Completing Schedule KS

Complete and provide Schedule KS to each nonresident shareholder and any Minnesota shareholder who has adjustments to income.

Purpose

An S corporation must provide each nonresident shareholder, and any Minnesota shareholder with adjustments to income, with enough information for them to complete a Minnesota income tax return and determine their correct Minnesota tax.

Schedule KS is used to provide shareholders with the information they need to file a Minnesota income tax return. The schedule shows each shareholder their specific share of the S corporation's income, credits and modifications. Be sure to provide the shareholder a copy of both the front and back of the completed Schedule KS and the instructions.

If there are no modifications or credits and there are no nonresident shareholders, you do not have to provide Schedule KS.

You must enclose with your Form M8 copies of the Schedules KS and attachments issued to your shareholders and copies of your federal Schedules K and K-1.

If you are required to amend your federal S corporation return or you have been audited by the IRS, you must file Form M8X and Schedules KS, if appropriate. See *Reporting Federal Changes* on page 3.

Line Instructions

Enter the name, address and identifying number of the shareholder. A $50 penalty will be assessed for each incorrect tax ID number used for a shareholder after being notified by the department that the number is incorrect.

Calculate lines 1–18 the same for all resident and nonresident shareholders. Calculate lines 19-33 for nonresident shareholders only.

Corporate Partners: *When completing Schedules KS, be sure to include the pro rata shares of any amounts reported on the Schedule KPC you received as a partner of a partnership (include Schedule KPC with your return).*

All Shareholders—lines 1–18

KS, line 1

Determine the interest you received from all non-Minnesota state and municipal bonds. Include the Minnesota portion of exempt-interest dividends if less than 95 percent of the exempt-interest dividends are from Minnesota state and municipal bonds.

Enter the shareholder's pro rata share of this amount on line 1.

KS, line 2

Determine the state income tax deducted in arriving at ordinary income or net rental income of the S corporation.

Do not include the minimum fee, the built-in gains tax, capital gains tax, LIFO recapture tax or excess net passive income tax in this amount.

Enter the shareholder's pro rata share of this amount on line 2.

KS, line 3

Expenses or interest deducted on your federal return that relate to income not taxed by Minnesota must be added back to the shareholder's Minnesota income.

Enter the shareholder's pro rata share of any federal deductions that are attributable to income not taxed by Minnesota, other than U.S. government bond interest or other federal obligations.

If you had expenses attributable to interest or mutual fund dividends from U.S. bonds, see line 8 of Schedule KS. Do not include these expenses on line 3.

Enclose an explanation or statement showing your computation.

KS, line 4

If, during the year, your total investment in qualifying property was more than $200,000 or if you elected more than $25,000 in section 179 expensing, your shareholders must add back to Minnesota 80 percent of the difference between the expensing allowed for federal and for state tax purposes. Your shareholders will be allowed to subtract their share of the addition in equal parts over the next five years when they file their state tax returns.

If you completed federal Form 4562 to claim the section 179 expensing for federal tax purposes, you must also complete lines 1 through 12 on a *separate* federal Form 4562 (referred to as your Minnesota Form 4562 below), to determine the amount required to be added back for Minnesota purposes.

Recalculate line 12 of your Minnesota Form 4562 using the same information from your federal Form 4562 and the following modifications:

- Subtract $475,000 from line 1 of your federal Form 4562, and enter the result on line 1 of your Minnesota Form 4562.
- Enter line 2 of federal Form 4562 on line 2 of your Minnesota Form 4562.
- Subtract $1,800,000 from line 3 of your federal Form 4562, and enter the result on line 3 of your Minnesota Form 4562.
- Enter the information from lines 6 and 7 of federal Form 4562 on lines 6 and 7 of your Minnesota Form 4562. However, if you have section 179 expensing from a flow through entity, use the amount from line 7 of Schedule KPC instead of the amount from line 11 of federal Schedule K-1.
- Enter line 10 of federal Form 4562 on line 7 of your Minnesota Form 4562.
- Recalculate lines 4, 5, 8, 9, 11 and 12 of your Minnesota Form 4562. The result on line 12 of Minnesota Form 4562 cannot be more than line 1 of that form.

Enter the shareholder's pro rata share of the amount on line 12 of the Minnesota Form 4562 on line 4 of Schedule KS.

KS, line 5

If you chose on your federal return the special depreciation allowance for certain qualified property, your shareholders must add back 80 percent of the bonus depreciation to Minnesota.

Follow the steps below to determine the shareholder's share to enter on line 5 of Schedule KS:

1 Add line 14 and line 25 of your federal Form 4562 . . . . ________

2 Total of any bonus depreciation amounts passed through to the S corporation as a partner of a partnership (from line 8 of Schedule KPC). . . . . ________

3 Add steps 1 and 2 . . . . ________

4 Multiply step 3 by the shareholder's percentage of stock ownership . . . . ________

Enter the result from step 4 on line 5 of the shareholder's Schedule KS.

Federal bonus depreciation subtraction. For five years following the addback year, your shareholders may be able to subtract one-fifth of the addback on their Minnesota income tax return. See the instructions for Form M1 for details.

Continued

KS, line 6
Enter the shareholder's pro rata share of any fines, fees and penalties that were deducted as business expenses paid to a government entity or nongovernment regulatory body as a result of a violation of law, or the investigation of any potential violation of law. This does not include amounts identified in a court order or settlement agreement as restitution or as an amount paid to come into compliance with the law.

KS, line 7
This line is intentionally left blank.
page 12.

KS, line 8
Interest earned on certain direct federal obligations is taxable on the federal return, but is not taxable on the state return.

Determine the net interest you received from primary obligations issued by the U.S. government, such as savings bonds and treasury notes, that are held directly by the S corporation. Do not include obligations where the U.S. government is only a guarantor. Be sure to subtract any investment interest and other expenses you deducted on the federal return that relate to this income.

Enter the shareholder's pro rata share of this amount on line 8.

KS, line 9
This line is intentionally left blank.
page 12.

KS, line 10
Enter the shareholder's pro rata share of the 2016 credit for increasing research activities that is passed through to the shareholders.

If the business qualifies, the credit cannot be claimed by the S corporation and the full credit must be passed through to the shareholders.

KS, line 11
If you operate a business in greater Minnesota and you hired a qualified student for an internship, you may be eligible for a tax credit.

1 Wages paid to the intern during the tax year 1__________

2 Multiply line 1 by 0.4 2__________

3 Enter the amount on line 2 or $2,000, whichever is less 3__________

Add the amount for all interns. Pass the amount of credit through to each partner based on their pro rata share of the entity's income for the taxable year. Include a copy of the 2016 Internship Provider/Employer agreement you are required to file with the Minnesota Office of Higher Education with your return.

The Office of Higher Education (OHE) and eligible institutions certify eligible employers and determine the total credit each eligible employer may receive. For more information, visit the OHE website: www.ohe.state.mn.us/mPg.cfm?pageID=2099.

KS, line 12
Enter the shareholder's share of the Historic Structure Rehabilitation Credit based on the shareholder's share of the S corporation's assets, or as specifically allocated in the S corporation's organizational documents, as of the last day of the taxable year.

You must also include the NPS project number, which is provided on the credit certificate you received from the State Historic Preservation Office of the Minnesota Historical Society when the project was completed and placed into service.

KS, line 13
Enter the shareholder's pro rata share of the Employer Transit Pass Credit that is passed through to the shareholders.

KS, line 14
Enter the shareholder's pro rata share of the Enterprise Zone Credit that is passed through to the shareholders.

KS, line 15
If, for regular tax purposes, you elected the optional 60-month write-off under IRC section 59(e) for all property in this category, skip lines 15–18. No adjustments are necessary.

Intangible drilling costs (IDCs) from oil, gas and geothermal wells are a tax preference item to the extent that the excess IDCs exceed 65 percent of the net income from the wells. The tax preference item is computed separately for oil and gas properties and for geothermal properties.

Enter the shareholder's pro rata share of the following: IDCs allowed for regular tax purposes under section 263(c), (but not including any section 263(c) deduction for nonproductive wells) less the amount that would be allowed had the IDCs been amortized over a 120-month period starting with the month the well was placed in production.

KS, line 16
Gross income from oil, gas and geothermal properties are used in determining if the excess IDCs exceed 65 percent of the net income from the wells.

Enter the shareholder's pro rata share of the aggregate amount of gross income within the meaning of section 613(a) from all oil, gas and geothermal properties that was received or accrued during the tax year.

KS, line 17
Deductions allocable to oil, gas and geothermal properties are used in determining if the excess IDCs exceed 65 percent of the net income from the wells.

Enter the shareholder's pro rata share of any deductions allocable to oil, gas and geothermal properties. Do not include any deductions for nonproductive wells.

KS, line 18
In the case of oil wells and other wells of nonintegrated oil companies, enter the shareholder's pro rata share of the amount by which the depletion deduction exceeds the adjusted basis of the property at the end of the tax year.

In computing the year-end adjusted basis, use the rules of section 1016. However, do not reduce the adjusted basis by the current year's depletion. Figure the excess amount separately for each property. If the depletion deduction for any property does not exceed the adjusted basis at year-end, do not include a tax preference amount for that property.

Nonresident Shareholders Lines 19-33

KS, line 19
Enter the shareholder's pro rata share of the S corporation's Minnesota source gross income. Minnesota source gross income is the total amounts apportioned to Minnesota included on line 3, 4, and 5 (other than losses) of federal Form 1120S; lines 18a, 19, and 20 (other than losses) of federal Form 8825; line 9 of Schedule F (1040); lines 3a, 4, 5a, 6, 7, 8a, 9, and 10 of Schedule K (1120S).

KS, lines 20–29
From the nonresident shareholder's federal Schedule K-1 (1120S), enter the Minnesota portion of the amounts on lines 20 through 29.

Continued

On line 28, include the Minnesota portion of any items from the Schedule K-1 that are not specifically labeled on lines 20-27 and 29.

Line 29 refers to the Minnesota apportioned amount of federal section 179 expense from the federal Schedule K-1, not the amount calculated on line 4 for the Minnesota addition.

All income of a Minnesota resident is taxed by Minnesota, regardless of the source.

Composite Income Tax and Nonresident Withholding

KS, line 31

When determining the shareholder's share of the S corporation's Minnesota source distributive income, you must make adjustments for any items you passed through to the shareholder on lines 1 through 10 of the shareholder's Schedule KS.

Follow the steps below to determine line 31:

1 The difference between line 4 of Schedule KS (M8) and the shareholders federal section 179 deduction from box 11 of the federal Schedule K-1 (1120S) . . . . ________

2 Federal bonus depreciation amount from line 5 of the shareholder's Schedule KS . . . . ________

3 Add step 1 and step 2 . . . . . . ________

4 Multiply step 3 by 80% (.80) . ________

~~5 Enter the amount from line 7 of Schedule KS . . . .~~ ________

~~6 Combine steps 4 and 5 . . . . .~~ ________

5 Multiply step 4 by apportionment factor from line 30 of Schedule KS . . . . . . ________

6 Combine lines 20-28 of the shareholder's Schedule KS . . ________

7 Add steps 5 and 6 . . . . ________

8 To the extent allowed by law, enter one-fifth of the shareholder share of the section 179 expensing that was added back in a year the shareholder elected to be included in composite tax or nonresident withholding was required . . . ________

9 To the extent allowed by law, enter one-fifth of the federal bonus depreciation that was added back in a year the shareholder elected to be included in composite income tax or nonresident withholding was required . . . ________

~~12 Enter amount from line 9 of Shareholder's Schedule KS . .~~ ________

10 Add steps 8, ~~11~~, and 9 . . . . . ________

11 Multiply step 10 by the apportionment factor from line 30 of the shareholder's Schedule KS. . . . . ________

12 Enter amount from line 29 of shareholder's Schedule KS ________

13 Add Steps 11 and 12. . . . . ________

14 Subtract step 13 from step 7 . ________

Enter the result from step 14 on line 31 of the shareholder's Schedule KS. This amount is the shareholder's adjusted Minnesota source distributive income.

KS, line 32

Composite Income Tax

Nonresident shareholders must pay tax if their Minnesota source gross income is more than the minimum filing requirement for the year ($10,350 for 2016).

Skip this line if the nonresident shareholder *did not* elect the S corporation to pay composite income tax on his or her behalf.

To determine the amount of composite income tax to pay on behalf of each electing shareholder, follow the steps below:

1 Multiply line 31 of Schedule KS by 9.85% (.0985) . . . . ________

2 Add lines 11-14 of Schedule KS . . . . ________

3 Subtract step 2 from step 1 . . . . ________

The result in step 3 is the amount you are required to pay on behalf of the electing shareholder. Enter this amount on line 32 of the shareholder's Schedule KS and check the box to indicate the shareholder's election to be included.

If the shareholder elects to be included in composite income tax but has zero tax due, enter zero on line 32. Even though the amount may be zero, be sure to check the box to indicate the election.

Once you have completed all the KS schedules for your electing nonresident shareholders, add the amounts on line 32 of all the schedules and enter the total on line 3 of Form M8. This is the amount of composite income tax you are required to pay on behalf of your electing shareholders.

KS, line 33

Nonresident Withholding

Nonresident shareholders who are not included in the composite income tax may be subject to withholding. See *Nonresident Withholding* on page 3 to determine if your nonresident shareholders are subject to Minnesota withholding.

To determine the amount of tax to withhold for each nonresident shareholder, follow the steps below:

1 Multiply line 31 of Schedule KS by 9.85% (.0985) . . . . ________

2 Add lines 11-14 of Schedule KS . . . . ________

3 Subtract step 2 from step 1 . . . . ________

The result in step 3 is the amount you are required to withhold from the nonresident shareholder, unless the individual submits Form AWC, *Alternative Withholding Certificate.*

If the individual submits Form AWC, withhold the amount from line 6 of the certificate. Check the box provided on line 33 of the shareholder's Schedule KS and also on line 4 of Form M8. Be sure to enclose a copy of the certificate when you file your return.

If the individual submits a false or fraudulent Form AWC, the department may require you to withhold the maximum percentage from that individual in the future, even if an exemption certificate is submitted.

Be sure to inform your shareholders that they must include their Schedule KS when they file their Form M1 to claim the Minnesota withholding. If the schedule is not included, the department will disallow the withholding and assess the tax or reduce their refund.

Schedule KS Instructions 2016

Shareholder's use of information provided on Schedule KS

Purpose of Schedule KS

Schedule KS is a supplemental schedule provided by the S corporation to its shareholders. The shareholders need this information to complete a *Minnesota Individual Income Tax Return*, Form M1.

A shareholder who is a Minnesota resident will be taxed by Minnesota on all of his or her distributive income from the S corporation even if the income is apportioned between Minnesota and other states. A nonresident shareholder will be taxed on the Minnesota distributive income from the S corporation.

These instructions are intended to help you report your share of the S corporation's income, credits and modifications on your Minnesota return.

You must include Schedule KS when you file your Form M1. If you do not include the schedule with your return as required, the department will disallow any credits and assess the tax or reduce your refund.

If you received an amended Schedule KS from the S corporation and your income or deductions have changed, you must file an amended Minnesota return. To amend your return, use Form M1X, *Amended Minnesota Income Tax Return.*

Line Instructions

Include amounts on the appropriate lines as shown on Schedule KS. Be sure to read the following line instructions for additional information.

Line 4
Section 179 Expensing

See Schedule M1M, worksheet for line 6 instructions, to determine how to report this amount.

Line 5
Federal Bonus Depreciation Addition

Include this amount on the appropriate line on the worksheet for line 5 in the Schedule M1M instructions.

Line 10
Increasing Research Activities Credit

Include in the total on line 3 of Schedule M1C. To claim this credit, you must include this schedule with Form M1.

Line 11
Greater Minnesota Internship Credit

Include on line 3 of Schedule M1B. To claim this credit, you must include this schedule with Form M1.

Line 12
Historic Structure Rehabilitation Credit

Include in the total on line 2 of Schedule M1B and enter the NPS project number in the space provided. To claim this credit, you *must* include this schedule with Form M1.

Line 13
Employer Transit Pass Credit

Any amount of the credit remaining from Form ETP, not claimed on form M8, line 6, may be passed through to shareholders based on their distributive share.

Include this amount on line 4 of your Schedule M1C. To claim this credit, you *must* include this schedule with Form M1.

Line 14
Enterprise Zone Credit

Include on line 4 of Schedule M1B. To claim this credit, you *must* include this schedule with Form M1.

Line 19
Minnesota Source Gross Income

Minnesota source gross income is used to determine if a nonresident is required to file a Minnesota income tax return. Gross income is income before business or rental deductions and does not include losses.

If your 2016 Minnesota source gross income is $10,350 or more and you did not elect composite filing, you are required to file Form M1 and Schedule M1NR, *Nonresidents/Part-Year Residents.*

If your 2016 Minnesota source gross income is less than 10,350 and you had Minnesota tax withheld (see line 33), file Form M1 and Schedule M1NR to receive a refund.

Lines 20–29
Minnesota Portion of Federal Amounts

Lines 20–29 apply to nonresident shareholders. All income of a Minnesota resident is assigned to Minnesota, regardless of the source.

If certain items are not entirely included in your federal adjusted gross income because of passive activity loss limitations, capital loss limitations, section 179 limitations or for other reasons, include only the amounts that you included in your federal adjusted gross income.

Include the amounts from lines 20–29 on the corresponding lines in column B of Schedule M1NR.

Lines 31–33
Composite Income Tax and Nonresident Withholding

Although Minnesota source gross income (line 19) determines whether you must file a Minnesota return, your Minnesota source distributive income is ultimately taxed.

Lines 31–33 were used to determine your share of the S corporation's Minnesota source distributive income. You may need to refer to these amounts when you file your home state's income tax return.

If you are required to pay Minnesota tax on your Minnesota source distributive income, the S corporation is required to withhold tax, unless you elect to have the S corporation pay composite tax to Minnesota on your behalf. If you elected for the S corporation to pay composite tax, you are not required to file Form M1.

Line 31. Your Minnesota source distributive income is considered your Minnesota taxable income from this S corporation.

If there is an amount on line 33 for Minnesota income tax was withheld, you must include your Minnesota source distributive income from line 31 on Schedule M1W, line 7, column B.

Line 32. If you elected composite income tax, the amount paid on your behalf equals 9.85 percent of your Minnesota taxable income on line 31, minus your share of any credits on lines 11-14. You are not required to file Form M1.

Line 33. If you did not elect composite income tax, the S corporation may be required to withhold tax from your Minnesota source distributive income. The amount withheld equals 9.85 percent of your Minnesota taxable income on line 31, minus your share of any credits on lines 11-14.

To claim nonresident withholding when you file your Form M1, include the amount from Schedule KS, line 33 on Schedule M1W, line 7, column C. Also include the amount from Schedule KS, line 31 on Schedule M1W, line 7, column B. You must include this schedule when you file your return.