

## Instructions for Schedule M—Modifications to Federal Adjusted Gross Income

### Additions to Federal Adjusted Gross Income

**Line 1**—Interest on securities issued by other states and their political subdivisions is taxed by Kentucky and must be reported. Also report dividends received from regulated investment companies (mutual funds) that are taxable for Kentucky income tax purposes. **Note:** *Interest from securities of Kentucky and its political subdivisions is exempt.*

**Line 2**—Enter the self-employed health insurance deduction from federal Form 1040, Line 29.

**Line 3**—Enter resident adjustment from Kentucky Schedule K-1. Partners, beneficiaries of estates and trusts and S corporation shareholders, see Kentucky Schedule K-1 instructions.

**Line 4**—Enter total depreciation from federal Form 4562 if you have elected to take the 30 percent or 50 percent special depreciation allowance or the increased Section 179 deduction for property placed in service after September 10, 2001. See Line 15 for additional instructions.

**Line 5**—Enter federal net operating loss reported on Line 21 of 2008 federal Form 1040.

**Line 6**—Enter other additions to federal adjusted gross income not listed above (attach detailed schedule).

Include:

- the portion of a lump-sum distribution on which you have elected the 20 percent capital gains rate for federal income tax purposes (Schedule P and Form 4972-K required);

- any mortgage debt forgiven under the Mortgage Forgiveness Debt Relief Act of 2007;
- the passive activity loss adjustment (see Form 8582-K and instructions);
- differences in pension (3-year recovery rule) and IRA bases;
- differences in gains (losses) from the sale of intangible assets amortized under the provisions of the Revenue Reconciliation Act of 1993; and
- differences in gains (losses) from the sale of depreciable property placed in service after September 10, 2001.

**Note:** Before entering the difference on Line 6 you must take into account any addition or subtraction affecting the at-risk limitations. See instructions for Line 17.

**Line 7, Total Additions**—Add Lines 1 through 6. Enter on Line 7 and on Form 740, page 1, Line 6.

### Subtractions from Federal Adjusted Gross Income

**Line 8**—Enter the amount of taxable state income tax refund or credit **reported on your federal return** and included as income on Form 740, page 1, Line 5.

**Line 9**—Enter interest income from U.S. government bonds and securities. Do not include taxable interest from securities, such as FNMA (Fannie Mae), GNMA (Ginnie Mae) and FHLMC (Freddie Mac), which are merely guaranteed by the U.S. government.

**Line 10, Pension Income Exclusion**—The 2008 exclusion amount is 100 percent of taxable retirement benefits or \$41,110, whichever is less. All pension and retirement income paid under a written retirement plan (qualified or unqualified) is eligible for exclusion. This includes pensions, annuities, IRA accounts, 401(k) and similar deferred compensation plans, income received from converting a regular IRA to a Roth IRA, death benefits, disability retirement benefits and other similar accounts or plans.

This exclusion is for each taxpayer and must be computed independently of your spouse who may be filing on the same return. A husband and wife must complete and claim their own exclusion, regardless of filing status. *Joint filers—Combine the separately computed pension exclusion amounts and enter on Schedule M, Line 10, Column B.*

### Pension Income Exclusion Worksheet

	Column A Spouse	Column B Yourself
<b>Step 1.</b>		
a. Enter taxable pension income reported on your federal Form 1040, Line 15(b) or 16(b); Form 1040A, Line 11(b) or 12(b).....	a	
b. Enter disability retirement benefits on Form 1040, Line 7 or Form 1040A, Line 7 .....	b	
c. Enter deferred compensation reported on Form 1040, Line 7 or Form 1040A, Line 7 .....	c	
d. Add Lines a, b and c .....	d	
<b>Step 2. Line d is \$41,110 or less.</b> Enter the amount from Line d on Schedule M, Line 10.		
<b>Step 3. Line d is more than \$41,110.</b> Do you have retirement income from the federal government, the Commonwealth of Kentucky or a Kentucky local government; or supplemental U.S. Railroad Retirement Board benefits?.....	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
If you answered no, enter \$41,110 on Schedule M, Line 10.		
If you answered yes, you must complete Schedule P to determine your pension exclusion.		

**Line 11**—Enter Social Security and Social Security equivalent U.S. Railroad Retirement Board benefits included on Form 740, page 1, Line 5. These amounts are reported on federal Form 1040, Line 20(b) (Form 1040A, Line 14(b)).

**Line 12, Long-term Care Insurance Premiums**—Enter long-term care insurance premiums paid in 2008. Do not claim as an itemized deduction.

**Line 13, Health Insurance Premiums**—Enter medical and dental insurance premiums paid for yourself, your spouse and your dependents. This deduction applies to premiums paid with after-tax dollars. **Note:** You **cannot** deduct on Line 13 insurance premiums paid with pretax dollars (cafeteria plans and vouchers already excluded from wage income) because the premiums are not included in box 1 of your W-2 form(s). Do not include long-term care insurance premiums included on Schedule M, Line 12. You may not deduct premiums paid on your behalf (advance payments) and you must reduce the amount you paid by the amount of health coverage tax credit. (See federal Form 8885.)

**Line 14**—Enter resident adjustment from Kentucky Schedule K-1. Partners, beneficiaries of estates and trusts and S corporation shareholders, see Kentucky Schedule K-1 instructions. Subtract the distributive share of net income from an S corporation subject to the franchise tax imposed under KRS 136.505 or the capital stock tax imposed under KRS 136.300.

**Line 15—Depreciation, Section 179 Deduction and Gains/Losses From Disposition of Assets—Important:** Use Schedule M, Lines 4 and 15 **only** if you have elected for federal income tax purposes to take the 30 percent or the 50 percent special depreciation allowance or the increased Section 179 deduction for property placed in service after September 10, 2001. A copy of the federal Form 4562 if filed for federal income tax purposes **must** be submitted with Form 740 to verify that no adjustments are required.

#### Reporting Depreciation and Section 179 Deduction Differences for Property Placed in Service After September 10, 2001

**Create a Kentucky Form 4562** by entering **Kentucky** at the top center of a federal Form 4562 above Depreciation and Amortization. In Part I replace the \$250,000 maximum amount on Line 1 with the Kentucky limit of \$25,000 and replace the \$800,000 threshold amount on Line 3 with the Kentucky phase-out threshold of \$200,000. In Part II, strike through and ignore Line 14, Special depreciation allowance for qualified property placed in service during the tax year.

Use the created Kentucky Form 4562 to compute Kentucky depreciation and Section 179 deduction in accordance with the IRC in effect on December 31, 2001. **Note:** In determining the Section 179 deduction for Kentucky the income limitation on Line 11 is Kentucky net income before the Section 179 deduction instead of federal taxable income. **Attach the created Kentucky Form 4562** to Form 740 and enter the amount of Kentucky depreciation from Line 22 on Line 15.

**Line 16**—Enter Kentucky net operating loss calculated from prior years. Keep worksheet detailing the net operating loss claimed with your records.

**Note:** If your net operating loss occurred in 2008, complete Kentucky Schedule KNOL to determine the amount of your loss to be carried forward in future years. Any carry forward of a prior year loss claimed on Line 16 of Schedule M should be calculated using a worksheet to be kept with your records.

**Line 17**—Enter other subtractions from federal adjusted gross income not listed above (attach detailed schedule). Include:

- income received from the tobacco quota buyout;
- income received as a result of the **Master Tobacco Settlement Agreement**, the secondary settlement fund referred to as “Phase II”;
- income received from the **Tobacco Loss Assistance Program (TLAP)**;
- income of precinct workers for election training or working at election booths;
- capital gains on property taken by eminent domain;
- passive activity loss adjustment (see Form 8582-K and instructions);
- income of a child reported on the parent’s return;
- artistic charitable contributions (if you do not itemize deductions);
- the federal work opportunity credit used to reduce wages;
- at-risk limitations (see instructions below);
- qualified farm networking project differences per KRS 141.0101(15);
- differences in the gains (losses) from the sale of intangible assets amortized under the provisions of the Revenue Reconciliation Act of 1993;
- differences in gains (losses) from assets purchased after September 10, 2001; and
- income of military personnel killed in the line of duty.

**Note:** All income earned by soldiers killed in the line of duty is exempt from Kentucky tax for the year during which the death occurred and the year preceding the death. Federal and state death benefits payable to the estate or any beneficiaries may also be excluded. Additional information may be found in the General Information section of the instructions for Form 740.

#### Determining and Reporting Differences in Gain or Loss From Disposition of Assets

—If during the year you dispose of assets placed in service after September 10, 2001, on which the 30 percent or the 50 percent special depreciation allowance or the increased Section 179 deduction was taken for federal income tax purposes, you will need to determine and report the difference in the amount of gain or loss on the assets as follows:

**Create a Kentucky form** by entering **Kentucky** at the top center of a federal Schedule D, federal Form 4797 and other applicable federal forms. Compute Kentucky gain or loss from the disposed assets using the Kentucky basis. Enter the difference in federal gain or loss and the Kentucky gain or loss on the appropriate line on Line 17. **Attach the created Kentucky Schedule D, Kentucky Form 4797 and other forms or schedules to support the deduction.**

**At-Risk Limitations**—Federal/Kentucky income (loss) differences may create different allowable losses due to at-risk limitations. If you have amounts invested in an activity for which you are not at risk and used federal Form 6198, At-Risk Limitations, complete federal Form 6198 using Kentucky amounts to determine if the Kentucky allowable loss differs from the federal allowable loss. For a passive activity, use the Kentucky allowable loss to complete Form 8582-K. For all other activities (nonpassive), enter the difference as an “other addition” or “other subtraction” on Line 6 or Line 17.

**Line 18, Total Subtractions**—Add Lines 8 through 17. Enter on Line 18 and on Form 740, page 1, Line 8.