

**SHAREHOLDER'S INSTRUCTIONS FOR SCHEDULE K-1 (FORM 720S)**

**PURPOSE**—Schedule K-1 (Form 41A720S (K-1)) is used to report to each shareholder the shareholder's pro rata share of income, credits, deductions, etc. A shareholder is liable for Kentucky individual income tax as provided by KRS 141.020 on the shareholder's pro rata share of the S corporation's income, whether distributed or undistributed.

**GENERAL INSTRUCTIONS**—Schedule K-1 (Form 720S) will help when preparing your Kentucky income tax return. Where "(attach schedule)" appears next to a line on Schedule K-1, it means the S corporation will have attached a statement to Schedule K-1 to show information for the line item, if applicable. If you believe the S corporation has made an error on your Schedule K-1 (Form 720S), notify the S corporation and ask for a corrected schedule. Do not change any item on your copy.

Schedule K-1 (Form 720S) does not show the amount of actual dividend distributions the S corporation paid to you. The S corporation must report such amounts to you on Form 1099-DIV. You report actual dividend distributions on federal Schedule B (Form 1040). Refer to the shareholder instructions you received for federal Schedule K-1 (Form 1120S) for information concerning your basis in corporate stock, elections to be made by you separately on your income tax return and not by the S corporation, etc.

Every individual, including estates and trusts, who is a resident of Kentucky and is a shareholder in an S corporation is required to report 100 percent of his or her share of income (loss), credits, deductions, etc. for Kentucky individual income tax purposes. **A nonresident shareholder must report the portion of his or her share of income attributable to the S corporation's business in Kentucky.** A **resident** is an individual domiciled within Kentucky or an individual who is not domiciled in Kentucky but maintains a place of abode in Kentucky and spends in the aggregate more than 183 days of the taxable year in Kentucky. A **nonresident** is any individual not a resident of Kentucky.

**At-Risk Limitations**—Generally, if you have a loss from any activity carried on as a trade or business or for the production of income by the S corporation and you, the shareholder, have amounts invested in that activity for which you are not at risk, you will be required to complete federal Form 6198, At-Risk Limitations, to figure the allowable loss to report on your Kentucky income tax return. Your deductible loss from each activity for the tax year generally is limited to the amount you are at risk or could actually lose in the activity, whichever is less. To help you complete Form 6198, if required, the S corporation will provide a schedule showing your share of income, expenses, etc., for each at-risk activity.

**Passive Activity Limitations**—The passive activity limitations in IRC Section 469 are figured at the shareholder level and may apply to any loss reported on Lines 1, 2 or 3 and any other related items of income, loss and deductions reported on Schedule K-1 (Form 720S). Refer to the federal Shareholder's Instructions for Schedule K-1 (Form 1120S) to determine if the passive activity limitations apply to your share of loss(es) reported on Schedule K-1 (Form 720S) and if you must file Form 8582-K, Kentucky Passive Activity Loss Limitations. When applicable, the passive activity limitations on losses are applied after the limitations on losses for a shareholder's at-risk amount.

**SPECIFIC INSTRUCTIONS—Kentucky Resident Shareholders (Form 740 Filers)**—You, as the shareholder, will need to determine the net difference between your federal Schedule K-1 amounts and your Kentucky Schedule K-1 amounts. This will adjust the items of income, loss and deductions used to compute your federal adjusted gross income to the Kentucky amounts shown in Column (b), Schedule K-1. To determine this difference, complete Lines 57 through 59.

**Line 57**—Include on this line the Kentucky Schedule K-1 amounts from Lines 1 through 5 and 8. Also include the amounts from Lines 6 and 10 that do not pass through to Form 740 or 740-NP, Schedule A as itemized deductions.

**Line 58**—Include on this line the federal Schedule K-1 amounts from Lines 1 through 9 and 11. Also include the amounts from Lines 10 and 12 that do not pass through to Form 740 or 740-NP, Schedule A as itemized deductions.

**NOTE:** If Form 8582-K is required, adjust the amounts entered on Lines 57, 58 and 59 to exclude any income, loss, deduction or expense related to a passive activity. Complete the passive activities adjustment worksheet (Form 8582-K, page 2) to determine additions to or subtractions from federal adjusted gross income. **See Form 740 instructions for Schedule M, Line 7 and/or Line 19.**

If amounts on Lines 4(d) and 4(e) are subject to the capital loss limitations, do not include on Lines 57 and 58. Complete federal Schedule D using Kentucky amounts to determine additions to or subtractions from federal adjusted gross income.

**Line 59**—Enter difference of Lines 57 and 58. If Line 57 is greater than Line 58, enter the difference as an addition to federal adjusted gross income on Schedule M, Line 3. If Line 58 is greater than Line 57, enter the difference as a subtraction on Schedule M, Line 15.

**Caution:** If the amount on Line 57 is a (loss) and Line 58 is a (loss), the smaller dollar amount of (loss) is the greater amount, and to determine the difference, subtract the smaller dollar amount from the larger dollar amount. If the amount on Line 57 is a (loss) and Line 58 is an income amount, or the amount on Line 57 is an income amount and Line 58 is a (loss), the income amount is the greater amount; therefore, add the two amounts to determine the difference.

**Nonresident Shareholders (Form 740-NP Filers)**—A nonresident individual who is required to file Form 740-NP, Kentucky Individual Income Tax Return Nonresident or Part-Year Resident, or who elects to file Form 740-NP to take advantage of capital loss and net operating loss carryovers shall enter the amounts from Schedule K-1 as follows:

If the percentage in Item B(2) is "100%," the amounts on Lines 1 through 5 and 8, portions of Lines 6 and 10 and the portion of Line 41(b) actually deducted for the current year must be entered on the appropriate lines of Form 740-NP and related schedules.

If the percentage in Item B(2) is less than 100 percent, the amounts on Lines 1 through 5 and 8, portions of Lines 6 and 10 and the portion of Line 41(b) actually deducted for the current year must be multiplied by this percentage and entered on the appropriate lines of Form 740-NP and related schedules. Amounts on Line 11(a) and the portions of Lines 6 and 10 which pass through to Schedule A (Form 740-NP) should not be multiplied by the percentage in Item B(2) since these amounts will be multiplied by the percentage on Form 740-NP, Section D, Line 36 (Percentage of Kentucky Adjusted Gross Income to Federal Adjusted Gross Income).

Refer to specific instructions below and federal Shareholder's Instructions for Schedule K-1 (Form 1120S).

**Lines 1 through 3**—Enter on federal Schedule E using Kentucky amounts or on Form 8582-K, if applicable.

**Line 4(a)**—Enter on Form 740-NP, Section D, Line 3.

**Line 4(b)**—Enter on Form 740-NP, Section D, Line 4.

**Line 4(c)**—Enter on federal Schedule E using Kentucky amounts.

**Lines 4(d) and (e)**—Enter on federal Schedule D using Kentucky amounts or Form 8582-K, if applicable.

**Line 4(f)**—Enter on applicable lines of your return (see federal Shareholder's Instructions for Schedule K-1 (Form 1120S)).

**Line 5**—Enter on federal Form 4797.

**Line 6**—Enter on applicable lines of your return (see federal Shareholder's Instructions for Schedule K-1 (Form 1120S)).

**Line 7**—Enter on Schedule A, Form 740-NP.

**Line 8**—Enter on federal Schedule E using Kentucky amounts.

**Line 9**—Enter on Schedule A, Form 740-NP.

**Line 10**—Enter on Schedule A, Form 740-NP.

**For All Shareholders**

**Lines 11 and 41 through 47**—See federal Shareholder's Instructions for Lines 12, 16 and 17, Schedule K-1 (Form 1120S).

**Individual Partners**—Enter the net distributive share income from Kentucky Schedule K-1 (Form 720S), Lines 1 through 5, 8 and portions of Lines 6 and 10 (multiplied by the percentage in Item B(2) for **nonresident** individual partners) on Line 2 of the Kentucky Limited Liability Entity Tax Credit Worksheet (located in Form 740, Form 740-NP or Form 741 instructions under Business Incentives and Other Tax Credits). If net distributive share income includes losses subject to passive activity or capital loss limitations, net distributive share income must be adjusted to include only amounts allowed to be deducted on the applicable Kentucky tax return.

Enter the amount from Line 56 on Line 7 of the Kentucky Limited Liability Entity Tax Credit Worksheet.

**Estates and Trusts (Form 741 Filers)**—Estates or trusts report the amounts shown on Schedule K-1 on Form 741, Kentucky Fiduciary Income Tax Return, and related schedules. See federal Shareholder's Instructions for Schedule K-1 (Form 1120S).