
Email: Lisa.Swiger@ky.gov

(1) Provide a brief summary of:

(a) What this administrative regulation does: This regulation is essential for providing guidance to multi-state corporations that must allocate and apportion income between multiple jurisdictions.

(b) The necessity of this administrative regulation: This regulation is necessary to guide taxpayers when determining apportionable and non-apportionable income and the manner for treating them on returns filed.

(c) How this administrative regulation conforms to the content of the authorizing statutes: The authorizing statutes require apportionable income to be apportioned to Kentucky, and this regulation provides guidance for taxpayers to do so consistently.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: This regulation sets forth objective standards for distinguishing apportionable and non-apportionable income

(2) If this is an amendment to an existing administrative regulation, provide a brief summary of:

(a) How the amendment will change this existing administrative regulation: These amendments correct the regulation to use new language contained in HB 487/GA2018. "Business" and "non-business" have been replaced by "apportionable" and "non-apportionable." Furthermore, examples included in the Multistate Tax Commission's ("MTC") model regulation have been incorporated to provide clearer guidance to taxpayers. Other substantive changes rely upon the MTC's model regulation as well.

(b) The necessity of the amendment to this administrative regulation: HB 487/GA2018 substantially changed Kentucky's income tax laws, and the regulation as written is deficient without the proposed amendments.

(c) How the amendment conforms to the content of the authorizing statutes: The authorizing statutes require the use of apportionable and non-apportionable income concepts.

(d) How the amendment will assist in the effective administration of the statutes: Clear guidance that includes examples will provide better guidance to taxpayers as well as provide unambiguous rules for department staff when verifying compliance.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: Multi-state businesses will need to comply with the updated language contained in this regulation and the statutes amended by HB 487/GA2018.

(4) Provide an analysis of how the entities identified in question (3) will be impacted by either the implementation of this administrative regulation, if new, or by the change, if it is an amendment, including:

(a) List the actions that each of the regulated entities identified in question (3) will have to take to comply with this administrative regulation or amendment: The concepts are between the

existing regulation and its proposed amendments are similar, but the updated language and examples provided will assist taxpayers to better comply with the law.

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3): No known costs beyond current compliance costs.

(c) As a result of compliance, what benefits will accrue to the entities identified in question (3): Taxpayers will pay the correct tax on business activities in Kentucky and will avoid penalties and interest for non-compliance.

(5) Provide an estimate of how much it will cost to implement this administrative regulation:

(a) Initially: None.

(b) On a continuing basis: None.

(6) What is the source of the funding to be used for the implementation and enforcement of this administrative regulation: The department General Fund budget covers routine compliance costs.

(7) Provide an assessment of whether an increase in fees or funding will be necessary to implement this administrative regulation, if new, or by the change, if it is an amendment: No increased fees or funding will be necessary to implement this regulation.

(8) State whether or not this administrative regulation establishes any fees or directly or indirectly increases any fees: No direct or indirect fees are established or increased by this amendment.

(9) TIERING: Is tiering applied? Tiering was not applied, because all taxpayers are treated equally by this administrative regulation.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

Regulation Number: 103 KAR 16:060

Contact Person: Lisa Swiger
Phone Number: (502)564-9526
Email: Lisa.Swiger@ky.gov

1. What units, parts or divisions of state or local government (including cities, counties, fire departments, or school districts) will be impacted by this administrative regulation? Only the Kentucky Department of Revenue will be impacted by implementing and enforcing the provisions of this regulation. No local governmental units are impacted by this administrative regulation.

2. Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation. KRS 141.010(3) and 141.120.

3. Estimate the effect of this administrative regulation on the expenditures and revenues of a state or local government agency (including cities, counties, fire departments, or school districts) for the first full year the administrative regulation is to be in effect.

(a) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for the first year? No new revenue will be generated by this administrative regulation at any time.

(b) How much revenue will this administrative regulation generate for the state or local government (including cities, counties, fire departments, or school districts) for subsequent years? None.

(c) How much will it cost to administer this program for the first year? No additional revenues beyond the current department budget appropriations.

(d) How much will it cost to administer this program for subsequent years? Current staff and department appropriations will be utilized to continue administration in the second year.

Note: If specific dollar estimates cannot be determined, provide a brief narrative to explain the fiscal impact of the administrative regulation.

Revenues (+/-): \$0

Expenditures (+/-): \$0

Other Explanation: