

1 FINANCE AND ADMINISTRATION CABINET

2 Department of Revenue

3 (Amendment)

4 103 KAR 16:340. [~~Apportionment and allocation; completed~~]Completed contract method.

5 RELATES TO: KRS 141.120

6 STATUTORY AUTHORITY: KRS 131.130[~~(+)~~], 141.120

7 NECESSITY, FUNCTION, AND CONFORMITY: KRS 141.120 provides for the division of

8 income of interstate business for tax purposes. KRS 131.130(1) authorizes the department to

9 ~~promulgate administrative regulations to administer and interpret Kentucky's tax laws. This~~

10 administrative regulation explains how the apportionable[~~business~~] income apportionment factors

11 shall be calculated when net income is reported on a completed contract basis.

12 Section 1. Definitions. (1) "Completed contract method of accounting" means a method of

13 accounting whereby apportionable[~~business~~] income from long-term contracts is reported for the

14 taxable year in which the contract is finally completed and accepted.

15 (2) "Long-term contracts" means contracts covering a period in excess of one (1) year from the

16 date of execution of the contract to the date on which the contract is finally completed and

17 accepted.

18 Section 2. General. If a corporation uses the completed contract method of accounting, the

19 apportionable[~~business~~] income earned within Kentucky shall be determined by [~~a weighted~~

20 ~~fraction, the numerator of which is the use of the apportionment factor weighted sales factor fifty~~

21 ~~(50) percent, plus the weighted property factor twenty five (25) percent plus the weighted payroll~~

1 ~~factor twenty five (25) percent, and the denominator of which is four (4),] the use of the~~
2 apportionment factor determined pursuant to KRS 141.120, as modified by the following special
3 rules for apportionable[~~business~~] income derived from long term contracts established in Sections
4 3 to 5[~~7~~]of this administrative regulation.

5 Section 3. Sales Factor. The numerator and denominator of the sales factor shall be determined
6 pursuant to KRS 141.120(9)[~~141.120(8)(e)~~] and the following special rules:

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

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

14 Section 4. [~~Property Factor. The numerator and denominator of the property factor shall be~~
15 ~~determined pursuant to KRS 141.120(8)(a) and the following special rules:~~

16 ~~—(1) The average value of the corporation's cost (including materials and labor) of construction~~
17 ~~in progress, to the extent that the costs exceed progress billing (accrued or received, depending on~~
18 ~~whether the taxpayer is on the accrual or cash basis for keeping its accounts), shall be included in~~
19 ~~the denominator of the property factor.~~

20 ~~—(2) The value of any construction costs attributable to construction projects in this state shall~~
21 ~~be included in the numerator of the property factor.~~

22 ~~—(3) Rent paid for the use of equipment directly attributable to a particular construction project~~
23 ~~shall be included in the property factor at eight (8) times the net annual rental rate even though the~~

1 rental expense may be capitalized into the cost of construction.

2 ~~— Section 5. Payroll Factor. The numerator and denominator of the payroll factor shall be~~
3 ~~determined pursuant to KRS 141.120(8)(b) and the following special rules:~~

4 ~~— (1) Compensation paid employees which is attributable to a particular construction project~~
5 ~~shall be included in the payroll factor even though capitalized into the cost of construction.~~

6 ~~— (2) Compensation paid employees who, in the aggregate, perform most of their services in a~~
7 ~~state to which their employer does not report them for unemployment tax purposes, shall be~~
8 ~~attributable to the state in which the services are performed.~~

9 ~~— Section 6.](1) The completed contract method of accounting shall require that the reporting of~~
10 ~~income (or loss) be deferred until the year in which the construction project is completed or~~
11 ~~accepted.~~

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

15 (3) The amount of income from each contract completed during the taxable year apportioned
16 to this state, plus other apportionable[business] income apportioned to this state[~~by the regular~~
17 ~~three (3) factor formula~~] such as interest income, rents, royalties, income from short-term
18 contracts, etc., plus all non-apportionable[nonbusiness] income allocated to Kentucky, shall be the
19 measure of tax for the taxable year.

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

22 (a) In the taxable year in which the contract is completed, the income (or loss) therefrom shall
23 be determined.

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

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

7 2. ~~[Each percentage determined by subparagraph 1 of this paragraph shall be~~
8 ~~multiplied by the apportionment formula percentage for that particular year as determined in~~
9 ~~Section 2 of this administrative regulation.~~

10 ~~3. The percentages determined by subparagraph 2 of this paragraph for each year~~
11 ~~during which the contract was in progress shall be totaled.]~~ The amount of total income (or loss)
12 from the contract determined under paragraph (a) of this subsection shall be multiplied by the total
13 percentage determined by subparagraph 1 of this subsection. The resulting income (or loss) shall
14 be the amount of apportionable[business] income from the contract derived from sources within
15 Kentucky.

16 Section 5[7]. Computation for Year of Withdrawal, Dissolution or Cessation of Business. (1)
17 Use of the completed contract method of accounting shall require that income derived from sources
18 within Kentucky from incomplete contracts in progress outside Kentucky on the date of
19 withdrawal, dissolution or cessation of business in Kentucky be included in the measure of tax for
20 the taxable year during which the corporation withdraws, dissolves or ceases doing business in this
21 state.

22 (2) The amount of income (or loss) from each contract to be apportioned to Kentucky by the
23 apportionment method established in Section 6(4)(b) of this administrative regulation of this


1 administrative regulation shall be determined as follows:

2 (a) The amount of business income (or loss) for each contract shall be the amount by which
3 the gross contract price from each contract which corresponds to the percentage of the entire
4 contract which has been completed from the commencement thereof to the date of withdrawal,
5 dissolution, or cessation of business exceeds all expenditures made during the period in connection
6 with each contract.

7 (b) In so doing, account shall be taken of the material and supplies on hand at the beginning
8 and end of the taxable year for use in each contract.

103 KAR 16:340

APPROVED:



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 16:340

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: HB 487/GA2018 modified Kentucky law to eliminate multi-factor allocation of apportionable (business) income. This amendment removes language about the payroll and property factors for completed contract method taxpayers.

(b) The necessity of this administrative regulation: Chapter 13A requires regulations to have statutory support and conform with statutes. This amendment corrects the regulation for changes brought about by HB 487/GA2018.

(c) How this administrative regulation conforms to the content of the authorizing statutes: The statutes allow the complete contract method of accounting, and this regulation provides technical guidance for determining apportionable (business) receipts under that method.

(d) How this administrative regulation currently assists or will assist in the effective administration of the statutes: Taxpayers have a clearer understanding of how receipts are allocated to multi-state business that use the completed contract method of accounting. Furthermore, department personnel gain understanding and process efficiencies through the consistent application of the rules in this area.

(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: Business taxpayers permitted to utilize the completed contract method of accounting are affected by the guidance provided by this regulation.

(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: Substantively, there are no major changes to this regulation as it relates to determining the receipts factor for apportionment. Therefore, no actions need to be taken to comply with this regulation.

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

(c) As a result of compliance, what benefits will accrue to the entities identified in question (3): Clear guidance and updates to current statutory authority assist business taxpayers with calculating their correct tax liability to avoid penalties and interest.

(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 funds regular implementation and enforcement efforts related to the use of the completed contract method of accounting.

(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 are required 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 indirectly fees are established by this regulation.

(9) TIERING: Is tiering applied? Tiering was not applied, because all taxpayers utilizing the complete contract method of accounting are treated equally.

FISCAL NOTE ON STATE OR LOCAL GOVERNMENT

Regulation Number: 103 KAR 16:340

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 Finance and Administration Cabinet, Department of Revenue is the only government entity 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 131.130(1) 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? None.

(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? Only currently budgeted department funds and staff will be used to implement this amendment. An exact dollar amount cannot be determined.

(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: