



1 FINANCE AND ADMINISTRATION CABINET

2 Department of Revenue

3 (Amendment)

4 103 KAR 16:230. Intangible expenses, intangible interest expense, and management fees.

5 RELATES TO: KRS 131.130, 141.205

6 STATUTORY AUTHORITY: KRS 131.130[(-)]

7 NECESSITY, FUNCTION, AND CONFORMITY: KRS 131.130(1) authorizes the

8 Department of Revenue to promulgate administrative regulations necessary to administer and

9 enforce Kentucky's tax laws. KRS 141.205 disallows intangible expenses, intangible interest

10 expenses and management fees when those expenses and fees are directly or indirectly paid,

11 accrued or incurred to, or in connection directly or indirectly with one or more direct or indirect

12 transactions with one or more related members or with a foreign corporation, unless certain criteria

13 are met. This administrative regulation establishes the requirements for when these expenses and

14 fees are allowed or disallowed.

15 Section 1. Definitions. (1) "Actual comparables" means transactions between the recipient and

16 unrelated parties that are identical to the subject transaction.

17 (2) "Comprehensive income tax treaty" means a convention, or agreement, entered into by the

18 United States, and approved by Congress, with a foreign government for the allocation of all

19 categories of income subject to taxation or the withholding of tax on interest, dividends, and

20 royalties, in order to prevent double taxation of the respective nations' residents, and to promote

21 the sharing of information.

1 (3) "Measured by, in whole or in part, net income" means that the receipt of the payment by
2 the recipient is reported and included in income for purposes of a tax on net income or in the
3 franchise for purposes of the franchise tax.

4 (4) "Reported and included in income for purposes of a tax on net income or in the franchise,"
5 means:

6 (a) For a tax on net income, reported and included in the net income apportioned or allocated
7 to the taxing jurisdiction; or

8 (b) For a franchise tax, reported and included in the franchise apportioned or allocated to the
9 taxing jurisdiction.

10 (5) "Subject transaction" means the transaction giving rise to the intangible expense, intangible
11 interest expense, or management fee.

12 Section 2. Disclosure; General. As part of the required disclosure, the entity shall provide a
13 description of the nature of the payment made to the recipient. This description shall contain:

14 (1) For intangible expenses or intangible interest expenses:

15 (a) A narrative regarding the subject transaction;

16 (b) The extent of the rights being transferred, for example, if a patent is being licensed:

17 1. Whether that license is exclusive or non-exclusive; and

18 2. Whether the transferee has any rights to sublicense;

19 (c) How the amount of the payment is calculated; and

20 (d) If there is a document that sets forth the terms of the subject transaction, a copy of that
21 document; and

22 (2) For management fees:

23 (a) A narrative of the services being performed for the entity by the recipient;

1 (b) How the amount of the payment is calculated; and

2 (c) If there is a document that sets forth the terms of the transaction, a copy of that document.

3 Section 3. Disclosure; Arm's Length Transaction. An entity may be required to establish that
4 the subject transaction was made at a commercially reasonable rate and at terms comparable to an
5 arm's length transaction.

6 (1) If there are actual comparables, the actual comparables shall be used.

7 (2) If there are no actual comparables, the two (2) primary factors to take into account if
8 determining whether the subject transaction was made at a commercially reasonable rate and at
9 terms comparable to an arm's length transaction shall be:

10 (a) The degree of comparability between the subject transaction and the proposed comparable
11 transactions; and

12 (b) The quality of the data and assumptions used in the analysis.

13 Section 4. Disclosure; Intangible Expense, Intangible Interest Expense, or Management Fee.

14 With respect to an intangible expense, intangible interest expense, or management fee, the entity
15 shall make additional disclosures if it cannot utilize any of the other methods to establish that it is
16 entitled to the deduction. The entity shall show that the payment made to the recipient was subject
17 to, in its state or country of commercial domicile, a net income tax, or a franchise tax, measured
18 by, in whole or in part, net income. If the recipient is a foreign corporation, the foreign nation shall
19 have in force a comprehensive income tax treaty with the United States.

20 Section 5. Corporation or Pass-Through Entity. A corporation or pass-through entity that
21 during the taxable year directly or indirectly paid, accrued, or incurred intangible expenses,
22 intangible interest expenses, or management fees to a related member or foreign corporation shall
23 attach to its tax return filed with the department:

1 (1) Schedule RPC, Revenue Form 41A720RPC; and [~~(Form number 41A720RPC),~~
2 ~~incorporated by reference in 103 KAR 3:040; and]~~

3 (2) Any additional disclosures required by Sections 2, 3, and 4 of this administrative
4 regulation.

5 Section 6. The disclosures related to management fees and the provisions of Section 5 of this
6 administrative regulation shall apply to taxable years beginning on or after January 1, 2014.

7 Section 7. The forms and materials prescribed herein may be inspected, copied, or obtained,
8 subject to applicable copyright law, from 8:00 a.m. to 4:30 p.m. at the Kentucky Department of
9 Revenue, 501 High Street, Frankfort, Kentucky 40601; at any Kentucky Department of Revenue
10 Taxpayer Service Center during normal operating hours; and on the department's website at
11 <http://revenue.ky.gov>.

103 KAR 16:230

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 16:230

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 provides guidance to taxpayers about the measurement of “arm’s length” transactions between related members in a group of companies, and deletes a reference to a forms regulation that was repealed in 2016.

(b) The necessity of this administrative regulation: This regulation is required to clarify how the department interprets the deductibility of certain related member deductions and comply with the provisions of KRS 13A.

(c) How this administrative regulation conforms to the content of the authorizing statutes: The related party statutes establish rules for deducting expenses between related members in a group of companies.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: This regulation provides clarity for determining when related member expenses are deductible and in what amounts by calculation.

(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: See (1)(a).

(b) The necessity of the amendment to this administrative regulation: See (1)(b).

(c) How the amendment conforms to the content of the authorizing statutes: See (1)(c) above.

(d) How the amendment will assist in the effective administration of the statutes: See (1)(d) above.

(3) List the type and number of individuals, businesses, organizations, or state and local governments affected by this administrative regulation: There are approximately 3000 taxpayers in Kentucky that comply with the provisions of this regulation annually.

(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: There are no new or additional actions required by the taxpayers listed in (3).

(b) In complying with this administrative regulation or amendment, how much will it cost each of the entities identified in question (3): There are no costs associated with the conforming changes made in this administrative regulation.

(c) As a result of compliance, what benefits will accrue to the entities identified in question (3): Taxpayers will not inadvertently rely on a repealed regulation for guidance.

(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's current budget will provide the funding necessary to implement this administrative regulation.

(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 additional fees or funding will be necessary to implement this administrative 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 by this administrative regulation.

(9) TIERING: Is tiering applied? Tiering was not applied, because all taxpayers with related member transactions are treated equally.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

Regulation Number: 103 KAR 16:230

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? The Department of Revenue is the only unit, part, or division of state or local government by this regulation.

2. Identify each state or federal statute or federal regulation that requires or authorizes the action taken by the administrative regulation. KRS 131.130(1) and 141.205.

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? There will be no revenue generated for any state or local government entity as a result of this administrative regulation. This amendment only updates 103 KAR 16:230 to conform to statute changes that would render this administrative regulation deficient otherwise.

(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? None.

(d) How much will it cost to administer this program for subsequent years? None.

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: